ATTORNEYS AT LAW

SCHELLENBERG WITTMER

OCTOBER 2013

Newsletter



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RESTRUCTURING LAW

The New Restructuring Law: Overview of the Main Novelties

The new restructuring law will presumably enter into force on 1 January 2014. Without fundamentally changing the existing legislation, selective amendments to the Debt Enforcement and Bankruptcy Act (DEBA) and to the Code of Obligations (CO) will facilitate restructurings in the future.

1 BACKGROUND

As a result of the grounding of **Swissair** in 2001, numerous parliamentary initiatives have demanded a review of the legal framework for restructuring of companies. After tough negotiations in recent years, the new legislation was finally adopted by the Swiss parliament on 21 June 2013. The deadline for a referendum expired unused on 10 October 2013, and all indications are that the Federal Council will put the legislation into force on 1 January 2014.

The issue was **controversial** for different reasons: on the one hand, some people denied any need for reform, whereas on the other hand, in particular the left wing criticized the proposed repeal of certain provisions protecting employees.

Despite these controversies, the Parliament was able to agree on a **compromise** which did not fundamentally redesign the restructuring legislation. In particular, the new legislation does not provide for a new (restructuring) tool, and the types of composition agreements were adjusted only occasionally. The concerns of the workers' representatives have so far been taken into account as a bargaining obligation regarding a **social plan** has been introduced. The Parliament has further decided not to establish a comprehensive **insolvency law for groups of companies**, a **special legislation for large bankruptcies**, or particular provisions on **restructuring loans**. The most important changes are outlined below.

In this context it should be noted that the **stay of bankruptcy proceedings** according to Article 725a CO will endure. The Federal Council had initially proposed to delete Article 725a CO in order to regulate the stay of bankruptcy as part of the composition moratorium in the DEBA (where it functionally belongs). The Parliament rejected this proposal and therefore in the future it will also be crucial to evaluate carefully whether in a specific case a stay of bank-

ruptcy or rather a composition moratorium is the better solution.

2 NOVELTIES OF THE COMPOSITION PROCEEDINGS – SWISS "CHAPTER 11"

The Swiss bankruptcy and composition law was substantially revised in 1997. The composition proceedings which were conducted under the revised law, particularly the various Swissair composition proceedings, revealed several **shortcomings and possible improvements** which the legislature took into account. The legislature was guided in part by the **U.S. Chapter 11**. Two types of changes are worth mentioning: Changes concerning the procedure, and substantive aspects.

Course of the procedure: The new law specifically provides for a significantly facilitated **access to composition proceedings**. Any composition proceeding begins with a relatively short provisional composition moratorium (lasting up to four months), allowing an analysis of the financial situation of the debtor and of its rehabilitation options. This provisional composition moratorium shall either (i) grant a breathing space to the debtor (which shall be prolonged only to a maximum duration of four months or continued in the form of a definitive composition moratorium if needed), enabling it to perform an accounting, financial or organizational restructuring, or (ii) already be approved with regard to the conclusion of a composition agreement. The composition moratorium is repealed *ex officio* in case the restructuring of the debtor succeeds before its term. The composition court shall not demand high requirements when asked to approve a composition moratorium. Contrary to today's law, the publication of an approved provisional composition moratorium will not be mandatory. Finally, in case of a definitive composition moratorium, the composition judge may appoint a creditors' committee, which supervises the commissioner and may issue recommendations.

"The new composition proceeding approaches the US Chapter 11."

Substantive aspects: In the future, during the composition moratorium, debt enforcement proceedings will neither be able to be initiated nor pursued, which – in contrast to today's law - also applies with regard to privileged claims. The new law further clarifies that freezing orders or other security measures based on composition claims are excluded. By explicitly regulating the fate of **future claims** which the debtor assigned prior to the approval of the composition moratorium, a dispute among legal scholars was cleared: If the assigned claim arises after the approval of the composition moratorium, the assignment is ineffective. With regard to the composition agreement, i.e. the agreement between the debtor and the creditors confirmed by the court which regulates the repayment or the waiver of claims, only minor changes have been made. Three such future changes are noteworthy:

- **First**, it will no longer be necessary to guarantee the dividend for all third-class claims;
- **second**, the part holders (members of limited liability companies or shareholders of the debtor) and not only the creditors must make an appropriate contribution for the restructuring; and

third, the new law now explicitly provides that the creditors may be compensated not only in cash but in the form of shares in a newly established hive-off vehicle or in the debtor itself.In sum, the composition moratorium will represent an entry point for both a restructuring and/or the approval of a composition agreement; as such, it is a more comprehensive tool than the stay of bankruptcy proceedings. The sole disadvantage of the definitive composition moratorium is that it must be published.

3 LONG-TERM AGREEMENTS

The explicit regulation of long-term agreements in bankruptcy and composition proceedings is a core element of the revision and in practice will provide clarity in an important area. Today it is often unclear how running long-term agreements (agreements involving continuing and repeated exchange of services, *e.g.* employment agreement, lease agreement, continuing supply agreement, license agreement) shall be treated in the event of an insolvency of one party. Only for very few types of agreements does the law provide for a solution in case one party becomes insolvent (for example, a mandate expires by operation of law due to the bankruptcy of the principal or the agent). In many cases, however, nothing happens: The agreement does not regulate the issue, the law is silent, and the competent bankruptcy administrator or the liquidator remains idle and does not exercise their legal option to enter into not fulfilled or only partially fulfilled continuing obligations instead of the debtor.

In the future, the competent administrator/liquidator will still have the option whether or not to enter into long-term agreements instead of the debtor, while the law now regulates the consequences in both instances. However, the legislator did not introduce a general right to terminate long-term agreements in the event of insolvency of a party. This right of termination exists only in case of a composition moratorium for the purpose of restructuring and continuation of the company.

The following constellations are possible in the event of an insolvency:

- **Entering into an existing long-term agreement** by the liquidator: Claims arising after the opening of bankruptcy or composition proceedings constitute mass liabilities and as such are to be fully repaid in advance (even before the privileged creditors). Claims incurred prior to the opening of bankruptcy or composition proceedings, however, are to be registered as regular (usually third-class) claims. It goes without saying that normally the liquidator is supposed to enter into agreements favorable for the debtor's estate, thereby generating mass liabilities that are paid first.
- **Ordinary termination** of long-term agreements by the liquidator within the statutory or contractual deadline. All claims are considered normal bankruptcy or composition claims.
- The liquidator **takes no action**, whereby the agreements continue according to civil law. New is the fact that the contractual partner may register its claim as

an ordinary bankruptcy or composition claim only until the next termination date or until the expiration of the fixed term.

> During a composition moratorium , the debtor receives the opportunity to **extraordinarily terminate** at any time on any specific date (and thus also with immediate effect) any long-term agreements other than employment agreements with the consent of the commissioner *"if otherwise the restructuring aim is made impossible"*. The contractual partner may only register its claim as an ordinary composition claim. Hence, the debtor may be released from long-term commitments, undoubtedly facilitating successful restructurings.

"The legislator did not introduce a general right to terminate long-term agreements in the event of insolvency of a party."

4 CLAW-BACK ACTIONS

By means of a so-called **claw-back action**, assets which a debtor gave away (so-called action to avoid a gift) or otherwise divested causing harm to creditors (voidability due to insolvency or voidability for intent) during a certain time period (one or five years) before the seizure of assets or the opening of bankruptcy proceedings must be returned under certain preconditions. In this context, there are three major novelties:

First of all, transactions that were approved by the composition judge or by the creditors' committee during the composition moratorium may **no longer** be **challenged**. This change creates legal certainty and will in particular facilitate the sale of businesses or individual assets to third parties or hive-off vehicles during a composition moratorium.

Then the **reversal of the burden of proof** shall provide that disposals of the debtor in favor of "related parties" may be challenged and thus more easily reclaimed: In case the debtor has transferred an object or amount of money to a related party up to one year prior to the opening of bankruptcy proceedings, the related party shall bear the burden of proof that there is no disproportion between the transfer and its consideration and that, accordingly, the conditions for an action to avoid a gift are not met. The same applies to the voidability for intent: The related party favored by the debtor must prove both that they did not know the debtor's intention to privilege, and that such intention was not recognizable for a bona fides party. The law explicitly states that companies of a group are considered related parties. According to the message, both natural and legal persons may be considered related parties, including friends and relatives as well as major shareholders.

Third, the right to challenge is **time-barred** (and not, like today, forfeited) after the expiry of two years from the seizure of assets, opening of bankruptcy proceedings or the approval of a composition agreement with assignment of assets. This clarifies the fact that the two-year period may be interrupted, for example by enforcing the claim.

5 TRANSFER OF EMPLOYEES / SOCIAL PLAN

The acquirer of an operation or part of an operation assumes *ex lege* all associated employees with all rights and obligations based on the compelling Article 333 CO, whereas the employees have the right to refuse their transfer. Today it is extremely controversial whether this automatic transfer also applies in case the operation is acquired in the context of bankruptcy or composition proceedings. It goes without saying that such compulsory transfer of all employees (possibly with high unpaid wages and social security claims) impedes restructurings and often reverses the intended protection of employees since a failed restructuring often destroys the last employments.

Article 333b rev. CO now provides that in case of an operation's acquisition during a composition moratorium, in the context of bankruptcy proceedings or a composition agreement with assignment of assets **no automatic transfer of employees** occurs. Of course, an acquirer may make an offer and negotiate the re-employment with the desired employees. Further, Article 335e rev. CO clarifies that the provisions relating to **mass dismissals** in the event of termination of business operations as a result of judicial decisions as well as mass dismissals in case of bankruptcy or a composition agreement with assignment of assets **do not apply**.

As a counterpart to this liberalization, Article 335h – Article 335k rev. CO provide that employers who for economic reasons intend to dismiss within 30 days at least 30 employees are required to **negotiate a social plan**. Lay-offs that are distributed over time but which are based on the same operational decision are added up. The law defines such social plan as an agreement in which the employer and the employees determine the measures to avoid lay-offs, to limit their number and to mitigate their consequences. The obligation to negotiate only applies to companies with at least 250 employees. If the parties are unable to find an agreement about the content of the social plan, the plan will, at the request of one party, be determined by a binding decision of an arbitral tribunal. The legislator (deliberately) left some leeway in the definition of the social plan which will in practice lead to discussions.

The law stipulates that the social plan must not jeopardize the **continued existence of the company**. This is to prevent operationally necessary restructurings from being undertaken due to the social plan obligation. In addition, the employees should not be in a position to torpedo the negotiations by requesting counter-productive demands. Finally, this provision also limits the discretion of the arbitral tribunal in the determination of the social plan.

It is welcome that employers will not always be obliged to make available the financial basis for a possible social plan (for example, by building up reserves, insurance, funds).

6 TRANSITIONAL PROVISION AND OUTLOOK

According to the only transitional provision, the new law will apply to composition proceedings if the request for a composition moratorium has been submitted after the entry into force of the new law, probably as of 1st January 2014, i.e. essentially the existing law remains exclusively applicable to any proceedings opened prior to the entry into force.

It should be stressed here that both the National Council and the Council of the States adopted a motion on 3 December 2012 and instructed the Federal Council to draft a bill on a comprehensive restructuring process in the CO. The initiators aim at creating incentives for timely restructurings and especially at enabling or facilitating restructurings prior to the opening of composition proceedings and thus outside the DEBA. It is therefore possible that the current revision will be outdated in the near future.

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The content of this Newsletter does not constitute legal or tax advice and may not be relied upon as such. Should you seek advice with regard to your specific circumstances, please contact your Schellenberg Wittmer liaison or any of the following persons:

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