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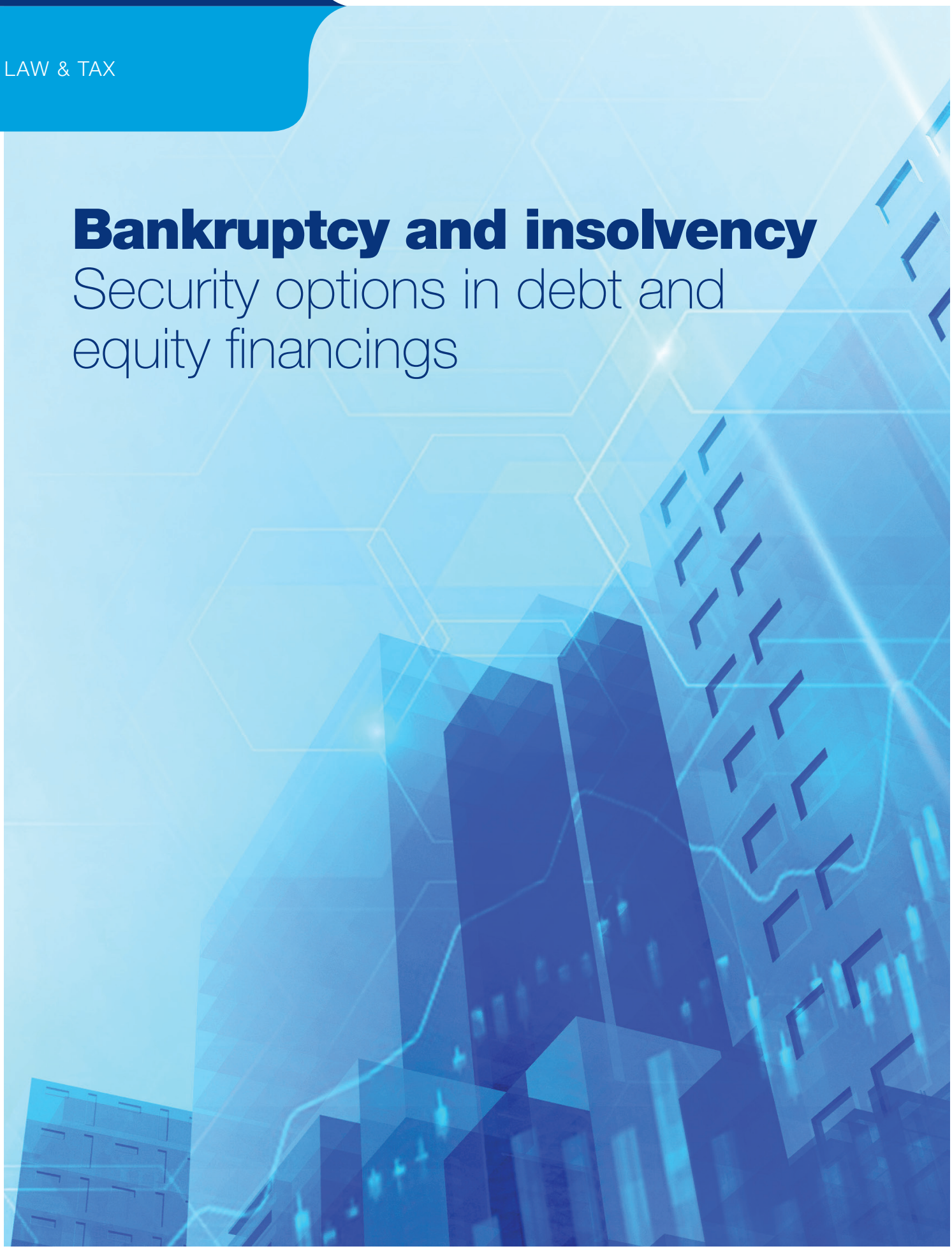
LAW & TAX

Bankruptcy and insolvency

Security options in debt and equity financings



1. What forms of security interest are generally taken over assets in Switzerland?

Rights of pledge (*Pfandrecht*) and, depending on the asset, assignments (*Sicherungszession*) or transfers for security purposes (*Sicherungsübereignung*) are the most common forms of security taken in Switzerland. Mortgages are rather rare in ordinary financing transactions, other than real estate financings, due to the relatively high costs and administrative requirements.

Except for mortgages, none of these forms of security require notarial deeds. However, written agreements are legally required for security interests over certain types of shares, receivables and other rights. Although pledge agreements over other assets, such as movable assets, do not require to be in writing, it is highly recommended to use the written form.

Whereas security rights over certain assets such as real estate, aircrafts and vessels need to be registered in order to create in rem effect, there is no national register listing all security interests (in contrast to Belgium for example). Although not required to create an in rem effect, pledges over intellectual property rights may be registered in the relevant register.

A standard security package under Swiss law in a finance transaction usually covers the shares or quotas in the Swiss entity, its bank accounts, trade and intercompany receivables, IP rights and insurance receivables.

Since Swiss law requires the transfer of the collateral to the pledgee or a security agent for the perfection of a security right over movable assets, such as machinery and equipment, this kind of assets is normally not part of the security package. Additionally, the floating charge is not a concept known under Swiss law.

A right of pledge or a mortgage is an accessory security right (*akzessorisches Recht*) which means that the creation, transfer and continuance is linked to the underlying claim and that therefore such security rights cannot be validly created in favour of a person who is not the creditor of the secured liabilities. For this reason, if a Swiss law security is held by an agent or trustee for the benefit of other parties, the concept of direct representation (*direkte Stellvertretung*) and a parallel debt are used. This does not apply to non-accessory security rights such as assignments and transfers for security purposes.

2. How are security interests enforced and what needs to be taken into account?

In general, a security right may be enforced if the secured obligations are not paid when due (*Verzugsfall*). The circumstances under which security interests can be enforced basically depend on the agreement between the parties and are subject to certain minimum requirements by law which protect the security provider.

Depending on the type of security and the agreement between the parties, the creditor as secured party may have to give notice of the intended enforcement before initiating the enforcement proceeding.

Security interests may be enforced either by private enforcement or by official debt enforcement proceedings under the Swiss Federal Debt Enforcement and Bankruptcy Act (*Bundesgesetz über Schuldbetreibung und Konkurs*, **DEBA**). In practice, parties often agree on a right of the secured party to choose between private enforcement without court involvement or official debt enforcement proceedings.

Out of court private enforcement is in most cases faster and less cumbersome. However, the secured party is obliged to realise the collateral in a way that allows it to obtain the best price for the assets under the circumstances, be it by way of private sale or public auction. Therefore, the secured party must organise and document the private enforcement process appropriately. Once official enforcement proceedings have been initiated or bankruptcy has been declared against the debtor, private enforcement of certain security rights is no longer possible and requires co-operation with the bankruptcy and enforcement administrators.

The agreement that the pledgee automatically becomes the owner of the pledged asset, claim or right in an event of default (*Verfallklausel*) is prohibited by law. However, the purchase of the pledged asset by a pledgee (*Selbsteintritt*) is allowed if (i) such pledged asset has a market value, (ii) the pledgee provides a detailed account based on the market value of the pledged asset (*Abrechnungspflicht*), (iii) the price will be applied against the secured liabilities and (iv) any surplus will be repaid to the pledgor.
An acquisition of the secured assets, claims or rights for less than the market value of such asset upon enforcement may be declared null and void by a Swiss court and/or may give rise to civil liability.

3. What remedies do unsecured creditors have?

All creditors who have claims against an insolvent debtor can participate in bankruptcy or insolvency proceedings. There are no restrictions in terms of nationality or jurisdiction, but secured creditors always have priority over unsecured creditors insofar as their claims are fully covered by the security. The unsecured claims are divided into three different classes and are accordingly satisfied out of the proceeds of the remainder of the bankruptcy estate (for the sake of simplicity, only claims that are relevant in the corporate context are mentioned below):

1. First class privilege is granted, amongst others, to claims of employees resulting from the employment relationship, which came into existence or became due not earlier than six months prior to the opening of the bankruptcy proceedings and which do not exceed the maximum amount of insurable annual earnings (currently CHF 148,200).
2. Second class privilege is granted to claims relating to social insurances, contributions to the family compensation fund and privileged bank deposits up to a maximum amount of CHF 100,000 per creditor.
3. The third class includes all other claims.

The creditors of the same class have equal rights among themselves. If there are not sufficient proceeds to fully satisfy the creditors within one class, they are distributed in proportion to the individual claim amounts, the so-called bankruptcy dividend (*Konkursdividende*). The creditors of a subsequent class are not entitled to the proceeds until the creditors of the preceding class have been completely satisfied.

If any secured claims cannot be satisfied in full by the proceeds realised out of the relevant asset, such pledgees become “normal” bankruptcy creditors and are assigned to one of the three aforementioned bankruptcy classes based on the type of their claim.

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