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* The Swiss Investment Report is provided by Wenfei Attorneys-at-Law Ltd. ("Wenfei"), a Swiss law firm with its seat in Zurich, which has gained extensive experience in providing services in Greater China.

The Swiss Investment Report is especially designed for Chinese Investors, who are intending to extend their business to Switzerland or Europe or are already doing business in Switzerland.

The Swiss Investment Report provides background information on the Swiss investment-related legal framework as well as information on current developments in the Swiss legislation from a foreign investor's perspective.

New Swiss Restructuring Law

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I. Introduction

After the "Grounding" of the Swiss Airline Concern "Swissair" in 2001, it was recommended in 2005 by an expert group to optimize the Swiss restructuring law through a partial revision in order to facilitate the restructuring of Swiss companies facing debt and liquidity issues. In 2008 the draft for a revised restructuring law was presented by the expert group, and on September 8, 2010 the Swiss federal council passed the message to amend the restructuring law. After initial disagreements within the Swiss parliament, the new law was passed by it on June 21, 2013. On January 1, 2014, the New Swiss Restructuring Law entered into force.

This issue of the Swiss Investment Report shall, firstly, provide an overview of the main changes introduced by the new restructuring law, secondly, show the impact of the new law on actual restructuring scenarios and, thirdly, compare it with the principles of the Chinese restructuring law.

II. Main Changes under the New Restructuring Law

The main goal of the revised restructuring law was to facilitate the restructuring of companies, by providing more legal flexibility for restructuring procedures. The following are the main changes:

A. Initiation of a composition proceeding

Under the new law, a composition proceeding ("Nachlassverfahren") shall be initiated with the approval of a **provisional moratorium** ("Provisorische Stundung") by the competent composition court ("Nachlassgericht"). The provisional moratorium shall be approved easier than under the old regime. Under the new law, the request for provisional moratorium shall particularly be accompanied by a provisional debt restructuring plan. It is not required anymore to provide a draft of a composition agreement already at the time of applying for the moratorium. The provisional moratorium may be granted by the composition court for a period of maximum four months. During such

time it shall be verified, whether the debts of the debtor can be successfully restructured.

If there is a chance for private restructuring or for approval of a composition agreement ("Nachlassvertrag") by the composition court, definitive moratorium ("Definitive Stundung") shall be approved by the composition court for further four to six months (in complex situation it can be extended up to 24 months).

B. Cancellation of the moratorium

Under the new restructuring law, a composition proceeding does not necessarily have to be accomplished with the approval of a composition agreement or bankruptcy of the debtor. The moratorium – under the new law – may also be **cancelled** again by the composition court, if the debtor's debts could be **privately restructured**.

C. Appointment of Commissioner not mandatory anymore

Under the new law, the composition court **does not mandatorily have to appoint a commissioner**, anymore.

D. Public announcement not mandatory

Furthermore, the provisional moratorium does **not necessarily have to be publicly announced**, if applied by the debtor or creditor(s), and as long as the protection of third parties is guaranteed. Hence, now it is possible to initiate a composition proceeding without disclosing it to the public, which can save a lot of good-will of the market towards the debtor.

E. Continuing obligations agreements

Upon approval of the commissioner, **continuing obligations agreements** (such as lease agreement, licensing agreements, etc.) may be **terminated at any time** subject to compensation to the counterparty, if elsewise the restructuring purpose would be impeded. The compensation to be paid to the counterparty shall be treated as composition claim ("Nachlassforderung"), which means that it is treated the same way as other non-privileged claims in

the composition proceeding. The termination of employment contracts are subject to different provisions (see below). If the debtor continues to profit from the performance of a continuing obligations agreement, then the obligation of the debtor shall not be treated as ordinary composition claim but as debts incumbent to the assets of the debtor, provided that the commissioner has approved the ongoing performance ("Massaschuld").

F. Changes with regard to the "Paulianas"

Acts of the debtor during the composition proceedings are in principle subject to objection requests ("Pauliana"), which means that assets, which have been alienated by legal acts under special circumstances shall be included again in the debt collection proceedings. For instance, any disposal of the debtor's assets without consideration or for a consideration, which is in disproportion to the actual value of the disposed asset, within the preceding year of the declaration of the debtor's bankruptcy or seizure of the debtor's assets is voidable.

The new restructuring law provides that any legal acts, which have occurred during the composition proceeding and have been approved by the composition court or, exceptionally by a creditor's committee, shall not be subject to these Pauliana-objection requests. Hence, it is advisable to make any agreements about the acquisition of debtor's assets entered into during the moratorium subject to the approval by the composition court (or creditor's committee).

For the so-called "Schenkungspauliana" and the "Absichtspauliana", in case the legal act has been entered into between the debtor and a related person, the burden of proof has been switched. Under the new law, the related person shall prove that there has not been a disproportion between the performance and the consideration ("Schenkungspauliana"), or that the affiliated person could not identify the debtor's intention to harm other creditors ("Absichtspauliana"). The new law made it clear that a company, which belongs to the same group of companies as the debtor, shall be deemed as related person.

G. Composition Agreement

The new restructuring law still provides for the same two kinds of composition agreements: (i) the ordinary composition agreement, and (ii) the composition agreement with assignment of assets.

The ordinary composition agreement may either provide for a moratorium composition, i.e. the creditors shall be paid in full, but later than originally agreed upon, or provide for a percentage composition, i.e. the creditors shall only be paid a certain percentage of their actual claims paid within an agreed time frame.

The composition agreement with assignment of assets ("Nachlassvertrag mit Vermögensabtretung") provides that the debtor's assets (fully or partially) shall be assigned to the debtor's creditor(s) or a third party.

The new law provides that in case of an ordinary composition agreement, the owner(s) of the debtor shall also make a reasonable contribution to the restructuring of the debtor. Hence, the owner of the debtor shall not profit from a restructuring without its own contribution.

Furthermore, the new law provides a legal basis for a **debt equity swap**. In case of a percentage composition, the composition dividend could also consist of the debtor's equity or the equity of a hive-off company, instead of cash. This option provides for additional flexibility during the restructuring procedure.

H. Employment relationships

The new restructuring law also provides for more flexibility with regard to employment relationships. If during the moratorium or when concluding a composition agreement with assignment of assets the debtor's business or part of its business is assigned to a third party, the employment relationships are only transferred as long as the employee **and the acquirer of the business** have agreed to it. Hence, the automatic transfer of the employment relationship (if agreed upon by the employee) in case of a business transfer during a composition proceeding has been abolished. Additionally, the

acquirer of the debtor's business is not jointly liable for the employee's claims, which have become due before the business transfer, anymore. Though, the employer's obligation to consult the employees before the business transfer still remains.

Together with the new restructuring law, the legislator also introduced a legal basis for the social plan. Hence, since January 1, 2014 there is a legal basis for the employer's obligation to negotiate and conclude a social plan in case the employer intents to have mass dismissals. Though, the new law also provides that the provisions about the social plan do not apply in case of mass dismissals during a composition proceeding, which is completed with the conclusion and approval of a composition agreement. Hence, in case the debtor's debts can be privately restructured during a composition proceeding and the moratorium can be cancelled by the composition court, the social plan obligation remains.

Furthermore, the general provisions for mass dismissals provided for in the Swiss Code of Obligations are not applicable in case a composition agreement with assignment of assets is concluded.

III. Practical Cases

In the following two possible scenarios shall show how the new restructuring law could be applied in order to optimize transactions during composition proceedings.

A. Establishment of a hive-off company

A Ltd. is producing engines. The Asian competition has become very fierce in recent years, which has led to a massive sales price reduction for engines on the international market. A Ltd. has not timely expanded its production to a low cost country in Asia, the manufacturing costs in Switzerland have become very high, and sales have dramatically dropped. There is no possibility to restructure A Ltd. anymore.

Though, the technical director of A Ltd is convinced that the technology of A Ltd is still very precious and state of the art and that the R&D Department

unifies valuable know-how. He has found a Chinese investor who would be interested in acquiring the technology and also the R&D Department of A Ltd. in Switzerland, and having the engines produced in China.

The question is how the technical director and the Chinese investor can acquire the technology and R&D Department of A Ltd. In the following one possibility is suggested:

Firstly, the technical director and the Asian investor jointly establish a hive-off company. Secondly, A Ltd. and the hive-off company conclude a sales and purchase contract regarding the acquisition of the technology and the R&D Department. Such sales and purchase contract shall define exactly which technology (and further assets), which contracts, and employees shall be transferred to the hive-off company. The sales and purchase contract shall be subject to the condition precedents that a moratorium will be approved by the composition court and that the composition court will approve the sales and purchase contract.

Thirdly, A Ltd. applies for provisional moratorium. As a debt restructuring plan, A Ltd. proposes to dispose of the technology and R&D Department as provided for in the sales and purchase contract and to conclude with its creditors a composition agreement with assignment of (the remaining) assets. At the same time A Ltd. applies to the composition court for approval of the sales and purchase contract with the hive-off company.

Fourthly, A Ltd. consults the employees or the representatives of the employees regarding the transfer of the employment relationships from A. Ltd. to the hive-off company.

Fifthly, the sales and purchase contract will be closed.

Sixthly, the composition agreement with assignment of assets shall be concluded with the creditors, approved by the composition court and executed by the liquidators of A Ltd.

The advantage of this approach for the technical director and Chinese investor under the new restructuring law is that the hive-off company can be

assured that no “Pauliana-claims” could be brought forward towards it by the creditors of A Ltd. Hence, it has more legal certainty with regard to the appropriateness of the sales and purchase contract. Furthermore, the hive-off company does only need to take over the assets and employees that are required for its future business.

B. Acquisition of a company by first acquiring the company’s debts

A Ltd. is a watch manufacturer. A few years ago, A Ltd. built a new manufacturing facility, in which its new movements are produced in a state of the art high-technology assembly line. A Ltd financed such manufacturing facility and the new assembly line with a bank loan. The production of the new movements has not started as smoothly as expected and the sales revenues with the new movements are very low. A Ltd. will not be able to meet the covenants of the bank loan agreement as of June 30, 2015. Additionally, it needs further liquidity. Besides, it has entered into disadvantageous long term supply agreements with European supplier, which additionally jeopardizes A Ltd.’s financial situation.

A Chinese watch manufacturer and supplier for watch manufacturers believed in the strategy of A Ltd. and had obtained strong interests in the business of A Ltd. He therefore acquired the loan from the bank with a discount. It now would also wish to acquire A Ltd., but wants to get rid of the long term supply agreements between A Ltd. and the European suppliers. Instead it wants to supply A Ltd. through its own group companies.

The question is how the Chinese watch manufacturer can reach its goal. In the following one possibility is suggested:

Firstly, the Chinese watch manufacturer and A Ltd. establish a debt restructuring plan, which is based on a debt equity swap.

Secondly, A Ltd. requests to the composition court to approve a provisional moratorium. A Ltd. submits the debt restructuring plan to the court according to which a percentage composition with a debt equity swap shall apply.

Thirdly, with the approval of the commissioner, A Ltd. terminates all disadvantageous long term supply agreements, subject to compensation to the counterparty, whereas the compensation to be paid to the counterparty will be treated the same way as other non-privileged claims in the composition proceeding. Concurrently, A Ltd. enters into new supply agreements with the group companies of the Chinese watch manufacturer.

Fourthly, the draft percentage composition agreement, according to which shares in A Ltd. are allocated to the creditors, is presented to the creditors for approval. The Chinese watch manufacturer undertakes to acquire the shares from the other creditors for an already defined purchase price.

In this scenario, the Chinese watch manufacturer eventually acquired A Ltd. by first acquiring a bank loan to A Ltd. This rather unconventional approach might be particularly interesting for Chinese investors, who are interested in a Swiss company, which under normal circumstances would not be available for Chinese investors.

IV. Comparison with PRC restructuring law

PRC restructuring law provides for two kinds of independent restructuring procedures: the **reorganization** and the **compromise**. Both restructuring procedures are regulated in the Enterprise Bankruptcy Law of the PRC. In many ways they have commonalities and similarities with the Swiss composition proceedings. Though, there are also some major differences.

In a nutshell, the reorganization procedure is more comprehensive than the compromise, but needs also more efforts and time to conclude. Generally speaking, if the debtor is in a real business crisis, such as distress in production and internal management, rather than common difficulties of paying debt as due and the debtor is eager to survive and obtaining such surviving capacity, then the debtor and/or creditor would rather apply for reorganization, since the reorganization procedure usually involves broader restructuring activities compared with compromise, like liability reorganization, assets transferring, recapitalization, adjustment of management structure and business scope & policy. Under these

circumstances, the debtor has motivation of sustaining operation not only limited to clearing off its debt. On the other hand, if the debtor primarily wants to solve the difficulty of paying matured debts, then he would rather file a request for compromise.

A. Reorganization

The reorganization procedure can be initiated by the debtor or a creditor. The application shall be submitted with the people's court. Furthermore, where a creditor applies for bankrupt liquidation against its debtor, after the people's court accepts the application for bankruptcy and before the debtor is announced bankrupt, the debtor or its capital contributor whose capital contribution makes up at least 10% of the debtor's registered capital may also apply for reorganization.

Apart from the general precondition for applying for reorganization which is that the debtor shall have obtained bankruptcy reasons, the law does not stipulate what the further requirements are in order to accept the application for reorganization. But in general, as long as there is no violation of compulsory regulations and no harm to the public interest, the court in most cases would accept the application for reorganization.

If the court accepts the application, it shall order the start of the reorganization and make an announcement to the public. Thereafter, a bankruptcy administrator or the debtor prepares the reorganization plan and submits it to creditors meeting for approval, which is grouped into 4 voting groups, i) The creditor's right with guaranty on the debtor's particular assets; ii) The employees' right, including wages, subsidies for medical treatment and other compensation for the employees as prescribed by the relevant laws and administrative regulations; iii) The taxes as defaulted by the debtor; iv) The common creditor's right. Where 1/2 or more of the creditors in a same voting group at the creditors' meeting agree to a draft of revival plan, representing 2/3 or more of the total amount of the creditor's right, it shall be deemed as an adoption of the draft of restructuring plan. Thereafter, the reorganization plan shall be submitted to the court for approval (Under certain

circumstances, the reorganization plan may also be approved by the court if the above quorums are not met.).

The reorganization plan shall be reviewed by the court formally and materially. Formal review is about the integrity of the submitted documents. The material review includes the following aspects: (i) whether the debtor has a bankruptcy reason or not; (ii) whether there is a possibility that the debtor could be saved (for example, whether the debtor has the willingness to reorganize or not, will the creditor obey the reorganization procedure, the feasibility of reorganization plan and do all the reorganization parties have the ability to complete the reorganization), and (iii) if the debtor deserves saving, from the perspective of social value, economic benefits, reorganization cost, etc.

Upon approval by the court, the reorganization plan shall be binding upon the debtor and all creditors, including the creditors with secured claim. In case the debtor fails to implement the reorganization plan, the people's court may upon request terminate the reorganisation plan and announce the debtor bankrupt.

B. Compromise

In principle, the compromise procedure is similar to the reorganization procedure. Though, there are a few main differences, which shall be pointed out in the following:

The compromise plan is not as comprehensive as the reorganization plan. Generally, it rules about a reduction of payment or payment at a later time than originally agreed upon between the debtor and creditor, but there could also be other arrangements feasible under the compromise such debt equity swaps or liquidity swaps.

Furthermore, contrary to the reorganization procedure, the compromise procedure may only be initiated by the debtor.

In Addition, there is only one group of creditors, and the compromise plan is adopted by the creditors, if ½ or more of the creditors with the right to vote

who attend the meeting, representing 2/3 or more of the total credit free from property guarantee agree to it.

And finally, the compromise plan is not binding upon the creditors with secured claims. They can still ask for payment of their due claims and, if the debtor does not pay, apply for realization of the security.

V. Conclusion

In conclusion, the Swiss restructuring law has gained more flexibility with its partial revision, which gives a better basis for companies in financial troubles finding a way out of the situation or at least saving part of its business, which under the old regime might not have been feasible. One of the main key changes is that the transfer of employment relationships can now be handled with more flexibility and therefore can be individually adjusted to each case. Furthermore, the new law gave more certainty to the acquirer of the business from the debtor, in case the sales und purchase contract has been approved by the composition court. Future practice will show whether and how the newly introduced debt equity swap will be applied.

From a comparative law point of view, it can be summarized that the Chinese compromise is rather similar to a Swiss moratorium and percentage composition or composition with assignment of assets. The Chinese reorganization is rather unique, since it could include further restructuring measures, such as change of management.

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