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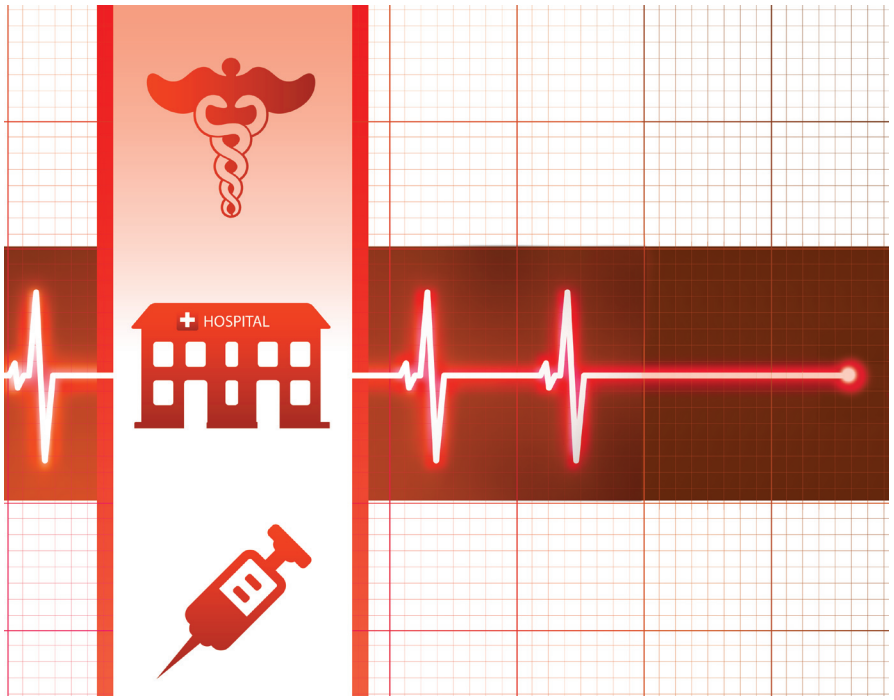
What Happens When **Hospitals** Are **Sick**?



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BY ADAM CHARLES ROGOFF

THE PROFOUND financial crisis that has gripped New York and the rest of the nation over the last several years has taken a toll on many of the area's and nation's hospitals and health care providers. In an effort to balance their budgets in response to the deteriorating economic climate, New York state and the federal government have repeatedly reduced hospital reimbursement rates over the last few years.

For example, from 2007 through 2009, New York state made cuts totaling over $985 million to its Medicaid program. For hospitals and other providers that rely heavily upon Medicaid for their reimbursements, such as a hospital with a high uninsured patient base, these cuts can turn a healthy system anemic.

Numerous hospitals are also not-for-profit, smaller community-based providers. These hospitals and health care providers lack the leverage to negotiate higher reimbursement rates from private insurance.

Other symptoms of health care in crisis include over bedding, competition from outpatient (ambulatory) centers, higher costs for new technology, and antiquated facilities for older, community-based hospitals. In the New York area alone, since 2005, at least 18 hospitals filed for bankruptcy.[1] When a health care entity enters bankruptcy, failure of the professionals to take into account specialized needs of the "patient" (both literally and figuratively) can hinder, if not be fatal to, the process.

While the Bankruptcy Code is generally applicable to health care cases, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (2005 Act) added special provisions for health care cases. These provisions relate to (i) patient record disposal; (ii) patient transfers to other health care facilities; (iii) appointment of a patient care ombudsman; and (iv) an exception to the automatic stay for the Secretary of Health and Human Services. Attendant costs were

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granted administrative expense priority.[2]

Under the 2005 Act, "health care business" means:

> any public or private entity (without regard to whether that entity is organized for profit or not-for-profit) that is primarily engaged in offering to the general public facilities and services for (i) the diagnosis or treatment of injury, deformity, or disease; and (ii) surgical, drug treatment, psychiatric or obstetric care.[3]

This definition includes a (i) general or specialized hospital; (ii) ancillary ambulatory, emergency or surgical treatment facility; (iii) hospice; (iv) home health agency; and (v) other similar health care institution.[4]

Patient Information and Records

The treatment of patient records and patient-sensitive information is something that most bankruptcy professionals are not used to addressing. However, various nonbankruptcy laws protect patient privacy, such as the Health Insurance Portability and Accountability Act of 1996 (HIPAA), and affect what information is disclosed.

These rules affect how patient data is listed in a debtor's bankruptcy schedules and statements under §521. Care should be taken to avoid inadvertently disclosing protected information.

Another important issue relates to maintenance of patient records; after all, access to such information could affect a patient's future treatment. Typically, the bankruptcy estate needs to store patient records according to applicable state and federal law, which can be many years, especially in the case of minor patients. These costs, which can be millions depending upon the number of patients, are typically paid by the estate if there are available funds. A tension can arise between non-bankruptcy law and the storage costs to an estate, especially if the provider is liquidating.

The 2005 Act added §351, which permits disposal of patient records.[5] If the estate cannot fund record storage, §351 allows records to be discarded with notice, balancing the patient's access to medical records with a shortened notice process, such as publishing notice in "appropriate" newspapers giving one year's notice to claim records.[6] During the first six months of this period, the trustee must attempt to notify directly by mail each affected patient and his or her insurance carrier of the disposal.[7]

If the published notice and direct mailing does not result in a patient's request for records, the trustee must notify "appropriate Federal agencies" to request that the agency accept storage of the records.[8] Finally, if no federal agency accepts the unclaimed records, the bankruptcy estate must destroy them in a way that ensures they cannot be reconstituted.[9] The costs incurred to dispose of records are entitled to administrative expense priority under §503(b)(8)(A).[10]

Patient Transfers and Ombudsman

As seen recently in hospital bankruptcies, services may close and patients need to be transferred. Any such transfer is subject to regulatory oversight, such as the New York State Department of Health's approval of a "closure plan."

Hospitals and other health care providers, especially not-for-profit corporations, have a **duty** (a '**mission**') to patient care that must be **balanced** with **creditors' rights** to recovery.

Section 704(a)(12) also establishes protection for patients. It creates an affirmative duty to use "all reasonable and best efforts to transfer patients" if the debtor is in the process of being closed.[11]

Any costs incurred by the estate to fund the patient transfer are entitled to administrative expense priority under §503(b)(8)(B). Bankruptcy Rule 2015.2, which requires the bankruptcy estate to give a patient 14 days notice of the transfer, provides additional protections.

A fundamental concern for any health care debtor is maintaining quality patient care. Literally, lives are at stake. Section 333 of the Bankruptcy Code, requiring the appointment of a patient care ombudsman, is one of the most direct aspects of the 2005 Act to address ongoing patient care.[12] The patient care ombudsman (1) oversees the provision of ongoing patient care and (2) represents the interests of the ongoing patients.

This broad objective allows the ombudsman to evaluate a health care facility's continuing operations and services related to patient care. Bankruptcy courts often look to the ombudsman to supervise and advise if patient care problems arise.

Balancing Bankruptcy and Health Care

Hospitals, nursing homes and other health care providers, especially not-for-profit corporations, have a duty (a "mission") to patient care.[13]

Not many decisions discuss the balance between creditors' rights to recovery and preservation of "mission" in health care cases. The few that do will address the patients' needs as an important consideration in the bankruptcy process.

For example, in *United Healthcare System*,[14] the debtor operated a children's hospital in Newark, N.J. and notified the state health commissioner that it had serious financial difficulties.[15] To keep the debtor operating while a solution was pursued, the state infused $3 million for operations, instructed the debtor to pursue the transfer of its pediatric services, and issued a moratorium against hiring the debtor's physicians to keep the group intact.[16]

During this period, the debtor met with the commissioner and pursued bidders.[17] The debtor accepted a bid that committed to continuing the children's hospital in one location with comprehensive services and agreed to provide $5 million for future investments.[18] The debtor viewed these as important elements of its health care mission. The sale was to be consummated in bankruptcy.[19]

In support of the sale, the health commissioner expedited the state approval process for the transfer.[20] However, in the bankruptcy, a competing bidder objected and submitted a "higher" bid. The bankruptcy court denied the proposed sale, because (in the court's view) it was not the best available price for the assets. The court believed that the competing offer was a higher and better bid.[21]

On appeal, the district court reversed, stating: The "[c]ourt must not only weigh the financial aspects of the transaction but also look to the countervailing consideration of a public health emergency."[22] The district court questioned the lower court's approving the economically greater offer where it "substituted its judgment for that of the Board," "instead of measuring the good faith judgment of the Board[.]"[23] A pure economic analysis collided with the

necessity to preserve the debtor's "mission" as an integrated children's hospital. The district court held:

> The Bankruptcy Court failed to acknowledge that the Board of United, a non-profit organization, had a fiduciary obligation to maintain the legacy of the Children's Hospital.…
>
> Courts are not experts in public health and safety issues and this Court bows to the knowledge of the Commissioner in those areas. If the Commissioner felt that there was a public need for the Children's Hospital to be operated as a unit in northern New Jersey, federal courts should accept it as such.[24]

As *United* aptly instructs, bankruptcy professionals should weigh the broader aspects of patient care, even in Chapter 11. The "highest" return for creditors may not always be the "best" or most appropriate result for ongoing patient care.

The Impact of State Law

Unlike many Chapter 11 cases where state law may be a factor, usually implicated by the issue at hand, in health care cases, state regulation is pervasive.

For example, under the New York Not for Profit Corporation Law, a not-for-profit entity must petition the state court before it may dispose of substantially all of its assets and demonstrate that notice to creditors of any sale has been given and that the value to be received is a fair value.[25] This concept applies to not-for-profit health care service providers.

Section 363(d)(1) requires the sale of property to be "in accordance with applicable nonbankruptcy law that governs the transfer of property by a corporation or trust that is not a moneyed, business, or commercial corporation or trust."[26] Section 541(f) further requires that any corporation that is tax-exempt pursuant to §501(c)(3) or 501(a) of the Internal Revenue Code transfer assets to a nontax exempt entity only "under the same conditions as would apply if the debtor had not filed a case under this title."

Accordingly, seeking to convert the ownership of assets from a not-for-profit debtor to a for-profit non-debtor requires compliance with state law conversion proceedings.[27] Compliance with nonbankruptcy law raises unique challenges in the sale of distressed health care assets.

Chapter 11 sales often proceed at "break neck" speed to preserve assets values and quickly remove the operating assets from the bankruptcy process. However, the purchaser of a health care debtor's operating businesses will likely require regulatory approval (a "certificate of need") from the health department.

Outside of bankruptcy, these processes can take many months. While certain options may exist to shift operations prior to regulatory approval (such as a management or receivership agreement with the buyer), there is no substitute for close coordination with the state health commissioner for expedited approval.

As evidenced by several recent hospital filings in the New York area (e.g., St. Vincent's, North General and Cabrini), closure may be the inevitable answer to over bedding, lower payor rates, and competition from outpatient treatment centers. Hospital closure is a complex and highly regulated process focusing on transitioning patient care, preservation of medical records, and disposal of controlled substances and hazardous materials.[28]

In light of the intense scrutiny from any hospital closure, it is wise for a debtor to seek bankruptcy court approval to implement the closure process. A bankruptcy filing can also aid by staying state court proceedings commenced by community groups to enjoin a closure.[29]

As a practical matter, despite the hardship to the community from a closure, a bankruptcy court is unlikely to deny a hospital's request to close if the hospital has complied with applicable statutory and regulatory requirements.[30] This is particularly true where the hospital demonstrates inadequate funding for continued operations only puts patient health at risk.[31]

1. In New York, St. Vincent's Hospital system filed twice. Other debtor hospitals in New York include Our Lady of Mercy, Cabrini, Auburn Memorial, New York United Hospital, Albert Lindley Lee Memorial Hospital, Brunswick Hospital Center, Parkway Hospital, Brooklyn Hospital Center, Victory Memorial Hospital, Bertrand Chafee Hospital, and recently, North General. In New Jersey, debtors include Bayonne Medical Center, Passaic Beth Israel, Barnert, St. Mary's, and Pascack Valley. In Connecticut, debtors include Johnson Memorial.
2. See 11 U.S.C. §503(b)(8).
3. 11 U.S.C. §101(27A)(A).
4. Id. §101(27A)(B).
5. H.R. REP. NO. 109-31, at 138 (2005). Bankruptcy Rule 6011 provides further guidance.
6. 11 U.S.C. §351(1)(A).
7. Id. §351(1)(B).
8. Id. §351(2) (federal agencies are not obligated to accept patient records).
9. Id. §351(3).
10. Id. §503(b)(8)(A). If the debtor's estate is administratively insolvent, legislative history suggests that such costs could be surcharged against secured creditor's collateral. See H.R. REP. No 109-31, at 139 (2005).
11. 11 U.S.C. §704(a)(12); 11 U.S.C. §1106(a)(1).
12. Section 332 also provides for the appointment of a consumer privacy ombudsman to address issues relating to the transfer of patient records. See e.g., *In re St. Vincents Catholic Med. Ctrs. of N.Y., et al.*, Case No. 10-11963 (Bankr. S.D.N.Y. April 16, 2010).
13. See *Manhattan Eye, Ear & Throat Hosp. v. Spitzer*, 186 Misc. 2d 126, 152, 715 N.Y.S.2d 575, 592 (Sup. Ct. N.Y. County 1999); see also *Shorter College v. Baptist Convention of Ga.*, 279 Ga. 466, 614 S.E.2d 37 (Sup. Ct. 2005); *Consumers Union of U.S. Inc. v. New York*, 5 N.Y.3d 327, 371 n.16 (2005).
14. *In re United Healthcare Sys.*, 1997 U.S. Dist. LEXIS 5090, at *15.
15. Id. at *1.
16. Id.
17. Id. at *1-2
18. Id. at *2, 6.
19. Id.
20. Id.
21. See id. at *17-18.
22. Id. at *17.
23. Id. at *18, 20.
24. Id. at *21.
25. See N.Y. NOT-FOR-PROFIT CORP. LAW §511.
26. 11 U.S.C. §363(d)(1).
27. 11 U.S.C. §541(f). See, *In re Bayonne Med. Ctr.*, Case No. 07-15195 (Bankr. D.N.J. 2007) (debtor, a community acute-care hospital, obtained bankruptcy court permission to sell its assets to a for-profit entity. Under New Jersey law, the transfer was permissible if the parties complied with the state law regulatory approvals under the Community Health Care Assets Protection Act (CHAPA). See N.J. STAT. ANN. §26:2H-7.11. The bankruptcy court approved the sale subject to the CHAPA conversion process.)
28. See 28 U.S.C. §959 (requiring debtor to operate its business in accordance with applicable law); *Norris Square Civic Ass'n v. St. Mary Hosp. (In re St. Mary Hosp.)*, 86 B.R. 393, 399-400 (Bankr. E.D. Penn. 1988) (enjoining certain aspects of hospital closure in light of failure to comply with applicable law).
29. See *St. Vincents*, 2010 Bankr. LEXIS 1607, at *16 (Bankr. S.D.N.Y. May 14, 2010) ("The State Court Plaintiffs violated the automatic stay by bringing the [action to enjoin the hospital closure] that sought to exercise control over property of the estate. Although the [action] was brought against the New York State Department of Health and did not name the Debtors, this technicality does not insulate the State Court Plaintiffs from 11 U.S.C. §362(a)(3).").
30. See *St. Vincents*, 2010 Bankr. LEXIS 1607, at *34 (granting closure motion where "the process of winding down the Hospital has been done in a procedurally proper manner").
31. See *St.Vincents*, 2010 Bankr. LEXIS 1607, at *32 ("[A] requirement by this Court to continue operation of the Hospital would have been extremely detrimental to the financial condition of the Debtors and would likely undermine the safety of the patients that would remain at an anemic facility."). See *St. Mary Hosp.*, 86 B.R. at 401 (noting that the practical effect of the court's injunction "may be very severely limited by the simple fact that the Debtor lacks cash and may find it impossible to maintain itself after a certain point in time).