LEXOLOGY

Switzerland - A new hope? The Swiss Government adopts its Dispatch to the Parliament on an amendment to the provisions governing recognition of foreign insolvencies

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On 24 May 2017, the Swiss Federal Council adopted its "*Dispatch with respect to an amendment of the Private International Law Act (Chap. 11: bankruptcy and composition)"* to the Swiss Parliament[1], after a consultation procedure was conducted between 14 October 2015 and 5 February 2016[2].

The provisions of the Private International Law Act ("**PILA**"[3]) currently in force require, following the recognition of a foreign insolvency, the opening in Switzerland of an ancillary bankruptcy, the so-called "*mini-bankruptcy*", in which a local liquidator is appointed for the purpose of liquidating the assets located in Switzerland, with a priority given to the Swiss privileged and secured creditors in the distribution of the proceeds of such liquidation.

The draft amended PILA proposes five important amendments. First, the requirement of reciprocity would be abolished. Second, the insolvency decrees rendered at the "*center of main interests - COMI*" could be recognized in Switzerland. Third, in the absence of privileged or secured creditors, as well as of creditors of a Swiss branch of the foreign insolvent entity, the Court of the recognition could, upon request, waive the ancillary bankruptcy procedure in favor of recognizing the powers of the foreign insolvency trustee. Fourth, a legal basis would be created so as to allow Swiss authorities and bodies to cooperate with foreign bankruptcy authorities and bodies. Lastly, the bill provides that the ordinary (non-secured and non-privileged creditors) of Swiss branches of foreign entities in bankruptcy could be listed in the schedule of claims of the ancillary bankruptcy.

1. The law currently in force

The current provisions of the PILA on the recognition of foreign insolvencies are built around the antagonist principles of territoriality and of international cooperation.

In its 24 May 2017 dispatch, the Federal Council explains that pursuant to the principle of territoriality, insolvency decrees rendered outside of Switzerland have no effect on Swiss territory. Access to the Swiss assets of the debtor is granted only after recognition of the foreign insolvency decree.

PILA provides for two specific requirements to be met for the recognition of foreign insolvency decrees: the decree must have been rendered in the country of the seat or domicile of the debtor; and only the decrees issued by a country where Swiss insolvency decrees can also effectively be recognized can be subject to recognition in Switzerland (the principle of reciprocity).

The recognition of the foreign insolvency decree is currently necessarily followed by the opening of a Swiss ancillary bankruptcy. The Federal Council describes the ancillary bankruptcy as a

procedure of mutual assistance, allowing international cooperation under the condition that certain (namely privileged and secured) Swiss creditors are satisfied in priority on the assets located in Switzerland.

Finally, the creditors of the Swiss branch of a foreign entity in bankruptcy can individually seek enforcement of their claims directly against the branch, outside of the ancillary bankruptcy proceedings.

2. Shortcomings of the current PILA provisions

The Federal Council identified several shortcomings in the current PILA provisions governing the recognition of foreign insolvencies.

It should be noted that Switzerland, not itself a member of the European Union, is surrounded by EU countries, which are, by necessity, its main commercial partners. While the European Parliament and the European Council adopted the recast Regulation 2015/848 of 20 May 2015 on insolvency proceedings, which gives jurisdiction to issue insolvency decrees to the courts where the debtor's COMI is located, Switzerland only recognizes insolvency decrees rendered in the State where the debtor has its seat or domicile. In practice, this discrepancy between European and Swiss law means that a debtor can be declared in bankruptcy in an EU State member (and recognized as such in the other EU State members) but continues to be considered in Switzerland as not being in bankruptcy because the insolvency decree was not issued at the company's seat. This asymmetric situation allows creditors in a foreign bankruptcy to seek individual enforcement of their claim on the assets located in Switzerland for their own interest and benefit. This harms the interests of the foreign bankruptcy estate and of the community of creditors. As such, the current Swiss rule that limits the possibility of recognition to the insolvency decrees issued in the State of the seat or domicile of the debtor is contrary to the principle of international cooperation that underlies the provisions of the PILA on recognition of foreign insolvency proceedings.

The Federal Council also points out the legal uncertainty about the **right to dispose of the assets** located in Switzerland. The question of who can dispose of these assets and in which manner is subject to an awkward and highly technical case law that, in practice, increases the costs, the length and the risks of the asset recovery process. Another complicating factor is that Article 271 of the Swiss Penal Code ("**SPC**") punishes unauthorized activities conducted on Swiss territory on behalf of a foreign authority (the "**Swiss Blocking Statute**").

The requirement of **reciprocity** also entails a significant increase of costs and length of the proceedings on recognition of the foreign insolvency decrees. To demonstrate that this requirement is met, the creditor or the foreign bankruptcy trustee has indeed to provide legal opinions and expertise on the foreign law on international bankruptcy.

The automatic opening of a Swiss ancillary bankruptcy after recognition of the foreign insolvency decree is also inefficient, since the mini-bankruptcy **aims only to protect privileged and secured creditors**. However, in practice, there is no need and no justification for the existence of ancillary bankruptcies when all creditors are unprivileged and unsecured. For the same reason, the severe restrictions imposed by the current PILA on the powers of the foreign bankruptcy trustee, requiring the involvement of Swiss authorities, are not justified where there are no privileged or secured creditors.

Finally, the possibility that **an ancillary bankruptcy coexists concurrently with individual debt collection proceedings against the Swiss branch** of the foreign entity in bankruptcy entails practical issues such as the attribution of the assets between the two estates. Despite these inconveniencies, the Federal Council recognizes legitimate interests in favoring the ordinary creditors of a Swiss branch over the ordinary creditors of the foreign bankruptcy.

3. The goals of the bill on recognition of foreign insolvencies

In light of the above described shortcomings of the current PILA provisions, the Federal Council presents its bill with four underlying goals:

1. **Simplifying the recognition of foreign insolvency decrees** in Switzerland through abolition of the reciprocity requirement. In addition, insolvency decrees issued where the debtor has the center of its main interests (COMI) may be recognized, as well as foreign decisions on claw-back claims closely related to the foreign insolvency decree recognized in Switzerland.

2. **Protecting creditors of a Swiss branch** by allowing them to be listed, equally with the privileged and secured creditors, in the schedule of claims of the ancillary bankruptcy.

3. **Simplifying the procedure for recognizing foreign insolvency decrees** by allowing for the possibility of the foreign bankruptcy trustee to request from the court of the recognition a waiver to the opening of an ancillary bankruptcy.

4. **Enhancing international cooperation** by adopting a formal legal basis that allows Swiss authorities or bodies to collaborate with foreign authorities or bodies in charge of related insolvency proceedings.

The Federal Council then submits an article-by-article commentary on the draft revised PILA. We will focus on the new protective remedies granted to the creditors of a Swiss branch, on the simplified liquidation procedure for the Swiss assets conducted by the foreign trustee, and on improving protection of the debtor's interests in case of legal composition of the foreign entity.

The first notable change under the draft amended PILA involves the **protection of the creditors of the Swiss branch**. The list of the "*protected creditors*" in international insolvencies is extended and an ancillary bankruptcy must be opened in Switzerland not only where there are privileged and secured creditors, but also where there are creditors of a Swiss branch of a foreign entity in bankruptcy.

The existence of such protected creditors prevents the simplified liquidation of the Swiss assets by the foreign bankruptcy trustee. If the branch is registered in the Swiss Trade Registry, it also creates an exclusive forum for recognition of the foreign insolvency decree at the place of branch registration.

The creditors of the Swiss branch may participate in the ancillary bankruptcy equally to the privileged and secured creditors and may be listed in the ancillary schedule of claims. They will receive, together with the privileged and secured Swiss creditors, distributions of the proceeds of liquidation of the Swiss assets before the other foreign bankruptcy creditors.

The second major change to the PILA is allowing the foreign trustee to directly act on the Swiss territory and to dispose of the Swiss assets. This **simplified liquidation procedure of the Swiss assets** is directly inspired by the banking insolvencies procedure provided for in Article 37g of the Act on Banks and Saving Banks ("**BA**") entered in force on 1 September 2011.

Upon request from the foreign bankruptcy trustee, the Swiss court of the recognition may waive the opening of an ancillary bankruptcy procedure in Switzerland, provided there are no protected creditors within the meaning described above. If ordinary creditors are domiciled in Switzerland, the court may also waive the mini-bankruptcy, provided it is demonstrated that the foreign bankruptcy proceedings duly take their interests into account. The waiving of the ancillary bankruptcy may be subject to specific requirements and limitations ordered by the court.

The draft amended PILA provides that in case the waiver is granted, the foreign bankruptcy trustee may exercise all the powers conferred by the law of the State where the foreign insolvency decree was issued, within the limits provided for by Swiss law. This goes beyond the current Swiss provisions on international banking insolvency.

Among the rights of the foreign trustee (as primarily defined by its domestic law), the draft amended PILA provides for the right of the foreign trustee to transfer the Swiss assets outside of Switzerland without being exposed to the risk of criminal sanctions due to the Swiss Blocking Statute. The draft amended PILA also grants legal standing to the foreign trustee to bring civil claims before Swiss courts (so far, this standing had only been granted to the ancillary liquidator). The foreign trustee may, for example, interrupt the statute of limitation by requesting the issuance of an order to pay or by filing a request for conciliation before the competent courts.

The limitations on the powers of the foreign trustee provided for by Swiss law are, on the one hand, the ones ordered by the Swiss court of the recognition and, on the other hand, all the acts that concern public authority such as the threat of criminal sanctions or the use of force with respect to the duty to provide information. Also, the foreign trustee may request third parties to disclose information, but may not threaten criminal proceedings or fines in case of refusal to cooperate. Such acts of constraint remain the domain of Swiss authorities (acting in the recognition proceedings or in execution of letters rogatory).

Finally, the debtor subject to insolvency measures outside of Switzerland can apply for recognition of the insolvency decree. Under the current PILA, only the creditors and the foreign trustee are entitled to do so. Together with the possibility of recognizing insolvency decrees issued in the State of the COMI, this new provision would enhance the chances of a successful restructuring of the insolvent entity and would allow the debtor to avoid bankruptcy.

Analysis

It must be noted that in its Dispatch, the Federal Council states its belief that, although the draft amended PILA does not take into account all the elements contained in the UNCITRAL Model Law on Cross-Border Insolvency ("**the Model Law**"), it contains all its central propositions. As such, the entry in force of the draft amended PILA would bring Switzerland to the rank of the countries who implemented the Model Law and adopted the most advanced legal provisions on the international level.

It is fair to admit that the draft amended PILA enhances the process of recognition of insolvency decrees and the status of the foreign trustee in Switzerland. Renouncing the requirement of reciprocity, as well as acknowledging the competence of the courts of the debtor's COMI would speed up and simplify the proceedings on recognition. It would also improve the level of protection of both the creditors' community and the insolvent debtor (in particular in cases of composition and restructuration of the debtor).

The adoption of a legal basis that grants Swiss authorities and bodies authorization to cooperate, not only with the State where the insolvency decree was issued, but also with all States in charge of related matters, would also probably support the Model Law goal of coordinating concurrent proceedings concerning the insolvent debtor.

The powers given to the foreign trustee to directly accomplish certain acts and to dispose of the Swiss assets would also improve the quality of the insolvent debtor's representation and, *in fine*, of the creditors' interests. The experience acquired in banking insolvencies shows that the foreign trustees of the main insolvency proceedings abroad have the best knowledge of their cases. They are in much better positions than Swiss ancillary liquidators to make strategic decisions in the proceedings in Switzerland, this for the ultimate benefit of all the creditors of the foreign insolvent entities. By avoiding the required tasks of coordination between the foreign trustees and the Swiss ancillary bankruptcy, recognition of the powers of the foreign trustees on the Swiss territory would also reduce the costs that will be borne, sooner or later, by the insolvent estate at the expense of the creditors.

As an illustration of the difference between the current and the proposed regime, one may compare the Swiss foreign insolvency proceedings regarding Stanford International Bank Ltd (In Liquidation) and those regarding Banca Turco Romana SA In Liquidation ("**BTR**"), two foreign insolvent banks. The former had to undergo an ancillary bankruptcy while the latter was granted recognition with a waiver of the ancillary procedure.

Stanford International Bank Ltd ("**SIB**") was a bank with registered headquarters in St John, Antigua and Barbuda. It was owned and operated by Texan billionaire Robert Allen Stanford, who was sentenced in 2012 by a US criminal court in Texas to 110 years in prison for having run the second-largest Ponzi scheme in history after Bernard Madoff's, defrauding 25,000 investors with losses in excess of US$7 billion[1]. In 2009, the High Court of Antigua ordered the bankruptcy of SIB. Concurrently, the U.S. Securities and Exchange Commission ("**SEC**") appointed a receiver to liquidate Robert Allen Stanford's assets, including SIB. Both the Antiguan liquidators and SEC Receiver applied for recognition with the Swiss Financial Markets Supervisory Authority FINMA ("**FINMA**"), the competent authority for bank insolvencies.

On 8 June 2010, FINMA ruled[2] that only the joint liquidators of SIB appointed by the courts of the registered seat of the bank, Antigua and Barbuda, could obtain the recognition of the bankruptcy in Switzerland. The receivership ordered by the authorities of the effective seat, the United States of America, could not be recognized in Switzerland along with the concurrent application for recognition of the liquidators appointed by the State of the registered seat of the insolvent bank[3]. The Swiss ancillary bankruptcy of SIB is still pending[4]. Despite recoveries of US$11.5 million through SIB's participation as plaintiff in Swiss criminal proceedings[5], the appeals filed by a bank in the ancillary proceedings have so far delayed the remittances to the foreign bankruptcy trustees, to their great frustration[6].

In contrast with the SIB frustrating situation, one may mention the example of Banca Turco Romana SA In Liquidation ("**BTR**"). That Romanian bank went into bankruptcy in 2002 because of acts of criminal mismanagement of public interests committed by members of its board of directors. On 30 April 2015[7], FINMA recognized BTR's bankruptcy without ordering the opening of a Swiss ancillary bankruptcy[8]. Instead, on the basis of Article 37g BA, FINMA authorized the bank, acting through its liquidator, to bring proceedings and to be remitted BTR's assets located in Switzerland. The only conditions precedent were that the powers of the liquidator were limited to the extent authorized by FINMA, that the decision on recognition be entered in force prior to such remittance abroad, and that the liquidator had to inform FINMA about transferring the Swiss assets outside of Switzerland. BTR was authorized to: a) bring civil claims in the criminal proceedings initiated by the Attorney General's Office of Geneva; b) enforce its US$180 million award in damages and interests obtained in the context of the criminal judgment rendered against the members of its Board of Directors in 2012; and c) bring actions for damages against third-party Swiss banks that were suspected of being complicit in the commission of the fraud. As no appeal was filed against the FINMA decision, the recoveries could be directly remitted to BTR's liquidator, without any delay or possible objection from a third party.

This comparison clearly shows the enhanced effectiveness allowed by the waiver of ancillary bankruptcy proceedings.

That being said, the draft amended PILA has shortcomings and the Federal Council's optimism about compliance of the draft amended PILA with the Model Law cannot be shared without the following comments.

First of all, although the draft amended PILA proposes to enable the foreign trustee to directly act in Switzerland, there is still no paradigm shift: the *principle* remains the opening of an ancillary bankruptcy, the *exception* being the empowerment of the foreign trustee to accomplish certain acts in Switzerland. This simplified procedure

would not be granted *ex officio* by the judge but upon request, and the judge could always limit the powers of the foreign trustee. The limitations at the judge's disposal allow a tailored use of the powers of the foreign trustee in Switzerland, but should not be used to jeopardize the efforts of international asset recovery in Switzerland.

We also believe that the Swiss compromise between the parties involved in the consultation procedure to protect the creditors of the Swiss branch does not comply with the principle of equal treatment of all the non-secured creditors provided for by Article 13 of the Model Law. The particular ties of the Swiss branch of a foreign insolvent entity to its Swiss creditors are already taken into account by the obligation to open an ancillary bankruptcy when there are privileged claims such as salaries or social contributions. To this extent, the legal protection of the Swiss privileged creditors pursues a justified social goal. We do not see any predominant reason for a better treatment of the ordinary creditors of a Swiss branch over the ordinary (and even privileged) creditors of the main insolvency proceedings.

More generally, one should not forget that, even if PILA is a federal act that is applicable and compulsory in all the 26 cantons, the decisions rendered in banking insolvency matters were issued by a single federal authority, FINMA. By contrast, the new provisions of PILA would have to be applied by 26 different cantonal jurisdictions, with different judicial traditions and different experiences in international insolvency matters. We only need to mention that the two largest jurisdictions in Switzerland, Geneva and Zurich, showed diverging views on the necessity to reform the current PILA in the consultation process, the former being in favor of simplifying the proceedings, the latter concluding that the number of international insolvency matters per year does not justify any amendment of the law.

This leaves significant room for forum shopping and conflicting decisions.

Also, jurisdiction of the Swiss court of the recognition at the place where the assets are located seems to preclude a foreign trustee from solely obtaining information in Switzerland when the alternative forum of the Swiss branch location is unavailable. The issue is how the courts of the different cantons would interpret and apply these provisions. Under the current PILA, the Swiss Federal Court ruled that it is sufficient that the foreign trustee shows a legitimate interest in recognition of the insolvency decree, even if there are no identified assets in Switzerland when the foreign trustee applies for recognition[9]. However, this decision was issued with the idea that the foreign trustee would eventually seek recovery of assets located in Switzerland, depending on the content of the information obtained in Switzerland. In light of this decision, would the cantonal courts grant recognition for the sole purpose of gathering information held by third-parties domiciled in Switzerland? The foreign trustee could still obtain information by requesting from the judge of the main proceedings abroad to issue an order against these third parties, an order that would then need to be executed through international civil assistance. This apparent loophole in the draft amended PILA may be an obstacle to the achievement of the goals of international cooperation and fair and efficient administration of international insolvency proceedings pursued by the Model Law.

One can also wonder how "*centre of the main interests*" will be interpreted by the Swiss courts of recognition. Will they apply the definition of "*effective seat*" within the meaning of Article 37g BA or will they prefer to refer to the centre of main interests within the meaning of Article 3 para. 1 of the EU Regulation 2015/848

Conclusion

The draft amended PILA must now be discussed and voted on by the Federal Assembly. Depending on the outcome of the parliamentary debates, it could be subject to referendum (this is, however, unlikely, given the technical nature of the matter). If adopted, the amended PILA provisions should enter into force in 2018.

A majority of the cantons and of the organizations involved in the consultation process (in particular *economiesuisse*, and several Swiss universities) as well as right and central right parties are favorable to the adoption of the amended PILA. It is worth mentioning the skepticism of the canton of Zurich, which believes that bi- or multilateral conventions with EU and/or EFTA State members would be sufficient to ensure international cooperation.

The simplified procedure for liquidating Swiss assets directly by the foreign trustee was approved by a majority of the consulted organizations and cantons. By contrast, the dilution of a Swiss branch's creditors' rights in the ancillary bankruptcy could be subject to more intense discussions and bargaining.

In any event, there is a strong hope that these new provisions will soon facilitate cross-border insolvency cooperation and allow a better protection of Swiss and foreign creditors' interests.

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