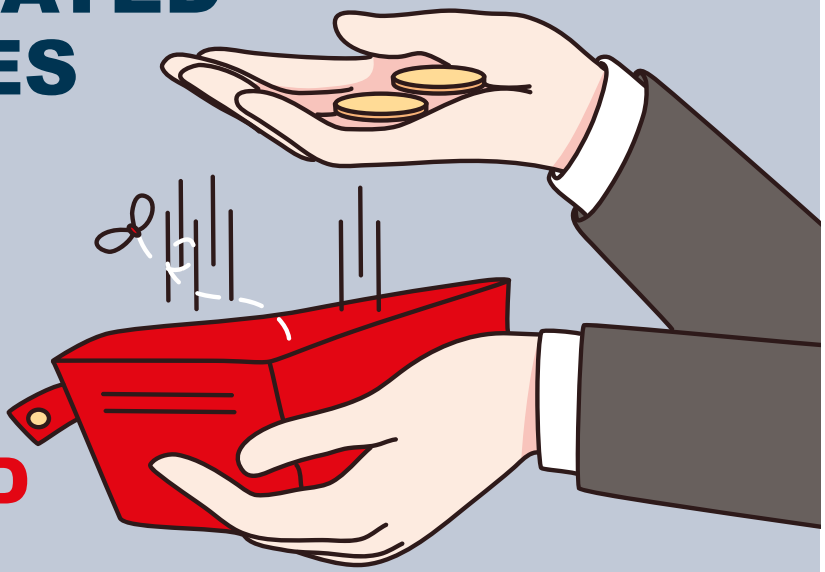
LIFTING THE VEIL ON CONSOLIDATED BANKRUPTCIES

UPDATE ON THE RECOGNITION OF FOREIGN BANKRUPTCIES IN SWITZERLAND



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On 14 July 2021, the Geneva Court of First Instance granted an application for the recognition of consolidated bankruptcies of Brazilian entities. For the first time, to our knowledge, consolidated bankruptcies (i.e., the combining of two or more bankruptcy proceedings into one) were recognised in Switzerland[1].

Since Swiss law does not provide for consolidated bankruptcies, how can we explain the recognition of such proceedings in this case? By the application of a principle well known in numerous jurisdictions: the piercing of the corporate veil.

This recent decision of the Geneva Court is an opportunity to give an update on the recognition of foreign bankruptcies in Switzerland by answering five questions frequently asked in practice.

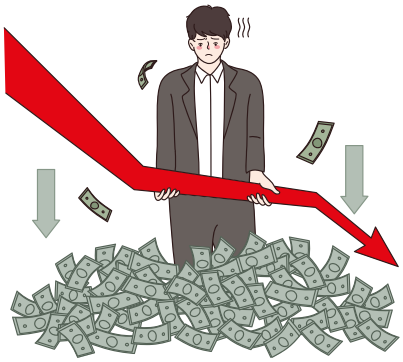
1. Why is the recognition of a foreign bankruptcy necessary?

In accordance with the principle of territoriality, foreign bankruptcies have in principle no effect in Switzerland. Access to the debtor's assets located in Switzerland is only possible once the foreign bankruptcy has been recognised.

Violations of the principle of territoriality may have criminal consequences. A foreign bankruptcy administrator acting as such in Switzerland – without the foreign bankruptcy having been recognised – may be subject to criminal prosecution under Article 271 of the Swiss Criminal Code, which punishes acts performed for a foreign state without authorisation[2].

1 Decision of the Geneva Court of First Instance of 14 July 2021, JTPI/9640/2021.

2 Pursuant to Article 271 (1) of the Swiss Criminal Code, any person who carries out activities on behalf of a foreign state on Swiss territory without lawful authority, where such activities are the responsibility of a public authority or public official, shall be liable to a custodial sentence not exceeding three years or to a monetary penalty, or in serious cases to a custodial sentence of not less than one year.



2. What does foreign bankruptcy mean?

Under Swiss law, foreign bankruptcy encompasses all proceedings that share the main characteristics of a Swiss bankruptcy, namely proceedings:

- caused by the debtor's insolvency;
- supervised by a state body;
- leading to the debtor's incapacity to dispose of his assets; and
- resulting in the liquidation of the debtor's assets and their distribution among creditors.

The cause and effects of the foreign proceedings are therefore decisive.

By way of example, winding-up proceeding under English law may have similar consequences as a Swiss bankruptcy, in particular the liquidation and the distribution of assets. However, they cannot be qualified as a foreign bankruptcy if they have been opened for a reason which is not related to the debtor's insolvency[3].

3. What is the legislative framework for recognition of a foreign bankruptcy?

The recognition of foreign bankruptcies in Switzerland is governed by Articles 166 et seq. of the Federal Act on Private International Law of 18 December 1987 (PILA). The competent authorities are the cantonal courts at the location of the foreign bankruptcy's assets.

If the debtor is comparable to a financial institution subject to regulation in Switzerland, (e.g., banks, insurance institutions, investments funds, etc.), the recognition is governed by the Federal Act on Banks and Saving Banks. The competent authority is the Financial Market Supervisory Authority (FINMA).

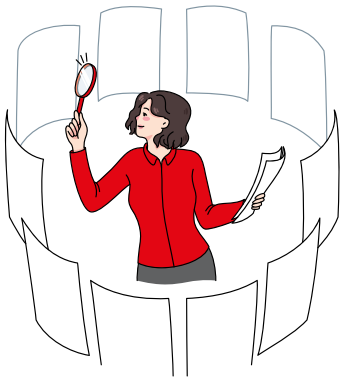
4. What are the main conditions to recognize a foreign bankruptcy?

On 1 January 2019, legislative changes entered into force to facilitate and simplify the recognition of foreign bankruptcies and to improve coordination with foreign proceedings.

Pursuant to Article 166 (1) PILA, the current conditions to recognize a foreign bankruptcy are the followings:

- the request for recognition is filed by the bankruptcy administrator, the debtor or a creditor;
- the bankruptcy decision is enforceable in the state where it was issued;
- the decision was issued in the debtor's state of domicile, or in the state of the centre of the debtor's main interests (COMI), provided the debtor was not domiciled in Switzerland when the foreign proceedings were opened;
- there are no grounds for non-recognition (e.g., imcompatibility with Swiss public policy, violation of fundamental procedural rights, lis pendens, res judicata).

The conditions mentioned in Article 166 (1) PILA also apply to the recognition of foreign bankruptcies falling within FINMA's competence.



5. What are the effects of the recognition of a foreign bankruptcy?

Once the foreign bankruptcy is recognised, Swiss law provides for two options.

Option 1: ancillary bankruptcy proceedings

The recognition of a foreign bankruptcy decision leads to the opening of ancillary bankruptcy proceedings in Switzerland, usually conducted by a local Bankruptcy Office, which will liquidate Swiss assets and claims of the foreign bankruptcy. This mutual assistance procedure makes it possible to assist the foreign authority conducting the main proceedings, while guaranteeing priority payment of certain Swiss privileged creditors: their claims are satisfied first from assets located in Switzerland. The remaining balance is transferred abroad after the foreign schedule of claims has been recognized in Switzerland.

Option 2: waiver of the ancillary bankruptcy proceedings

At the request of the foreign bankruptcy administrator, the Swiss court or FINMA may agree to waive the ancillary bankruptcy proceedings if no Swiss-based privileged creditors exist and if Swiss creditors' claims are adequately taken into account in the foreign proceedings.

In such case, the foreign bankruptcy administrators may exercise in Switzerland all powers to which they are entitled under the law of the state in which the bankruptcy proceedings were opened, with the exception of coercive powers.

3 Decision of the Swiss Federal Court of 25 July 2014, 5A_952/2013.

Case study: the recognition of Brazilian consolidated bankruptcies

The Brazilian proceedings

The Probank Group was a corporate group mainly composed of companies based in Brazil that provided telecommunication services, including electronic voting services to the Brazilian government.

Between 2004 and 2006, due to mounting debts, the Probank Group allegedly restructured its shareholding to conceal the assets of its ultimate beneficial owners.

As of September 2013, the Brazilian courts opened bankruptcy proceedings against several Probank Group companies. The proceedings were subsequently consolidated to ensure equality between the various creditors of the Probank Group.

In addition, the Brazilian courts also extended, on the basis of Article 50 of the Brazilian Civil Code, the effects of the bankruptcy proceedings to fourteen – national and foreign – individuals and companies related to the Probank Group because of their involvement in acts of fraud against the bankrupt entities with the purpose to conceal their assets.

The extension of the bankruptcy proceedings to those third parties was based on a principle similar to the piercing of the corporate veil.

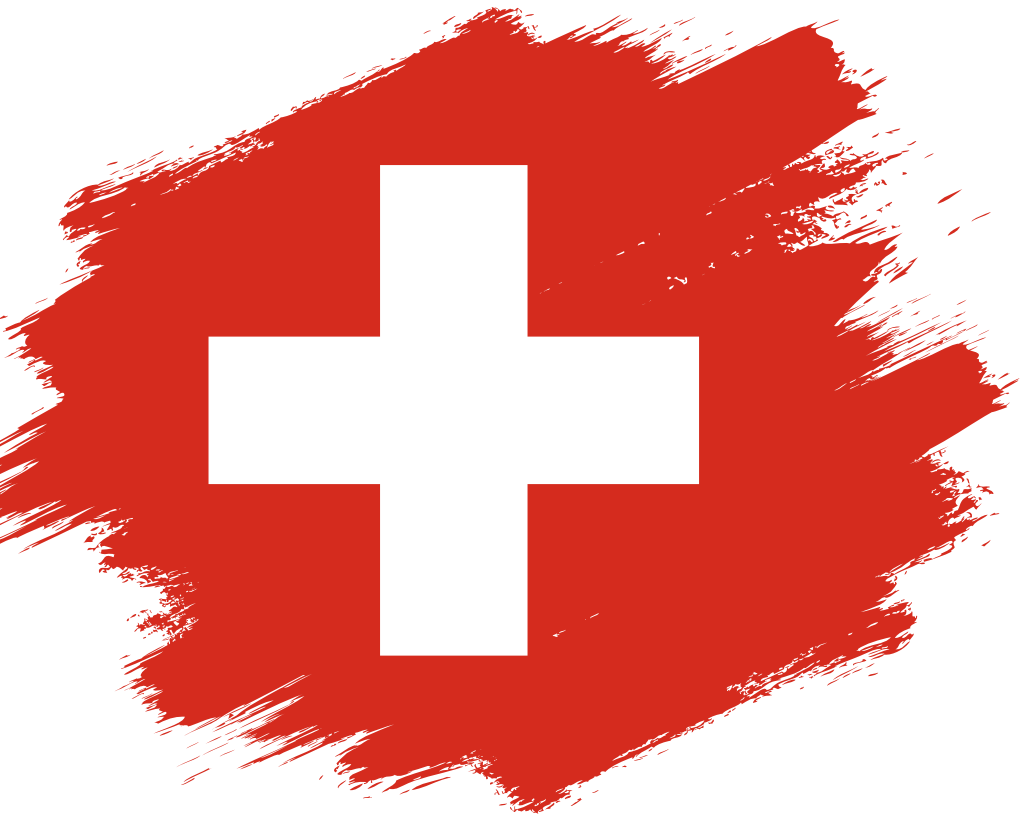
The recognition in Switzerland

On 14 July 2021, the Geneva Court of First Instance recognized the Brazilian consolidated bankruptcies.

In the context of the Swiss ancillary bankruptcy, the Geneva Bankruptcy Office also recognized the extension of the effects of the Brazilian bankruptcy proceedings to BVI companies by sending freezing and productions orders to the various Swiss banks where they held their accounts.

Under Swiss bankruptcy law, the atomistic principle is the rule: each independent legal subject must be the subject of an independent bankruptcy proceedings.

Thus, how can the position of the Geneva Court and Bankruptcy Office be explained?



The principle of piercing the corporate veil also exists in Swiss law (Durchgfriff). It is derived from Article 2 (2) of the Swiss Civil Code, according to which the manifest abuse of a right is not protected by law. It allows creditors of a company to reach the assets of another company or individual in case of abuse of the company structure.

Although the consolidation of bankruptcies does not exist under Swiss law, the Swiss government contemplated it in 2002 following the bankruptcy of Swissair. In this context, the expert group in charge of amending the Swiss Debt Enforcement and Bankruptcy Act debated the opportunity to introduce this concept in the new provisions of said Act. Most of the experts considered that the consolidation of bankruptcy proceedings could be justified in exceptional cases, based in particular on the principle of piercing the corporate veil. Even though the experts decided eventually against the explicit mention of this concept in the revised Act, this evidenced that the recognition of consolidated foreign bankruptcies would not breach Swiss public policy.

For the same reason, the extension of the effect of the Brazilian bankruptcies to third parties based on their fraudulent act did not breach Swiss public policy.

The consolidation of the Brazilian bankruptcies and the extension of their effects pursued objectives that were in line with Swiss law, namely the protection of creditors' interests and the prohibition of the misuse of entities. Under these circumstances, there were no grounds to refuse the recognition of these foreign bankruptcy proceedings.

This case illustrates the pragmatic attitude of Swiss courts and authorities towards the recognition of foreign bankruptcies and enforcement of their claims.

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