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Issues & Overview

Is Bankruptcy The Cure For Distressed Hospitals?

The financial woes leading to recent bankruptcies and closures of an increasing number of hospitals are attributable to many factors, including insufficient reimbursement from Medicare and Medicaid, insufficient contributions from state charity care programs which require hospitals to provide care to all regardless of the ability to pay, as well as increased competition from physician-owned private ambulatory centers which attract high margin patients. However, hospitals seeking chapter 11 protection face many obstacles which may diminish, rather than augment, a hospital's chance of survival. The bankruptcy courts which oversee the cases are often hamstrung due to the unique nature of hospital cases. Before seeking chapter 11 protection, a hospital should consider all available options and chapter 11 should truly be the option of last resort.

The Difficulties Of A Hospital Bankruptcy Case

Many hospitals are organized as not for profit corporations which are managed, in general, by Boards of Trustees whose board members, in many instances have received little, if any, training in hospital oversight or state fiscal or clinical regulations. A not for profit hospital is founded on a charitable mission of providing health care to the community. Its federal tax-exempt status is dependent upon providing a community benefit while operating an emergency room that provides care to patients without regard to their ability to pay.

The Bankruptcy Code precludes the filing of an involuntary petition against a not for profit entity. Accordingly, a not for profit hospital does not face the threat of creditors joining to file an involuntary bankruptcy petition against it. This is good, because many social and economic considerations suggest that any bankruptcy, voluntary or involuntary, is not the best option for an insolvent hospital. In a bankruptcy case, creditors have defined roles and representation through the mechanism of the creditors' committee, while the community the hospital serves does not. Unlike the shareholders of a for profit corporation who have the opportunity to form an equity holders' committee in a bankruptcy case, members of the community, who are the stakeholders of a non-profit hospital, typically have no similar committee and group representation. In addition, the costs of administration of a bankruptcy case increase the financial burden on the distressed hospital. A chapter 11 petition initiates a costly round of professional fees for the debtor's professionals as well as the fees of counsel and financial advisors for the creditors' committee.

Further, in many instances, the specter of bankruptcy makes it much more difficult for hospitals to attract patients and retain and attract qualified health care personnel. The rumors of financial problems and bankruptcy can cause physicians to seek privileges and

refer their patients elsewhere. Doctors increasingly obtain admission privileges at multiple hospitals, which gives them more flexibility. Inadequate staffing in key departments may leave little choice but to close selected departments, or in some cases the entire hospital. While the bankruptcy court may be an adequate forum to address the purely financial aspects of a distressed hospital, it should not be its role to determine which communities should have acute care hospitals and which should not.

The Bankruptcy Court's Inherent Limitations

A basic tenet of bankruptcy law is that the chapter 11 debtor has a duty to maximize value for the estate and its creditors. In exercising this mandate, bankruptcy courts have the power to compel the liquidation of a business if there are continuing losses and when a liquidation will benefit all creditors. In most cases, bankruptcy courts routinely apply these principles to adjust millions, if not, billions of dollars of debt. In hospital cases, however, the bankruptcy court must also take into consideration the fact that a debtor is a charitable institution providing critical medical services to a community which can make a difference between life and death. Further, a bankruptcy court is powerless to compel the liquidation of a not for profit hospital by operation of section 1112(c) of the Bankruptcy Code without the hospital's consent.

Faced with these inherent limitations, bankruptcy courts are simultaneously required to adjust millions of dollars of debts and balance the interests of classes of creditors with competing interests, while being cognizant of the fact that its decisions may have immediate impact on the community's ability to readily obtain critical medical care. The difficulty of this charge is magnified by the fact that most hospitals seeking chapter 11 protections are losing money on a daily basis and a quick restructuring is often difficult, if not impossible.

Is There a Solution?

A not for profit hospital with an experienced management team might better serve its charitable mission, its patients, the community and its creditors by using its resources outside of bankruptcy to develop a restructuring plan through negotiation with its major creditors and state regulatory and financing authorities. To the extent a restructuring plan is not a viable option, management could explore the possibility of a strategic alliance or sale of the hospital. Bankruptcy may then be an appropriate option if the potential purchaser insists on acquiring the assets of the hospital free and clear of old debts through a bankruptcy auction. Finally, if neither a turnaround plan nor a sale can be achieved, the hospital may formulate a plan of orderly closure in close cooperation with the state department of health that licenses and regulates the hospital's health care activities.

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