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The Intersection Of Bankruptcy Law And Health Care Regulation

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The recent Chapter 11 filings by several New York City hospitals is reason to revisit the inter-relationship of state health care regulation and the federal Bankruptcy Code. An inherent tension exists between the two by virtue of the fundamental differences in their goals and purposes. States regulate hospitals and other health care providers to protect the health and safety of their citizens. Bankruptcy laws, on the other hand, are primarily concerned with maximizing asset values for distribution to creditors. When these goals conflict, what factors should the Bankruptcy Court consider in determining which takes precedence?

The situation presented by the case of *In re United Healthcare Systems, Inc.*, 1997 WL 176574(DNJ) brought this question into sharp relief. The District Court's opinion is a well-reasoned analysis that deserves attention given the financial uncertainty facing many hospitals and other health care institutions.

The factual background of the *United* case was as follows: United Healthcare Systems ("United") was a not-for-profit corporation that operated both an adult acute care hospital and the Children's

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Hospital of New Jersey in Newark. The Children's Hospital was designated by New Jersey statute as "the State's specialty acute care children's hospital for Northern New Jersey."

In early 1997, United notified the Commissioner of Health and Senior Services of New Jersey (the "Commissioner") that it was suffering serious financial difficulties and was on the verge of closing. Recognizing the importance of the health care services provided by the Children's Hospital, the Commissioner made a \$3 million emergency payment to United to cover payroll and other operating expenses and directed United to locate a purchaser for the Children's Hospital on an expedited basis.

United's Board of Trustees (the "Board"), with the assistance of the Commissioner, formulated a request for proposals ("RFP") for the sale of the

Children's Hospital, which was circulated to potential bidders on February 5, 1997. Responses to the RFP were required by February 10, 1997 and the Commissioner directed that the sale process be completed by February 15, 1997, which deadline he later extended, at United's request, to February 17, 1997.

Four bidders responded to the RFP. United analyzed the bids, held discussions with each of the bidders and invited them to make oral presentations to United's Board and medical staff. The Board selected St. Barnabas Health Care System ("St. Barnabas") as the winning bidder, in part because, alone among the bidders, it proposed to operate the Children's Hospital at a single location. On February 17, 1997, a contract of sale was negotiated and the parties filed applications with the Commissioner for the issuance of the Certificates of Need and licenses required for St. Barnabas to commence operations of the Children's Hospital. The Commissioner granted the applications the following day.

To ensure that St. Barnabas would acquire the Children's Hospital's assets but not its liabilities, the agreement of sale required that United initiate a Chapter 11 bankruptcy case and obtain Bankruptcy Court approval of the sale. In accordance with this requirement, United filed a Voluntary Chapter 11 Petition on February 19, 1997. On the same date, United submitted an application to the Bankruptcy Court to approve the sale of the Children's Hospital's assets to St. Barnabas pursuant to Section 363 of the Bankruptcy Code, which requires that the Bankruptcy Court approve a sale of assets, other than in the ordinary course of

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business, by a Chapter 11 debtor, and allows the purchaser to acquire the assets free and clear of third party interests.

The sale application was opposed by one of the unsuccessful bidders. Simultaneously with filing its objection, this bidder submitted a revised bid, increasing its offering price. The Bankruptcy Court, following a four-day evidentiary hearing, refused to approve the sale to St. Barnabas. It found that the decision of United's Board to approve the sale to St. Barnabas was not a sound business judgment because St. Barnabas' bid was not the highest offer and that the Board's decision made it impossible for the Bankruptcy Court to obtain a fair price for United's assets for the benefit of its creditors. The Bankruptcy Court declared the sale to St. Barnabas to be a nullity and directed United to apply to the Commissioner to reconsider his grant of a Certificate of Need to St. Barnabas and to permit United to reopen the Children's Hospital for a limited time to allow the Bankruptcy Court to conduct a new sale.

St. Barnabas appealed the Bankruptcy Court's decision to the United States District Court for the District of New Jersey. The District Court granted St. Barnabas' request for a stay of the Bankruptcy Court's order pending appeal and established an expedited schedule for briefing and oral argument.

In a thoughtful opinion, the District Court reversed the Bankruptcy Court's Order. In doing so, the District noted that the case presented the "very complex and difficult interrelationship between public health issues and bankruptcy" and that the "interrelationship of the State's health care concerns and the bankruptcy court's monetary goals is one of first impression."

Analyzing this interrelationship, the District Court found that, on the facts of the case, public healthcare concerns should take precedence over financial considerations. The District Court concluded that the proper role of the Bankruptcy Court, when presented with a case so clearly involving public health issues, was to subordinate the protection of creditors' financial interests to the overriding public interest in having access to quality medical care. The District Court also left no doubt as to whether the federal courts

or the New Jersey Commissioner of Health was the final arbiter of public health concerns. "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."

Viewed in this context, the District Court had little trouble determining that the Bankruptcy Court had committed reversible error in holding that United's Board had not exercised sound business judgment in approving the sale to St. Barnabas. Instead of recognizing the primary importance of public health concerns, the Bankruptcy Court had virtually ignored the public health emergency threatened by the imminent closure of the Children's Hospital, and had "overwhelmingly focused on the monetary aspects of the competing bids." Rather than engaging in "mere financial analysis of the two bids with the clarity of hindsight", the District Court held that the Bankruptcy Court was obligated to consider the totality of circumstances faced by the Board. In the District Court's view, the most important of these circumstances were the "Commissioner's emergent actions" in orchestrating an expedited sale and licensure process in order to insure the uninterrupted provision of acute pediatric care services at a single location.

In the District Court's view, United's Board had not failed to exercise sound business judgment by refusing to accept what was arguably a higher offer from a competing bidder because, alone among the bidders, St. Barnabas proposed that the Children's Hospital would continue to operate at a single Newark location and committed \$5 million in new investment. By ignoring these important public health considerations and focusing solely on the financial terms of the competing offers, the Bankruptcy Court had impermissibly substituted its own, after-the-fact, business judgment for the business judgment of United's Board made in the crises atmosphere of a public health emergency.

Reversing the Bankruptcy Court's ruling, the District Court opined that the "Bankruptcy Court may not impede the

State in its obligations to protect the health and safety of its citizenry" even if the Bankruptcy Court is thereby hindered from obtaining the highest price for the debtor's assets. In other words, the provisions of the Bankruptcy Code do not preempt state statutes and regulations designed to protect the public health and welfare even if the state regulatory scheme has a depressing affect on the value of a debtor's assets.

For all of its complexity, the *United Healthcare* case was, in one sense, simple in that the courts were presented with a prior determination by the Commissioner of Health of what actions were necessary to address a "public health emergency." It was the Bankruptcy Court's refusal to defer to the Commissioner on how to handle this emergency that led the District Court to reverse the ruling of the Bankruptcy Court. In this respect, the District Court's holding was undoubtedly correct.

While the District Court's opinion in the *United* case should provide guidance to federal courts confronted with similar issues, the *United* decision leaves many questions unanswered. For example, one can easily envision situations in which the Bankruptcy Court is required to decide cases implicating health care concerns of a less critical nature than was the case in *United*. Must the Bankruptcy Court defer to the public health officials in all such cases? There may also be cases in which the Bankruptcy Court is required to act before a decision has been made by the state's health care officials. Should the court be required to wait until the state regulators have made a determination in all such cases, even if delay threatens the erosion of asset values? Do the health care regulators have an affirmative duty to advise the Court of their position on public health issues?

Given the financial pressures faced by hospitals in the current economic environment, it seems safe to assume that these and similar questions will be presented to the Bankruptcy Courts with increasing frequency. Bankruptcy judges will be required to find the correct balance on a case by case basis when confronted with what the *United* decision accurately described as the "very complex and difficult interrelationship between public health issues and bankruptcy."