paragraph

February 5th, 2014

news

Facilitation of Rehabilitation

The Swiss legislator has reacted to the Swissair-Grounding by partially revising the insolvency law with regard to rehabilitation as per 1 January 2014; its new rules also impact labour law. The revision's purpose is to facilitate rehabilitation of financially distressed companies.

The basic system of insolvency law regarding rehabilitation remains unchanged. As before, a debt moratorium takes place firstly, and will be followed by the conclusion of an ordinary composition agreement (moratorium or dividend agreement) or a composition agreement with the assignment of assets. As in the U.S. Chapter 11- proceedings the debt moratorium must however no longer result in a composition agreement or in bankruptcy. Based on the revised law, in order to facilitate rehabilitation of companies, the debt moratorium can also be granted solely for the purpose of a deferral.

Under the revised law the composition procedure must always commence with a provisional debt moratorium which subsequently – if necessary – becomes definitive. The provisional debt moratorium can be ordered without hearing the creditors, lasts up to four months and – in justified cases – must not be published as far as third-party interests are sufficiently protected and a respective request is submitted. In contrast, the definitive debt moratorium can be approved for up to 12 months, in exceptionally complex cases up to 24 months and must be published in any case.

The provisional and the definitive debt moratorium in essence have the same effects. During the definitive debt moratorium as well as during the published provisional debt moratorium – and with the sole exception of debt recovery proceedings concerning real property liens – no debt recovery proceedings may be initialized or continued nor may the debtor's assets be seized. During the non-published provisional debt moratorium debt recovery proceedings may however be initialized but not continued. The statute of limitations is suspended during the term of any kind of debt moratorium and – with the exception of urgent cases – all civil and administrative proceedings concerning composition claims are stayed.

The revised insovency law regarding rehabilitation law has been aligned with the U.S. Chapter 11-proceedings.

In case of a definitive debt moratorium or a non-published provisional debt moratorium a commissioner must be appointed. In justified cases, the published provisional composition can do without a commissioner. The commissioner supervises amongst others the debtor's business activity and – based on a respective order of the composition court – is either involved in the debtor's operational activity or even entrusted with its overall management. If circumstances so require, the composition court appoints a creditor committee to supervise the commissioner and to authorize him for certain transactions. Should the rehabilitation of the company succeed before the end of the debt moratorium period, the composition court revokes the moratorium. However, should there clearly be no hope for a successful rehabilitation or a composition agreement, bankruptcy proceedings will be initiated ex officio.

In contrast to the past, the owners of a company in a debt moratorium must now financially contribute to its rehabilitation in case the composition will be terminated by an ordinary composition agreement. The practice under the revised law will tell what forms of contribution will be accepted. The revised law also introduces the option to grant the creditors a composition dividend in the form of participation or membership rights with the debtor company or with a with a rescue company (also known as „debt equity swap" or „bail in"). In the event that the composition agreement is rejected by the creditors or disapproved by the court bankruptcy proceedings will be initiated ex officio.

Despite the facilitations introduced by the revised insolvency law the existing instrument of bankruptcy deferment remains in place. As a result, companies in financial distress now have the choice between bankruptcy deferment as well as the new composition procedure thus increasing the available options for action as well as increasing the professional level of rehabilitation advice. The bankruptcy deferment which – in comparison to the redesigned composition procedure – displays hardly any advantages, will henceforth presumably only be applied in exceptional cases.

Another part of the revision concerns long-term contracts (e.g. landlord/tenant or leasing contracts; not however, employment contracts). The revised law makes a distinction between a) liquidation cases (i.e. bankruptcy or a composition agreement with the assignment of assets) and b) compositions for the purpose of rehabilitation. Now, as before, long-term contracts according to a) can only be terminated with proper notice, i.e. on a contractual or statutory basis. With regard to b) however, long-term contracts can also be terminated extraordinarily, i.e. at any time, however subject to the commissioner's approval.

The provisional debt moratorium may – if justified – be effected without public notice.

In these cases the creditor is solely entitled to claim what he would have been entitled for in the case of a regular termination of the contract (e.g. rental payments up to the next regular termination date). The creditor may then file this claim as a composition claim entitling him to receive a composition dividend as provided for in the composition agreement. Benefits gained by the creditor as a result of the termination will be offset. This option to (substantially) intervene in an established contractual relationship could turn out to be a very effective rehabilitation instrument in many cases. According to the wording of the law the debtor may however only make use of this option in case restructuring efforts would otherwise fail. Time will tell how strict the aforementioned requirement will be handled in practice.

The recently introduced privilege for value added tax claims (in bankruptcy cases) by the Value Added Tax Law effective as of 1 January 2010 has been already revoked. This privilege has been responsible for substantially complicating many rehabilitation efforts or had even made them fail because a composition agreement would only be approved under the proviso that the fulfilment of all privileged claims (in bankruptcy cases) are guaranteed. As a result, value added tax claims now **qualify as ordinary third class claims, the fulfilment of which no longer needs to be guaranteed in order to obtain court approval of the composition agreement.**

When taking over a business in the course of a debt moratorium, bankruptcy or a composition agreement with the assignment of assets, the purchaser is no longer required to take over all existing employment agreements. Whether and to which extent employment relationships are taken over is subject to negotiation by the involved parties on a case by case basis and requires furthermore the respective employees' consent. In addition, the purchaser's joint liability for pending claims by employees no longer applies in such cases.

As a (political) compromise to this facilitated business take-over, a general obligation to provide for a severance plan has been introduced for cases of mass layoffs. This rule does however not apply to mass layoffs taking place in the course of a bankruptcy or a composition procedure resulting in a composition agreement. Apart from these two cases, employer and employees are obliged to negotiate a severance plan. The severance plan is an agreement containing measures to avoid or to limit terminations of employment contracts and to mitigate respective consequences without compromising the company's continuing existence. Respecting this, the parties are free to determine the contents of the severance plan. In the event that the parties are unable to reach an agreement, a court of arbitration must authoritatively determine its content. The obligation to provide for a severance plan applies solely to companies with more than 250 employees dismissing more than 30 employees within 30 days due to economic grounds, whereby deferred dismissals are added up if based on the same business decision.

The revision provides finally for facilitation of avoidance actions, i.e. the challenge of asset transfers executed by the debtor within a certain time period before the seizure of property **or initialization of bankruptcy proceedings damaging the creditors' interests. The revised law eases the burden of proof in case of an action to avoid a gift and of voidability of intent as far as asset transfers in favour of closely related persons are concerned (i.e. particularly affiliated companies). The closely related person must now prove in the case of an action to avoid a gift that the asset transfer was on a „quid pro quo" basis and in the case of voidability of intent that the fraudulent intent of the debtor behind the transfer was unapparent to him. However, transfers executed during the debt moratorium and having been approved by the composition court or by a creditor committee may not be challenged anymore.**

Damian Hess
Attorney-at-Law, lic. iur. LL.M.
Associate

Gaudenz Geiger
Attorney-at-Law, lic. iur. LL.M.
Associate

Staiger, Schwald & Partner Ltd.
Genferstrasse 24, P.O.Box 2012, CH-8027 Zurich
Telephone +41 58 387 80 00, Telefax +41 58 387 80 99

Thunstrasse 7, P.O.Box 281, CH-3000 Berne 6
Telephone +41 58 387 88 00, Telefax +41 58 387 88 99

ssplaw@ssplaw.ch, ssplaw.ch