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Insolvency Law Newsletter Switzerland

Revision of Swiss Insolvency Law: Focus on Reorganisation

1. Introduction

The Swiss insolvency law dealing with restructuring goes back to the last large revision of the act and entered into force on January 1, 1997. The goal of the legislator was not only to provide for an orderly liquidation of enterprises but also to enable a successful restructuring.

In the wake of the Swissair insolvency in 2001, voices were raised to review the existing legal frame work by giving priority to the restructuring rather than to the liquidation.

On September 8, 2010 the Federal Council has issued its report for the revision of the Swiss Debt Enforcement and Bankruptcy Act ("SDEBA"). The focus of the revision is the facilitation of a debtor's reorganisation. According to the report the following key issues are addressed in the revision:[1]

- Moratorium also available as a restructuring method and not only with the focus on a composition plan or bankruptcy;
- Bankruptcy postponement as part of insolvency law available for all corporate entities;
- Increase influence of creditors during the moratorium;
- Fulfilment of all obligations under the composition plan must no longer be secured as a requirement for approval of composition plan;
- Shareholders must make contribution for reorganisations;
- Informal cooperation in group insolvencies in Switzerland but no group insolvency law;
- Introduce termination right of contractual counter party for long term contracts against full indemnification;
- Facilitate voidable preference proceeding in the case of transfers within the same group of companies;
- Exclude claims for voidable preference where transfer is approved by appropriate insolvency authority;
- Remove statutory landlord's lien;
- No obligation to assume all of the employees in the case of a transfer of a business as part of insolvency restructurings;
- Obligation to establish a social plan for qualifying enterprises;
- Remove privilege for unpaid VAT.

2. Summary of the most important changes to be introduced

2.1 Coordination amongst authorities

In the case of an insolvency involving various entities of the same group, the law currently in force does not mandate coordination between the competent authorities. Art. 4a SDEBA introduces an obligation of the competent authorities to coordinate their procedures as much as possible but without going into any details. Whilst there may be coordination such as instituting the same liquidator for the various entities, it must be noted that there are segregated insolvency proceedings for each separate legal entity. Furthermore, according to Art. 4a para. 2 SDEBA, the competent authorities may designate one competent authority for all the proceedings.

The approach of one consolidated insolvency proceeding for group companies, however, was rejected, given that under Swiss law each legal entity follows its own sort. Consequently one must bear in mind the limitations of the coordination and

[1] Federal Council Report to the amendment of the Swiss Insolvency Law of September 8, 2010

cooperation between the different authorities, since in each separate insolvency proceeding it is the duty of the insolvency administrator to maximise the proceeds for the creditors of that very entity.

2.2 Temporary stay for certain debt enforcement measures

In connection with the introduction of the Federal Civil Procedural Act, the Federal Council proposed an extension of the temporary stay for certain debt enforcement measures. This amendment was, however, never enacted. Art. 56 SDEBA now reinstates the old more restricted version. The temporary stay applies only between 7 am and 20 pm, on Sunday's and official bank holidays as well as seven days before and after Easter, Christmas and from Juli 15. - Juli 31. Exceptions apply for attachments and urgent measures to safeguard assets. A limited stay applies also in case of the debtor serving in the Swiss army.

2.3 Bankruptcy declaration in case no composition plan appears possible

The bankruptcy court may submit the case to the composition court in case it is of the view that a composition plan might be possible even without a pertaining petition from the debtor or a creditor (Art. 173a SDEBA). The composition court will grant a provisional moratorium if it comes to the conclusion that a composition plan may be achievable

In case the composition court finds that no composition plan might be achievable, it will declare bankruptcy without sending the case back to the bankruptcy court.

2.4 Termination of long term contracts

The introduction of a statutory termination right for long term agreements such as lease agreements, employment contracts or loan agreements was highly disputed. On the one hand it was acknowledged that certain long term agreements may make a restructuring difficult or at least costly on the other hand it was not deemed appropriate to interfere with the freedom of contract permitting parties to benefit from longer term agreements.

Art. 211a SDEBA however makes it clear that claims arising under long term contracts can be made only until the expiration of the next termination period or of the fixed period.

Benefits of the creditor (such as being able to relet the premises in the case of a long term lease agreement or finding alternative employment in the case of an employment agreement) will need to be accounted for. Unless the insolvency estate has assumed the contractual performance, these claims are insolvency claims ranking *pari passu* with those of the other creditors.

2.5 No privilege for VAT claims

The privilege for VAT claims has been discarded in the interest of the equal treatment of the creditors. It was also felt that in particular with smaller insolvencies, the privilege of the VAT claims often prevented a successful reorganisation.

2.6 Landlord's lien discarded

The statutory landlord's lien has been discarded and the references in the SDEBA to such liens eliminated.

2.7 Approval by competent authorities makes transaction immune from challenges as voidable preference

Transactions made during a moratorium (such as the sale of a business or certain assets) and which were approved by the competent authority or the creditors committee cannot be challenged as a voidable preference (Art. 285 para 3 SDEBA).

This clarification is important, since under the act currently in force and the Federal Supreme Court's practice, the there is a risk that such transactions can nevertheless be challenged (in case the composition plan is not approved) as a voidable preference. This risk is being eliminated with the introduction of the revised act.

2.8 Reversal of burden of proof for certain transactions with related parties

In case of challenging a transaction (Pauline actions), the burden of proof lies with the claimant. This means that the claimant challenging such a transactions has

to prove for instance that there was an apparent disparity between the consideration exchanged by the insolvency debtor and the recipient or that the transaction in question was intended to harm other creditors or to permit a preferential treatment and that the other party to the transaction should have recognised such intent.

Through the changes introduced to Arts 286 para 3 and 288 para 3 SDEBA the burden of proof is reversed in the case of transactions involving related parties. Related parties are also entities belonging to the same group of companies.

2.9 Interruption of the statute of limitations for Pauline actions possible

According to the wording of the law currently in effect, the statute of limitations for Pauline actions cannot be interrupted and the claims are forfeited, unless a legal action will be filed in time. The revision found this to be a mistake and clarified that also the statute of limitations may be interrupted such as by way of an agreement or by the filing of payment summons.

2.7 Provisional moratorium

2.7.1 Approval of provisional moratorium

Under the revised law, a creditor may seek protection under a provisional moratorium at any point in time by filing a request which must contain an updated balance sheet and profit and loss statement, a liquidity plan and a provisional restructuring proposal. Contrary to the law currently in effect, no draft of a composition plan will have to be submitted. A provisional moratorium may also be applied for by a creditor that is entitled to file a request for bankruptcy (Art. 293 SDEBA).

The composition court will have to decide immediately upon the filing of a request (Art. 293a SDEBA). The creditors will not be heard. The court may request the posting of an adequate bond for the administrator's fees. Only where it is obvious that no restructuring or composition plan can be achieved may the court declare bankruptcy.

The maximum duration for the provisional moratorium is four months.

2.7.2 Designation of provisional trustee as a rule

With the granting of the provisional moratorium the court will need to designate a provisional trustee. In exceptional cases, the court can refrain from designating a provisional trustee, for instance where no third party rights are in jeopardy (Art. 293b SDEBA).

The trustee's primary obligation is to supervise the debtor in the interest of the existing creditors and to determine, in the case of a composition plan, how such plan may be drawn up and to supervise restructuring measures to be undertaken already during the period of the provisional moratorium.

2.7.3 No mandatory publication of provisional moratorium

In many cases, an effective restructuring can be successfully implemented only, if the respective endeavours are not made public. Under the current law, the provisional moratorium must be published. Contrary to the moratorium, the bankruptcy postponement according to Art. 725a Code of Obligations only needs to be published, if publication is deemed necessary for safeguarding the interests of the creditors.

The revised law provides that no publication is necessary in case of valid reasons. However, if no publication takes place, a provisional trustee must be designated (see Art. 293c SDEBA).

2.7.4 No appeal against the granting of a provisional moratorium and designation of provisional trustee

The granting of a provisional moratorium and the designation of a provisional trustee may not be appealed. An appeal will only be possible against the decision of a definitive moratorium (Art. 293d SDEBA).

2.8 Definitive moratorium

2.8.1 Approval of definitive moratorium

If during the provisional moratorium it appears that that a reorganisation or confirmation of a composition plan may be achieved, the composition court grants a

definitive moratorium for a period of four to six months. The court decides *ex officio*.

The debtor and the creditor who may have filed an application for a moratorium will be heard. The provisional trustee issues a report to the court. Other creditors may be invited as well. If the court finds no chances of a successful reorganisation or approval of a composition plan, it will have to issue a bankruptcy order (Art. 294 SDEBA).

2.8.2 Designation of Trustee

The court will designate one or more trustees. The duties of the trustee include drawing up a composition plan, if necessary, supervising the debtor's conduct of business, establishing an inventory, publishing a request to the creditors to register their claims, and the calling of a creditors' meeting (see Art. 295 SDEBA).

2.8.3 Creditors' committee

If deemed necessary, the composition court establishes a creditors' committee, where the various categories of creditors must be adequately represented.

The creditors' committee supervises the trustee, and may issue recommendations and, instead of the composition court, grants permission to certain actions such as the sale or encumbrance of the fixed assets, the granting of security interests, or donations (see Art. 295a and Art. 298 para 2 SDEBA).

2.8.4 Extension of moratorium

Upon motion of the trustee, the composition court may extend the moratorium to 12 and in complex cases up to 24 months. In the case of an extension beyond 12 months, the trustee must call a creditors' meeting to take place no later than nine months from the granting of the definitive moratorium (Art. 295b SDEBA). The creditors' meeting may replace the members of the creditors' committee designated by the composition court and substitute the court designated trustee. Unfortunately, the revised law does not determine how the creditors' meeting passes its resolutions (other than on an approval of a composition plan (see Art. 305 SDEBA[2])). Hence we are of the view that decisions are passed with the absolute majority of the votes passed (see Art. 235 SDEBA).

2.8.5 Appeal against decisions of the composition court

The decisions of the composition court (other than the granting of a provisional moratorium) may be appealed by the debtor and creditors. An appeal has no suspensive effect (Art. 295c SDEBA).

2.8.6 Mandatory publication of moratorium

The granting of the definitive moratorium must be published and a respective mentioning made in the land register.

2.8.5 Lifting of moratorium

In case the reorganisation can be successfully completed prior to the expiry of the moratorium, the composition court will lift the moratorium. The decision of the composition court may be appealed (Art. 296a SDEBA).

2.8.6 Bankruptcy declaration

Prior to the expiry of the moratorium, bankruptcy will be opened if this is deemed necessary to conserve the debtors assets, if there is obviously no chance to succeed with a reorganisation or confirmation of a composition plan, or the debtor is in breach of the limitations imposed upon by the moratorium or of the instructions of the trustee (Art. 296b SDEBA).

2.9 Effects of moratorium

2.9.1 Effects on creditors' rights

The aim of the revision is to adjust the effects of the moratorium to the effects of a bankruptcy. During the moratorium, debt enforcement proceedings are stayed also for privileged creditors, except for claims secured by a mortgage. The realisation of the

[2] Majority of the creditors representing $^2/_3$ of the amount of the claims filed or ¼ of the creditors representing ¾ of the mount of the claims filed.

mortgage by a sale of the real property however remains stayed.[3]

Sequestration of the debtor's assets and other measures securing a creditors claim are excluded. Assignments of claims which come into existence only after the date of the granting of the moratorium have no effect. Civil- and administrative law proceedings regarding claims will be stayed. The running of the statute of limitations is tolled. Interest stops to accrue with the granting of the moratorium, except for secured claims, unless the composition plan provides otherwise.

Set-off is limited in the same way as bankruptcy, i.e. the set-off situation must have existed at the time of the granting of the moratorium. Obligations of the debtor which are not for a sum of money may be accelerated and monetized at the discretion of the trustee.

2.9.2 Effect on debtors capacity

The debtor may continue to run its business under the auspices of the trustee. The composition court may however determine that certain actions may not be taken without the consent of the trustee or it may authorise the trustee to run the business. Fixed assets may neither be sold nor encumbered without the authorisation by the composition court or creditors' committee. The rights of a good faith acquirer remain protected. The moratorium may be revoked where the debtor is in breach of these limitations or instructions given by the trustee (Art. 298 SDEBA).

2.10 General provisions on composition plan

2.10.1 Conditions for ratification by court

In case the composition plan has been approved by the requisite majority of the creditors, the composition court will have to ratify the composition plan. The ratification (see Art. 306 SDEBA) is subject to the following conditions:

1. The proceeds to the creditors are commensurate with the debtor's (financial) potential;

2. The fulfilment of the privileged claims and of the obligations incurred during the moratorium is adequately protected; and

3. In the case of an ordinary composition plan (percentage agreement), the shareholders must make an adequate contribution to the plan. This could mean that the shareholders will first need to agree on a reduction of the share capital before the infusion of new capital by way of a capital increase. Such shareholder contribution may be waived, in case the percentage agreement without shareholder contribution results in a better result for the creditors than bankruptcy.

Compared to the previous law, the requirement that the fulfilment of all obligations under the composition plan must be adequately secured has been abandoned, since that was seen too big a hurdle for a successful reorganisation.

The decision of the composition court can be appealed; the appeal has suspensive effect (Art. 307 SDEBA).

In case of a rejection of the composition plan, the composition court will have to declare the company bankrupt. This decision is not subject to appeal since already the decision not to ratify the composition plan can be appealed (Art. 309 SDEBA).

2.20.2 Effect of ratification

With the ratification the composition plan becomes binding on all creditors under the exclusion of creditors secured by a pledge to the extent of the coverage by such pledged assets (Art. 310 SDEBA).

Obligations incurred during the moratorium with the consent of the trustee form an obligation of the estate, in the case of a composition plan with the assignment of assets or declaration of bankruptcy.

[3] Although the revised law (as well as the law currently in effect) is silent on this issue, we are of the view that a creditor is entitled to privately liquidated collateral provided to him by the debtor on the condition that the creditor has been granted the right to privately liquidate and account for the collateral. This applies most likely to collateral which has a market value. In bankruptcy, however, collateral that has not been liquidated (subject to certain exceptions for collateral in book entry securities on account with a bank or securities dealer or collateral provided by way of transfer of title) must be handed over to the bankruptcy liquidator (Art. 198 SDEBA).

2.20.3 Settlement by way of shares in NewCo

In practice, a restructuring may be achieved by a combination of an assignment of assets to the creditors and the incorporation of a new company. The revised law clarifies that the consideration to the creditors under the composition plan may also consist in shares of a NewCo (Art. 314 para 1bis SDEBA).

2.20.4 Content of composition plan

The composition plan contains provisions regarding the creditors waiver of claims which are not covered by the liquidation of the assets assigned to the creditors or detailed rules as to an eventual claim for the amount not recovered.

The designation of the liquidators and the number and member of the creditors' committee and the allocation of the respective powers.

The method of liquidation, unless provided for by law, as well as the method of securing an assignment in the case of an assignment of the assets to a third party.

The method of publication and notification of creditors in addition to the Commercial Gazette (see Art. 318 para 1 and para 1bis SDEBA).

2.20.5 Statute of limitations for voidable preferences

The start date for the statute of limitations for voidable preferences and fraudulent conveyances is the granting of the moratorium (Art. 331 para 2 SDEBA).

2.20.6 Insolvency creditor entitled to propose a composition plan

Art. 332 para 1 SDEBA clarifies that also a creditor in a bankruptcy proceeding may propose a composition plan which will be subject to discussions at the earliest at the second creditors' meeting.

3. Changes to be introduced to the Code of Obligations ("CO")

3.1 Employee transfer in the case of a transfer of a business or part thereof

Art. 333b CO clarifies that in case of a transfer of a business or part thereof in a moratorium, bankruptcy or composition plan with assignment to the creditors only such employment relationships and rights and obligations thereunder will be passed on to the acquirer, as will be agreed. This clarification is important and permits a transfer of a viable business without legacy obligations relating to the employees transferred and employees made redundant prior to the transfer.

Furthermore, the provision of Art. 333 para 3 CO regarding joint and several liability of the transferor and transferee for certain claims under employment contracts accrued prior to the transfer and those accrued thereafter until the statutory termination period does not apply.

The provisions regarding mass dismissals (primarily a consulting obligation under the existing laws) do likewise not apply to mass dismissals in the case of cessation of a business due to a court decision, bankruptcy, or in connection with a composition plan by way of assignment of assets (Art. 335e para 2 CO).

3.2 Social plan

Art. 335i CO introduces the obligation of an employer to negotiate a social plan with the employees in case the employer regularly employees in excess of 250 employees and envisages to terminate - within a period of thirty days - at least 30 employment contracts for business reasons. In case no agreement can be reached, a social plan will be established by a court of arbitration.

These provisions do not apply in the case of mass dismissals in bankruptcy or moratorium ending with a composition plan.

4. Entering into effect

The Federal Council will determine the entering into effect of the revisions.

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