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ARTICLE

Swiss Insolvency Laws and IP Licence Agreements

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The situation is a familiar one in times of crisis. Licensor of software, know-how, patents or other IP rights gets into financial difficulties or even insolvency. Licensee wants to know what will happen to its licence. Of course, the answer depends not only on the terms of the licence agreement and the law that governs that agreement, but also on the laws of the place where the insolvent party is located. The protection afforded to a licensee can vary greatly depending on the licensor's location. Whereas a licensee may be shielded to some extent from the consequences of a US licensor's bankruptcy by the US Bankruptcy Code (11 USC Section 365), at least where the licence is exclusive and for patents, copyright or know-how, in many countries the position is not so comfortable for the licensee.

The conditions in Switzerland, the taxation and regulatory regime, are generally favourable for IP holding companies and so licence agreements often involve a licensor located in Switzerland. Where a Swiss licensor becomes insolvent, licensees are often surprised by the provisions of Swiss insolvency law and the difficulties that arise. Recently licensees from Swiss licensors have become even more exposed with the entry into force on 1 January 2014 of an amendment to the Swiss Federal Debt Enforcement and Bankruptcy Act ('Bankruptcy Act'), intended principally to ease the restructuring of companies in financial difficulties, but bringing with it a number of changes of direct relevance for licence agreements.

1. The bankruptcy officer decides whether to enter into the licence, be it in whole or in part or not at all

Under Swiss law, a contract will not automatically be terminated due to the opening of bankruptcy proceedings. Whether or not a contract can be terminated on insolvency, depends on the law and the agreement that covers the contractual relationship. If there is no option for termination, the bankruptcy officer of a Swiss insolvent company may choose whether to enter into a contract or not. If he chooses yes, the counterparty (the solvent party) may request security for its performance. If he chooses not, or if he does not make an express choice, the solvent party is left with a claim that may be filed in the bankruptcy. Any claims that are not for a sum of money are converted into a monetary claim of a corresponding amount. With regard to long-term agreements, which include licence agreements, the solvent party is entitled to file a claim the value of which is calculated from the date the bankruptcy proceedings were opened until the next date of termination or until the fixed contract period expires. Any contractual benefit that is drawn by the solvent party during this period must be deducted from this claim.

The bankruptcy officer typically has an interest in winding down the company as quickly as possible, not in continuing it as a going concern, and so will often choose not to enter into long-term contracts. With the revision of the Bankruptcy Act, a bankruptcy officer has however a further option with regard to long-term agreements. He may decide to enter into part of a contract only (Art. 211a para. 2 Bankruptcy Act). This might mean entering into a patent licence with respect to certain patents or certain territories only, for example. Claims for performance then actually rendered are claims against the bankrupt estate rather than claims in the bankruptcy, and so have a rather higher chance of being paid. Claims for the period before the bankruptcy is declared and claims under the contract that do not relate to performance actually rendered remain as claims in the bankruptcy. A licensee may not have any interest in a licence grant for only part of the patents or territories originally licensed, but has few options other than termination of the agreement as a whole on the basis that it can no longer be objectively expected to continue with the licence relationship, and filing of claims in the bankruptcy for that part of the originally agreed licence that is not performed.

2. Right to terminate the licence for a company in moratorium proceedings

Another new provision introduced into the Bankruptcy Act on 1 January 2014 gives a company in moratorium proceedings (prior to bankruptcy proceedings or the ratification of a composition agreement) an extraordinary right of contract termination for long-term agreements at any time (Art. 297a Bankruptcy Act). As a protection for creditors, the approval of the moratorium administrator is required. It is a condition

of approval that a restructuring would not be possible if the contract were to continue. It is expected that the hurdles to get an approval for an extraordinary termination will be rather low and an approval should normally be granted by the administrator. The counterparty then has a claim for full compensation for the early termination after deduction of amounts that could have been recovered during the period of compensation. However, the claim is for a dividend in the bankruptcy or composition agreement, not directly against the company.

The changes to the Bankruptcy Act also introduce a new protection for transactions concluded during a moratorium. With the change, such transactions cannot later be challenged provided they are approved by the company's moratorium administrator (Art. 285 para. 3 Bankruptcy Act).

3. Claw-back challenges

One method commonly used in Switzerland and elsewhere to protect licensees against the insolvency of the licensor is the deemed assignment of ownership of the IP rights just before insolvency proceedings are filed. However, this method needs careful consideration in light of the third important set of changes for licence agreements under the new Swiss law, which relate to claw-back actions, the so-called 'Pauliana' challenges (Arts. 286-288 Bankruptcy Act). These allow creditors to attack transactions of a bankrupt company that are not at arms' length in the following circumstances: If five years prior to the opening of bankruptcy proceedings sales of assets were made with the intention, apparent to the other party, of disadvantaging the debtor's creditors or of favoring certain of the debtor's creditors to the disadvantage of others; if one year prior to the opening of bankruptcy proceedings the debtor made gifts or transactions where it received a consideration out of proportion to its own and; if one year prior to the opening of bankruptcy proceedings the following acts were conducted by the debtor while it was already overindebted: The granting of collateral for existing obligations that the seller was previously not obliged to secure, the settlement of a monetary debt by any manner other than in cash or other normal means of payment or the payment of a debt prior to payment becoming due.

The amended law changes the burden of proof for such challenges where the challenged transaction involves closely related parties, being for example family and friends, group companies or majority shareholders. So, for example, where an alleged gift is made to a closely related person, the closely related person now bears the burden of showing fair value was received by the bankrupt company in return. Also, where there was an intention to benefit some creditors at the expense of others, a closely related person who benefits has the burden of showing that it could not have known of any intention by the debtor to disadvantage other creditors. There was already a presumption instituted by the Federal Supreme Court achieving the same effect, but this is now embodied in the law. Therefore, it is strongly recommended to obtain fair value opinions and/or solvency opinions for any transactions between closely related persons or entities where the financial health of one party is questionable.

Finally, there is a change to the rules on time limits for bringing Pauliana claims. Whereas previously claims were completely time barred after a period of two years from the opening of bankruptcy proceedings, now they will prescribe after two years (Art. 292 Bankruptcy Act). Also, the time periods are suspended during a moratorium proceeding prior to bankruptcy or the ratification of a composition agreement (Art. 288a Bankruptcy Act). All of these changes will ease the way for challenges based on the 'Pauliana' provisions, making it riskier to acquire ownership of IP from a (nearly) insolvent company.

4. What can be done?

The impact that Swiss insolvency laws may have on a licence agreement with a Swiss counterpart should be taken into consideration already when drafting the agreement. If the counterparty has an interest in terminating the licence as quickly as possible in an insolvency situation (a typical licensor position), it will want to have a corresponding termination right written into the agreement. If the counterparty has an interest in the licence continuing beyond insolvency (a typical licensee position), a long termination period may assist – not in prolonging the licence as such, which the bankruptcy officer may anyway choose not to keep on, but in providing a claim and a respective creditor position in the bankruptcy. This may also help in acquiring information on interested bidders for the IP in question and giving the counterparty the opportunity to make its own offer to buy out the licence if the bankruptcy officer decides to perform a private sale at the appropriate point in time.

Bankruptcy laws become relevant again when financial difficulties first arise, as they may impact on the steps that can be taken in order to prepare for a bankruptcy or to try to avoid a bankruptcy. Finally, the new provisions promoting moratorium proceedings may provide additional protection as the focus is on continuing the company in financial difficulties as a going concern.

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