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# ANLEIHENSOBLIGATIONEN IM KONKURS DES SCHULDNERS
# DEBENTURES IN THE BANKRUPTCY OF THE DEBTOR

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*Consequences of the Appointment or Non-appointment of a Joint Representative pursuant to Art. 1183 Swiss Code of Obligations*

In the bankruptcy of the debtor, the creditors of a debenture have the possibility to appoint a loan representative and to grant him power of attorney for the equal protection of their rights. The decision of the loan creditors influences the handling of the bankruptcy proceedings to not an unsubstantial extent. The schedule of claims is shaped differently concerning the loan creditors when a loan representative is appointed. Correspondingly, the procedures for the legal protection of the loan creditors in an action to contest the schedule of claims, for the assignment of rights to litigate within the meaning of Art. 260 Swiss Bankruptcy Law or in the second meeting of the bankruptcy creditors are also different. These differences will be presented in the following article.

## 1. INTRODUCTION

When debentures with uniform conditions are issued by public subscription by a private debtor with domicile or business branch in Switzerland, the creditors of each individual debenture shall form a group of creditors (Art. 1157 Swiss Code of Obligations). Such a group of creditors is not a legal entity and therefore also does not have legal capacity. Within the scope of the powers given to it by law (Art. 1164 Swiss Code of Obligations), capability to act as a party is however conferred on it[1]. Where a debenture debtor goes into bankruptcy, a convened meeting of the loan creditors can grant a power of attorney for the equal protection of the rights of the loan creditors in the bankruptcy proceedings (Art. 1183 Swiss Code of Obligations). Depending on whether a joint representative is appointed or not, protection of the rights of the loan

[1] Federal Court Decision 113 II 285

creditors in the bankruptcy of the debtor is shaped differently.
Publicly issued debentures are today regularly traded on the stock exchange. Experience shows that trading on the stock market is not automatically suspended after initiation of bankruptcy proceedings regarding the debtor. The composition of the loan creditors constantly changes due to trading without the bankruptcy trustee receiving knowledge of this. When the debenture creditors have not appointed a joint representative, problems arise from this for preparing the schedule of claims.

## 2. MEETING OF THE LOAN CREDITORS

Pursuant to Art. 1183 par. 1 Swiss Code of Obligations, the bankruptcy trustee must immediately convene a meeting of the loan creditors. In ordinary bankruptcy proceedings, the bankruptcy trustee is only appointed at the first meeting of the creditors (Art. 237 par. 2 Swiss Bankruptcy Law). Correspondingly the view in doctrine is that the meeting of the loan creditors can only occur after the first meeting of the creditors has taken place[2]. In my opinion, the text of the law in regard to the time of the meeting of the loan creditors cannot be narrowly interpreted. Should before the commencement of the bankruptcy, a meeting be held in connection with reorganization proceedings and it has appointed a joint representative to protect interests in the event of a bankruptcy, this representative must be able to act for the loan creditors from the time of commencement of the bankruptcy. It would be contrary to the interests of the loan creditors and the meaning of Art. 1183 Swiss Code of Obligations if the representative could not exercise his power of attorney until a confirmation in an additional meeting of the loan creditors after the first meeting of the bankruptcy creditors[3].
Likewise it is not understandable why the choice of a loan representative cannot be already negotiated and agreed upon before the first meeting of the creditors in a meeting of the loan creditors which was called even before the commencement of the bankruptcy but was held only after the commencement of the bankruptcy. The position of the loan creditors would be strengthened by a joint representative also in the first meeting of the creditors because they could proceed uniformly.
The appointment of a joint representative requires the consent of more than half of the issued capital (Art. 1180 Swiss Code of Obligations). The provisions in Art. 1164 et seq. apply in general for carrying out the meeting of the loan creditors. In particular, each loan creditor has the possibility to contest their resolutions pursuant to Art. 1882 Swiss Code of Obligations.

## 3. NO JOINT REPRESENTATIVE IS APPOINTED

### 3.1 PRINCIPLE

In this case each loan creditor must independently protect his rights in the bankruptcy of the debtor (Art. 1183 par. 2 Swiss Code of Obligations).
The loan creditor will be treated the same as all other bankruptcy creditors. In reference to the admission of the loan creditors on the schedule of claims, the following consequences emerge.

[2] A. Ziegler, Commentary to the Swiss Civil Code, Law of Obligations, 19th title, Bonds and Debentures, N2 to Art. 1183 Swiss Code of Obligations; Ch. Steinmann in Commentary to the Swiss Civil Law, Law of Obligations II, N3 to Art. 1183

[3] A. Ziegler, cited above, N3 to Art. 1183 Swiss Code of Obligations



### 3.2 ADMISSION OF THE LOAN CREDITORS ON THE SCHEDULE OF CLAIMS

In the schedule of claims the creditors must be listed individually. An admission as «bearer» is not allowable. The bankruptcy trustee and the other creditors must examine each claim notified – also set-off defenses – and if needed be able to reject them or contest them by an action to contest the schedule of claims[4]. This principle applies also for the collation of loan creditors. Each of these creditors must be included in the schedule with its percentage of the debenture and listed by name. The bearer instrument claim represented in the loan will be converted thereby into a registered instrument claim[5]. Transfer of the claim arising from the debenture can then only occur by assignment of the claim and delivery of the bond to the acquirer. Only the listed loan creditors have rights to the bankruptcy dividends or a third party who proves it is their legal successor by submission of an assignment document[6].
Each loan creditor is therewith obligated to give notice of his claims making known his identity. Notification through a representative without making known his identity is not allowable. Should the creditor refuse to make his identity known, notification must be rejected. The merits of the claim are not examined; acceptance or refusal of the noticed claim cannot be decided on[7]. Loan creditors who do not give notice of their claims, likewise do not participate in the bankruptcy[8].
Each creditor is obligated to prove the existence of his claims and to submit to the bankruptcy trustee the corresponding proof (Art. 232 par. 2 line 2 Swiss Bankruptcy Law). The bearer bond represents the right to claim of the loan creditor. The loan claim becomes due at the time of commencement of the bankruptcy (Art. 208 Swiss Bankruptcy Law). Notification of the claim in the bankruptcy is a collection procedure. Correspondingly, the bankruptcy trustee can request submission of the original document according to security law principles[9]. In particular for bonds traded on the stock exchange, the bankruptcy trustee cannot avoid requesting submission of the bonds. Otherwise it risks that the schedule of claims at the time of availability for inspection no longer corresponds to the actual relationships. Consideration should in any case be given to the current practices in securities trade for collecting the bonds. Today bonds are regularly traded without documentation. The original certificates are deposited with SIS Segaintersettle AG. The percentages for the individual loan creditors are only recorded in the books. Correspondingly the loan creditors are not in the position to present the originals bonds representing their percentages to the debentures. The problem can be solved by allowing delivery of the bonds over the clearing system of the banks in a bank account for the bankruptcy estate.

### 3.3 THE BANKRUPTCY OF BIBER HOLDING LTD. AS EXAMPLE

For Biber Holding Ltd. there were four debentures with various conditions for around CHF 100 million outstanding at the time of the commencement of the bankruptcy in January 1997. All bonds were traded on the stock exchange. Trading on the stock exchange was not suspended after the commencement of the bankruptcy. The meetings held of the loan creditors for all four bonds did not appoint a joint representative. In view of the planned avail-

[4] Federal Court Decision 57 III 135 et seq.

[5] Federal Court Decision 42 III 387 et seq.

[6] Federal Court Decision 42 III 188

[7] Fritsche/Walder, Debt Enforcement and Bankruptcy according to Swiss Law, Band II, § 46, N3a; Federal Court Decision 57 III 135

[8] Dieter Hierholzer, in Commentary to the Federal Law regarding Bankruptcy, N3 to Art. 244 Swiss Bankruptcy Law

[9] Meier/Hayoz/von der Crone, Securities Law, p. 34

ability for inspection of the schedule of claims in the spring of 1998, the bankruptcy trustee requested the known bondholders to submit their bonds. Submission could be done by delivery of the physical original certificates to the bankruptcy trustee or by delivery of the bonds through the clearing system of the banks into the account of the bankruptcy estate of Biber Holding Ltd. at the Zurich Cantonal Bank. At the same time, a last call for debtors was published with the same request. Over 900 bondholders with around 99 % of the outstanding capital submitted their bonds. Trading on the stock exchange was suspended at the end of November 1997 based on a request of the bankruptcy trustee. The proceedings to draw up the schedule of claims could be carried out without difficulties in the spring of 1998.

## 4. THE LOAN CREDITORS APPOINT A JOINT REPRESENTATIVE

### 4.1 CONTENTS OF THE POWER OF ATTORNEY OF THE JOINT REPRESENTATIVE

Pursuant to the wording of Art. 1183 par. 1 Swiss Code of Obligations, the power of attorney is given to the representative for the purpose of the «equal protection of the rights of the loan creditors». It includes therewith only those actions which serve this purpose. Belonging to these is the notification of the claim arising from the debenture to the bankruptcy trustee, the action to contest the schedule of claims against the bankruptcy estate, respectively the defense against actions to contest the schedule of claims of other creditors as well as representation of the loan creditors in the second meeting of the bankruptcy creditors[10]. Without express resolution of the meeting of the loan creditors, the representative has no further powers of attorney. In particular, he can submit petitions for the creditors group only for precautionary protection of fixed time periods in the proceedings to draw up the schedule of claims or in the assignment of litigation rights pursuant to Art. 260 Swiss Bankruptcy Law[11].

### 4.2 ADMISSION OF DEBENTURES ON THE SCHEDULE OF CLAIMS

The loan representative gives notice of the entire loan claim in the name of the creditors group. He does not need to give the names of the individual loan creditors. He also does not have to submit the bonds as proof of the loan claim[12]. The group of creditors will be listed as such in the schedule of claims. The individual loan creditors can remain anonymous. Correspondingly any objections – for example those for set-off – against the individual loan creditors cannot be reviewed or be pleaded by the bankruptcy trustee in the proceedings to draw up the schedule of claims.

### 4.3 VOTING RIGHTS OF THE JOINT REPRESENTATIVE AT THE SECOND MEETING OF THE CREDITORS

The question regarding how many votes the representative of the loan creditors group represents in the second meeting of the bankruptcy creditors is answered in various ways in legal doctrine[13]. In my opinion in answering the question, on the one hand, the interests of the loan creditors, on the other hand, however also the interest of all the bankruptcy creditors for an orderly carrying out of the bankruptcy proceedings must be taken into consideration.

The opinion that the representative can only represent as many votes as he received in the meeting of the loan creditors is not convincing. In particular the interests of those loan creditors who participated at the meeting and did not approve the granting of the power of attorney, are not taken into consideration with this solution. These loan creditors are to be excluded from participation at the second meeting of the bankruptcy creditors because the loan representative equally represents the interests of the loan creditors group. Despite this, the loan representative would have no right to vote for the excluded creditors.

The view that the loan representative would have as many votes as there are loan creditors may not normally be feasible. The number of loan creditors can change constantly without the bankruptcy trustee or the representative of the loan creditors group having received notice of it. This is especially the case with widely distributed bonds which are traded on the stock exchange. Also even at great expense, it is not possible for the loan representative to constantly produce proof of the actual number of loan creditors. The case of Biber Holding Ltd. shows that not even when the bonds were collected, did all the loan creditors give notice to the bankruptcy trustee. The number of votes represented by the loan representative would be dependent on chance and would be different depending on the time of the second meeting of the bankruptcy creditors. For any circulation resolutions, the number of his votes would change from case to case. Thereby an orderly carrying out of the bankruptcy proceedings would be impaired.

In my view, the following solution would best take into consideration the interests of the loan creditors group as well as those of all bankruptcy creditors: The number of votes represented by the loan representative would correspond to the number of loan creditors who participate or are represented at the meeting of the loan creditors. The number of votes would remain unchanged for the entire duration of the bankruptcy proceedings. On the one hand, each loan creditor can make sure that his votes are represented in the bankruptcy. On the other hand, the other creditors and the bankruptcy trustee will know the definitive number of votes of the loan representative after the meeting of the loan creditors. The notice of the meeting of the loan creditors (publication) could refer to the manner in which the voting rights of any loan representative would be determined.

### 4.4 ACTION TO CONTEST THE SCHEDULE OF CLAIMS AND ASSIGNMENT REQUEST WITHIN THE MEANING OF ART. 260 SWISS BANKRUPTCY LAW

The loan creditors group has no doubt the capacity to litigate and has a plaintiff's right of action to initiate an action to contest the schedule of claims against one of the other creditors or to further pursue a claim of the bankruptcy estate after assignment of the litigation rights within the meaning of Art. 260 Swiss Bankruptcy Law[14]. The loan representative is in contrast not authorized without special power of attorney to represent the loan creditors group in such proceedings. Only to preserve short fixed time periods (Art. 250 Swiss Bankruptcy Law) is he allowed in such cases to submit as a precaution a petition for the loan creditors group[15]. Subsequently a meeting of the debenture holders must decide whether the loan representative is au-

[10] A. Ziegler, cited above, N 6 and 7 to Art. 1183 Swiss Civil Code; Ch. Steinmann, cited above, N 5 and 6 to Art. 1183 Swiss Civil Code

[11] A. Ziegler, cited above, N 7 to Art. 1183 Swiss Civil Code; Ch. Steinmann, cited above, N 6 to Art. 1183 Swiss Civil Code

[12] A. Ziegler, cited above, N 7 to Art. 1183 Swiss Civil Code

[13] A. Rohr, Fundamentals of Issuing Law, p. 292; A. Ziegler, cited above, N 6 to Art. 1183 Swiss Code of Obligations; Ch. Steinmann, cited above, N 5 to Art. 1183 Swiss Code of Obligations

[14] Federal Court Decision 113 II 289 f

[15] A. Ziegler, cited above, N7 to Art. 1183 Swiss Code of Obligations; CH. Steinmann, cited above, N 6 to Art. 1183 Swiss Code of Obligations

thorized to litigate for the loan creditors group. Should a power of attorney not be granted, the individual loan creditors must have the possibility to themselves litigate[16]. These loan creditors cannot any longer appear as a loan creditors group. They must carry out the proceedings in their own names and at their own risk. How do the loan creditors prove however their right of action? How will it be ensured that any claim proceeds within the meaning of Art. 250 par. 2, resp. Art. 260 par. 2 Swiss Bankruptcy Law, can be settled? Neither the individual loan creditors nor their claims are evident from the schedule of claims. In my opinion, these problems can be solved with the following procedure: The loan creditors who want to carry out the litigation must duly notify the bankruptcy trustee of their claims (see 3.2 above) and prove this by submitting their bonds. The schedule of claims will be adjusted as follows: The loan creditors will be released from the anonymity of the loan creditors group and be separately listed under their own names with their claims in the schedule. Thereby the loan creditors are in the position to prove their plaintiff's right of action and the bankruptcy trustee can settle (Art. 250 par. 2 Swiss Bankruptcy Law), respectively have the settlement reviewed (Art. 260 par. 2 Swiss Bankruptcy Law), regarding any claim proceeds.

### 4.5 PAYMENT OF BANKRUPTCY DIVIDENDS

The loan representative is not authorized to accept the bankruptcy dividends for the loan creditors group. Payment of the bankruptcy dividends may only be made to persons who prove their identity by submission of the original bonds. Because the bankruptcy trustee only receives information about the identity of the individual loan creditors at the time of the dividend payment, it should still then be able to raise any objections – for example set-off amounts[17]. This possibility should in any case be of a rather theoretical nature. A loan creditor who must expect a set-off claim, can transfer his bond for the purpose of collection to another person. The bankruptcy trustee would then not learn the identity of the true creditor.
Inasmuch as loan creditors do not demand payment of the bankruptcy dividends accruing to their portion of the debentures, the bankruptcy trustee must hold the amounts not drawn available for ten years. After the expiration of the ten years, a retroactive distribution will be made within the meaning of Art. 269 Swiss Bankruptcy Law.

## 5. FINAL CONSEQUENCES

From the viewpoint of the bankruptcy trustee, the proceedings are simplified with a loan representative. Instead of possibly several hundred loan creditors, they have only one contact person for the debenture. It is then the responsibility of the loan representative to correctly organize the loan creditors group.
In contrast, it is easier for each individual loan creditor to protect his individual rights without a loan representative. He can immediately and without a big procedure decide whether he submits an action to contest the schedule of claims or wants to pursue a claim of the bankruptcy estate after assignment of the litigation rights. As the price, he must take into consideration a limitation of negotiability of the bond and giving up anonymity.

[16] A. Ziegler, cited above, N7 to Art. 1183 Swiss Code of Obligations; CH. Steinmann, cited above, N 6 to Art. 1183 Swiss Code of Obligations

[17] A. Ziegler, cited above, N 10 to Art. 1183 Swiss Code of Obligations



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