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ARTICLE

# Enforcement of Security in Swiss Involuntary Insolvency Proceedings

**Dunja Koch**, Partner, Froriep Renggli, London, UK, and **Sabina Schellenberg**, Froriep Renggli, Zurich, Switzerland

## I. Introduction

Despite a comprehensive revision of the Swiss Debt Collection and Bankruptcy Act ('DCBA') in 1997 there has been little change to the fundamental idea of bankruptcy law that both available options, namely bankruptcy[1] and debt moratorium and composition agreement[2] (together 'involuntary liquidation proceedings'), lead mostly to the same result and that is: liquidation.

It is not that involuntary liquidation proceedings are limited to a few unknown companies. Not the least since the famous Swissair grounding, the legal community has been involved in some major cross border proceedings and assisted foreign creditors in connection with queries regarding potential restructuring, claims against the estate or representations in creditors' committees. The insolvency of Petroplus has led to further legal issues with regard to Swiss involuntary liquidation proceedings where foreign law is involved.

In general, involuntary liquidation proceedings according to the rules of the DCBA are open to foreign creditors and they are treated equally to Swiss creditors. However, formal requirements applicable in Swiss involuntary liquidation proceedings may present some hurdles for foreign creditors, which they did not always expect. Creditors with foreign security must be aware that any security in Swiss involuntary liquidation proceedings will be assessed according to Swiss law as the applicable lex fori concursus.[3]

As a Civil Law jurisdiction, Swiss property law recognises only certain types of property and security rights (*Numerus Clausus*, *Typenzwang*) and the content of these property rights is defined by mandatory law (*Typenfixierung*). A Swiss bankruptcy officer or a liquidator in a moratorium and composition agreement (together the 'administrator') who has to decide whether or not to accept a creditor as a secured creditor, will assess whether Swiss property law institutions and Swiss law concept have been applied – in other words, whether the relevant security right qualifies or may be deemed as a Swiss type of security right.

In the following sections an overview of the main types of Swiss security rights and the requirements for a valid creation and enforceability will be given and differences to the system of English law security rights will be identified.

## II. System of Swiss security

The Swiss system of security rights may be summarised in Table 1. It is drawn according to the type of collaterals.

As the foreclosure of security in persona is not part of the involuntary liquidation proceedings (the collateral does not belong to the estate and there is no surplus to be handed out to the estate), we do not further address this type of security.

### *1. Pledges*

Pledges can be granted on movable physical assets, rights and real estate. For a pledge to be valid, the collateral must be exactly determined and individualised or at least, sufficiently determinable (principle of specificity, *Spezialitätsprinzip*). Consequently, as a matter of Swiss law, it is not possible to grant a pledge over all assets, or even a group of assets.

A pledge requires a (visible) transfer of physical possession of the pledged chattel to the pledgee. It is a strict condition that a pledge is not validly established as long as the pledgor has unrestricted access to the collateral.

As a consequence, according to Swiss law, it is practically not possible to pledge an asset that the debtor needs for his daily business activities, e.g. machines inventory or goods. Further, a pledge over future assets comes only into existence once the security holder has possession over the chattel.

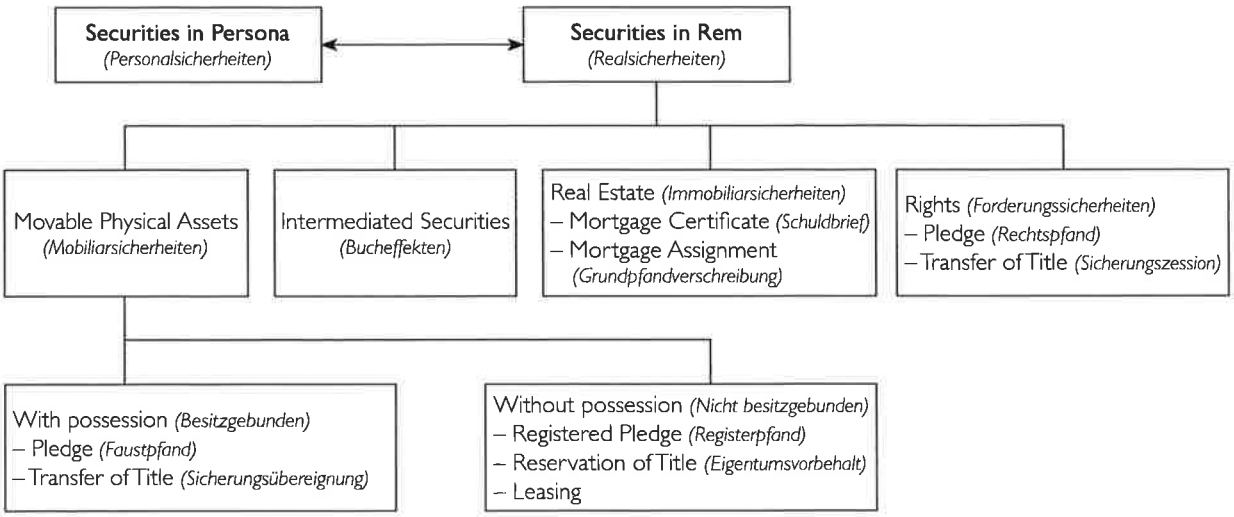
Notes

1 In Switzerland, the legal term 'bankruptcy' applies to individuals, businesses and corporations according to article 39 DCBA.

2 This procedure consists of two stages, the moratorium stage in which enforcement proceedings can neither be initiated nor continued and the composition stage in which the composition agreement is ratified and executed.

3 Switzerland is not part of the EU. Accordingly, the EC Directives do not apply in Switzerland. As Swiss bankruptcy law does not know the concept of COMI, involuntary liquidation proceedings for entities domiciled in Switzerland follow the rules of Swiss bankruptcy law.

**Table 1. Swiss Security Rights**




For pledges of claims and rights a written pledge agreement is required (as an equivalent to the transfer of possession). Further, if there exists a certificate reflecting the right (e.g. a share), the certificate must be transferred according to the form required by the law (e.g. endorsement, transfer of declaration).

### 2. Security transfer of title/security assignment

This security can be used with regard to the transfer of property on movable physical assets (e.g. shares) or the transfer of a right (e.g. account receivables, or a bank account). It is a fiduciary transaction whereby the assignor transfers the full title of ownership to a creditor, bound by a security agreement that the creditor shall only have the right to enforce and liquidate the security if the debtor defaults. As a result, the creditor is in the position of full ownership. It is to be mentioned that Swiss law does not draw the distinction between the legal and the beneficial ownership.

Security assignments do not require notification to the third party debtor for the perfection of the assignment unless the underlying agreement contains respective provisions.

### 3. Security on intermediated Securities

Intermediated securities are personal or corporate rights of a fungible nature against an issuer which are credited to a securities account. Security on intermediated securities can be created by the transfer of intermediated securities to the security holder's account. In addition, a security interest in intermediated securities may also be created if the account holder and the custodian irrevocably agree that the custodian must carry out instructions from the secured party without any further consent or cooperation from the account holder. The security of a control agreement may pertain to (1) specific intermediated securities, (2) all intermediated securities credited to a securities account; or (3) a proportion of the intermediated securities credited to a securities account up to a specified value.

## III. Enforcement of security in Swiss involuntary liquidation proceedings

### 1. Secured creditors

As soon as involuntary liquidation proceedings are opened, creditors are not entitled anymore to initiate enforcement proceedings. In bankruptcy proceedings, pledgees are not allowed to realise their security or to perform a private sale even if private sales were agreed in their pledge agreement. Therefore, in bankruptcy proceedings, the secured creditor must deliver[4] the collateral to the administrator and, as a rule the administrator will sell the assets in a public auction. If certain conditions are met, the administrator can also decide to

Notes

4 According to Swiss Criminal Code, a creditor who fails to deliver up collateral to the administrator can be liable to prosecution.

conduct private sales. The proceeds of the sale will be delivered to the secured creditor in the amount of the secured claim by the administrator and the surplus (if any) booked as assets of the estate.

On the contrary, in moratorium and composition agreement proceedings, the secured creditor is not obliged to deliver the collateral to the administrator and is, subject to respective provisions in the security agreement, entitled to realise the security. However, a secured creditor does not have complete discretion as to when and how to sell the collateral. There is an obligation for the creditor to take reasonable care to obtain the best price at the time, and if the sale price was deemed unacceptable, a creditor would be liable towards the estate or creditors ranking behind. It must be noted that secured creditors are only entitled to enforce security after completion of the moratorium stage and if they are accepted by the administrator as secured creditors.

Consequently, irrespective whether bankruptcy proceedings or moratorium and composition agreement proceedings apply, also secured creditors must file their claim in the proceedings with a short statement of reason with regard to the claim and the validity of the security right. With regard to foreign security rights, the administrator will assess whether the security can in effect be re-qualified and accepted as a security under Swiss law.

A creditor whose claim or security right is rejected will receive a written ruling.[5] Should the creditor want to contest this order, it must file an action regarding the qualification before the court. It is this stage of the proceedings where a creditor may challenge also the administrator's decision to deny a re-qualification of a foreign security as a Swiss security and accept the foreign secured creditor only as an unsecured creditor.

The position of a secured creditor is different where a security was created by transfer of title or assignment. Here enforcement by the administrator is not necessary as the ownership has already been transferred and the relevant assets do not form part of the estate. Creditors are entitled to enforce their security and satisfy their debt without being obliged to file a claim in the proceedings. Also, with regard to security interest in intermediated securities, the secured party may realise the intermediated securities according to the terms and conditions stipulated in the security agreement by selling or acquiring the collaterals and offsetting the proceeds or the value against the secured debt. This right will not be affected by the commencement of involuntary liquidation proceedings.

### *2. Principle of universality*

When a court orders involuntary insolvency proceedings, a debtor's assets, including pledged assets, irrespective of where they are located, form part of a sole estate (principle of universality). Consequently, the realisation of all assets will be performed according to the rules of the DCBA. The opening of involuntary liquidation proceedings leads to an automatic stay with also extraterritorial effect. As a result, the administrator is in principal entitled and will try to realise all assets wherever located in the world. This means that for foreign assets a Swiss administrator will have to request for legal assistance or the performance of an ancillary insolvency proceedings.

In practice, foreign creditors with security rights over assets located outside Switzerland often entered into an agreement allowing them either to enforce the security on a private sale basis, or to resort to a foreign law institution (e.g. scheme of arrangement or receivership under English law) and perform a foreclosure sale abroad on their own benefit. They then act without any involvement of the Swiss administrator, in practice mostly before the latter has even applied for legal assistance abroad or has requested the performance of ancillary insolvency proceedings.

In this respect, it must be taken into account that from the legal point of view of the Swiss administrator, creditors doing such an action could potentially be liable and considered as unjustly enriched regardless whether or not they file a claim in the Swiss proceedings and whether or not they realised the security in a formal proceeding according to the foreign law. In particular, this risk materialises if the administrator comes to the conclusion that a foreign security right cannot be recognised in Switzerland because it was not validly established according to Swiss principles. The administrator will then qualify the claim as an unsecured claim as a result of which the respective creditor is only entitled to a dividend payment. Further, the administrator could potentially try to claw back the proceeds out of a foreclosure sale from the foreign creditor.

Of course, such an action will only be seriously considered by the administrator if the likely proceeds are high enough to justify costly court proceedings possibly to be initiated abroad. However, it needs to be mentioned that the administrator can also assign such claims to other unsecured creditors who will be entitled to conduct the proceedings on behalf of the estate. If these creditors are successful, they can use the obtained proceeds for satisfying their own claims and covering the costs and are only obliged to hand over any surplus to the estate.

**Notes**

5 Foreign creditors will have to name a Swiss representative in order to receive individual communication.

## IV. Comment and outlook

If it is intended to secure an obligation of a Swiss debtor, it must be taken into account that in case of involuntary liquidation proceedings, from a Swiss point of view, Swiss bankruptcy and property law will be applicable on the creditor's rights. It is therefore crucial that the security agreements consider the Swiss concept of security rights and create the possibility of re-qualification of the security right as a Swiss security instrument.

Even if the foreign security interest is accepted in the Swiss proceedings, it must be borne in mind that the realisation of security rights can be a slow procedure dependent on the decisions of the Swiss administrator, in most cases a state official who has not really an interest to speed up proceedings.

Voices about the need for a reform increased already in connection with the Swissair proceedings and at the end of 2010 the Swiss Federal Council finally presented a bill for an amended bankruptcy law the main aim of which is to facilitate restructuring of insolvent companies. The amended law would introduce a new chapter on debt moratorium and composition agreement. The parliament will discuss the bill in 2013. As regards the old civil law rules on property and security, there are however, no intentions for any amendment. This will leave the topic of qualification of a type of security and importantly, the re-qualification of foreign security into Swiss security alive for the foreseeable future.

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