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Restructuring and Insolvency

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Hospitals in the emergency room - debt restructuring proceedings as a possible restructuring instrument

Josef Caleff, Olivia Wipf

Key Take-aways

1.
More and more Swiss hospitals are finding themselves in situations of financial distress due to rising costs.

2.
It is the duty of the board of directors as the highest management body of a hospital organized as a Swiss stock corporation to assess and, if necessary, adopt restructuring measures.

3.
The debt restructuring proceedings pursuant to articles 293 et seq. DEBA are an important restructuring instrument and can be a suitable way to avoid bankruptcy.

1 Background

Rising costs in the Swiss healthcare system are a concern not only for politicians and the public, but also for **hospitals as businesses**. For years, they have been faced with rising expenditure, growth in the number of patients and high labor costs for highly qualified staff. In particular, because of flat rates per case introduced in 2012 and the increase in outpatient treatments costs can no longer be covered in some cases. As a result, more and more hospitals are experiencing financial difficulties. One restructuring instrument that hospital management can then seek is **debt restructuring proceedings** in accordance with articles 293 et seq. of the Swiss Federal Act on Debt Enforcement and Bankruptcy **(DEBA)**. As reported in the media, this course was recently chosen by Zurich's Wetzikon Hospital, operated by GZO AG. In particular, this was done in order to postpone the repayment of a CHF 170 million bond issued by GZO AG and to find a solution with creditors, while at the same time being able to continue hospital operations more or less unchanged. However, debt restructuring proceedings are not always the right instrument for resolving a crisis.

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2 General information on debt restructuring proceedings

If a company cannot resolve financial difficulties through business management measures and out-of-court solutions with its creditors, judicial debt restructuring proceedings pursuant to articles 293 et seq. DEBA can offer an opportunity for (partial) restructuring and averting imminent bankruptcy. When bankruptcy proceedings are opened, the debtor's business is normally shut down immediately. Bankruptcy must end with the liquidation of all of the debtor's assets and the dissolution of the company. This is highly problematic for hospitals, as patients must continue to be treated and patient files must be transferred. In contrast, debt restructuring proceedings are aimed at **the continuation of the company**. As with bankruptcy proceedings, debt collection and court proceedings are suspended and claims against the debtor are deferred. Under the supervision of the debt restructuring court, debt restructuring proceedings therefore give the insolvent debtor a "grace period" during which he has the opportunity to find a solution with creditors and to restructure his business in whole or in part, while it can continue to operate practically without restrictions and under the management of the same bodies, but under the supervision of an administrator.

3 Duty of the board of directors to submit a request for a debt restructuring moratorium

Swiss hospitals are predominantly and increasingly run as stock corporation. In a **stock corporation**, the board of directors bears the overall responsibility for the financial management of the company: it has the non-transferable and inalienable task of organizing the accounting, financial control and financial planning systems as well as submitting an application for a debt restructuring moratorium and notifying the court in the event of over-indebtedness in accordance with article 725b of the Code of Obligations **(CO)**. Consequently, the board of directors cannot discharge its duty and liability with regard to the financial management of the company in general and the aforementioned tasks in particular – especially the filing of an application for a debt restructuring moratorium – by delegation to the management or third parties.

The law describes **three financial distress scenarios** of the stock corporation in more detail with corresponding duties of the board of directors to act. The board of directors must always act "with the required urgency". Debt restructuring proceedings can be relevant in all three scenarios, which often occur simultaneously:

In situations of financial distress, the board of directors has a duty to act with the required urgency.

In the event of **imminent insolvency in accordance with article 725 CO**, the board of directors must, if required, take restructuring measures and submit, "if necessary" an application for a debt restructuring moratorium. The same applies in principle in the event of **capital loss in accordance with Art. 725a CO**. The law does not define specific restructuring measures in the event of imminent insolvency or capital loss. It is therefore up to the board of directors to decide at its own discretion which steps are suitable for ensuring liquidity and, if necessary, for the long-term restructuring of the company. Examples include renegotiating existing contracts with financial institutions (in particular loan agreements), extending payment terms, taking out or applying for new loans, restructuring assets (sale and lease back), increasing capital by resolution of the general meeting, or

reducing costs through job cuts or salary reductions. There is also no legal definition of when debt restructuring proceedings as a restructuring instrument must be initiated “if necessary” so that the board of directors may avoid liability.

In case of **over-indebtedness in accordance with Art. 725b CO**, the board of directors is generally obliged to notify the court: It must submit a request for a debt restructuring moratorium or notify the court for the purpose of opening bankruptcy proceedings (so-called “notice of over-indebtedness”).

Debt restructuring proceedings give a company time to restructure while continuing to operate.

4 Course of debt restructuring proceedings

4.1 Initiation of debt restructuring proceedings

In principle, debt restructuring proceedings can be initiated by a request of the debtor, a creditor or, at least theoretically, ex officio by the bankruptcy judge seized. In the case of a stock corporation, the court at the registered office of the company has jurisdiction. The court appoints one or more **administrators**, who are responsible in particular for examining the restructuring possibilities, the creditors‘ call, negotiations with creditors and drafting the debt restructuring agreement. During the provisional debt restructuring moratorium (see below), the appointment of an administrator may be waived in justified cases.

If the debtor submits the request itself, as is usually the case in practice, the request must be accompanied by a current balance sheet, income statement and liquidity plan or similar documents showing the debtor‘s current and future assets, earnings or income situation, as well as a provisional restructuring plan. These documents must be prepared carefully and correctly - anyone who misrepresents their financial situation may be liable to prosecution for fraudulently obtaining a court debt restructuring agreement.

A prerequisite for judicial debt restructuring proceedings is that the debtor can advance the costs of the proceedings. The application must therefore be submitted in a timely manner, i.e. at a point in time when the company‘s financial situation still allows for the advance on costs to be paid.

4.2 Provisional debt restructuring moratorium

Debt restructuring proceedings begin when the court grants a **provisional debt restructuring** moratorium for a maximum of four months (with the possibility of extension up to a maximum of eight months). A provisional debt restructuring moratorium is generally granted if the debtor is facing or will soon face imminent insolvency and restructuring does not appear impossible from the outset. However, a prerequisite is that the company is able to cover its costs (wages, rent, consumable materials, etc.) during the moratorium from current income (cash flow) or new funds (bridge loan). **No debt enforcement proceedings** can be brought against the company during the moratorium. The restructuring possibilities are examined in detail and could already be implemented while operational activities continue. Upon request, the debt restructuring court can waive public announcement of the provisional debt restructuring moratorium (so-called “silent debt restructuring moratorium”).

4.3 Definitive debt restructuring moratorium

If, during the provisional moratorium, there is a prospect of restructuring or confirmation of a debt restructuring agreement, the debt restructuring court will grant the moratorium **definitively** for a further four to six months. At this point at the latest, the debt restructuring moratorium is made public and an administrator must mandatorily be appointed.

The aim of a debt restructuring moratorium is the deferral and (partial) cancellation of outstanding claims.

4.4 End of debt restructuring proceedings

In the best-case scenario, the debt restructuring proceedings end with the complete payment of all creditor’s claims or with a voluntary agreement with all creditors, e.g. regarding a debt waiver. However, complete restructuring is generally not possible. The aim of debt restructuring proceedings is therefore generally to reach a **debt restructuring agreement** with the creditors that enables the company to continue its business in whole or at least in part. A distinction is made between the ordinary debt restructuring agreement (dividend settlement), in which the creditors are promised payment of a portion of the claims, and the debt restructuring agreement with assignment of assets (liquidation settlement), in which the creditors receive the debtor’s assets or a portion thereof for realization. The debt restructuring agreement must be approved by the court, which requires in particular that the registered privileged claims (in particular those of employees and social security institutions) are satisfied in full and that either the majority of creditors representing at least two thirds of the claim amount or a quarter of the creditors representing at least three quarters of the total amount of the claims have

agreed to the debt restructuring agreement. However, debt restructuring proceedings can also end in the opening of bankruptcy proceedings, particularly if restructuring is not possible or the debt restructuring agreement is rejected.

5 Summary

In situations of financial distress, debt restructuring proceedings pursuant to articles 293 et seq. DEBA can be a **suitable restructuring instrument** for hospitals. For the board of directors of a hospital managed as a stock corporation, submitting an application for a debt-restructuring moratorium is a non-delegable task. The board of directors generally has a great deal of discretion in the choice of restructuring measures. In fact, debt restructuring proceedings are not the appropriate instrument in every situation of financial distress. The primary purpose of a debt restructuring moratorium is to defer outstanding claims and, if the restructuring is not completely successful, a later (partial) cancellation of the claims as part of a debt restructuring agreement. As in the case of Wetzikon Hospital, debt restructuring proceedings can therefore offer relief if the company is confronted with a large number or amount of unpaid claims that cannot be satisfied and corresponding debt enforcement proceedings must be expected. On the other hand, fundamental liquidity problems arising from ongoing operations are not solved by debt restructuring proceedings. These must be countered with other restructuring measures. If restructuring is not possible, the hospital must file for bankruptcy.

Dr. Urs Hoffmann-Nowotny
Partner
urs.hoffmann-nowotny@swlegal.ch

Benno Strub
Counsel
benno.strub@swlegal.ch

Prof. Dr. Olivier Hari
Of Counsel
olivier.hari@swlegal.ch

Grégoire Wuest, LL.M.
Partner
gregoire.wuest@swlegal.ch

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Schellenberg Wittmer Ltd
Attorneys at Law

Zurich
Löwenstrasse 19
P. O. Box 2201
8021 Zurich / Switzerland
T +41 44 215 5252
www.swlegal.com

Geneva
15bis, rue des Alpes
P. O. Box 2088
1211 Geneva 1 / Switzerland
T +41 22 707 8000
www.swlegal.com

Singapore
Schellenberg Wittmer Pte Ltd
6 Battery Road, #37-02
Singapore 049909
T +65 6580 2240
www.swlegal.sg