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BANKRUPTCY LAW

Health Care Bankruptcy Prescription for 2006

New act created protections
for patients and the community
at large

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Most bankruptcy cases begin and end with dollars and cents. There are generally negotiations between the debtor and its creditors regarding the repayment of debts and the restructuring of the business to achieve profitability. However, when the debtor is involved in the health care industry, there are interests that supersede the distribution to creditors and the debtor's future business model — patients and the community at large.

Congress has recognized the risks inherent in health care bankruptcy cases to patients through certain recently enacted amendments to the Title 11 of the United States Code (Bankruptcy Code) as part of the Bankruptcy Abuse Prevention and

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Consumer Protection Act of 2005 (BAPCPA). The amendments to the Bankruptcy Code specify a new type of debtor — the “health care business” organization — to which special rules and regulations will apply. BAPCPA defines health care businesses to include 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 the diagnosis or treatment of injury, deformity or disease; and surgical, drug treatment, psychiatric, or obstetric care. A health care business includes any general or specialized hospital; ancillary ambulatory, emergency, or surgical treatment facility; hospice; home health agency; and any other health care institution that is similar to these entities. A health care business also includes any long-term care facility, including any skilled nursing facility; intermediate care facility; assisted living facility; home for the aged; domiciliary care facility; and any similar institution which is primarily engaged in offering room, board, laundry or personal assistance with activities of daily living and incidentals to activities of daily living.

In addition to the creation of a health care business classification, Congress created five protections to patients and the community at large.

Patient Ombudsman

Perhaps the most sweeping change in BAPCPA to the health care industry is the creation of a patient ombudsman. Section 333 has been added to the Bankruptcy Code to codify the creation of this new role in bankruptcy cases and provides that, a “patient care ombudsman” must be appointed in all Chapter 7, 9, or 11 cases where the debtor is deemed to be a health care business. Within 30 days of the commencement of any health care bankruptcy case, a patient ombudsman must be appointed to act as a patient advocate “unless the court finds that the appointment of such ombudsperson is not necessary for the protection of patients under the specific facts of the case.” The ombudsman is required to monitor the quality of patient care provided to patients of the debtor, to the extent necessary under the circumstances, including interviewing patients and physicians. In addition, not later than 60 days after the date of appointment, and not less frequently than at 60-day intervals thereafter, the ombudsman must report to the court after notice to the parties in interest, at a hearing or in writing, regarding the quality of patient care provided to patients of the debtor. Furthermore, if such ombudsman determines that the quality of patient care provided to patients of the debtor is declining significantly or is otherwise being materially compromised, the ombudsperson is to file with the court a motion or written report, with notice to the parties in interest, immediately upon making such

determination.

The powers of the ombudsman are extraordinary and model the role of an examiner. See, 11 U.S.C §§ 1104, 1106. Generally, examiners are appointed upon a certain dollar threshold of claims being satisfied or upon a finding cause which may include mismanagement, fraud or other acts of impropriety. In the health care arena, such person will be appointed, irrespective of whether there is fraud or mismanagement.

The role of the ombudsman is front and center in health care cases, but it is unclear how that role will be defined and how influential the ombudsman will be. The role of the ombudsman will be case specific and depend on the circumstances which face each debtor. A bankruptcy court may seek the input of the ombudsman on all issues which will affect individual patients or groups of patients. As a result of the broad powers of the ombudsman, such person will have an immediate and significant effect on health care cases. The patients now have a voice in the Bankruptcy Court; time will tell how loud that voice is.

Limitations on Asset Sales

Prior to the institution of BAPCPA, there existed an inherent tension in the sale of health care businesses under the Bankruptcy Code and the interplay of state law. The tension arose based on the fact that bankruptcy courts are primarily focused on a return to creditors, while state law looks to the effect of a sale of a health care business on the community at large. This tension was evident in the bankruptcy case of United Healthcare Systems, a not-for-profit corporation that operated both an adult acute care hospital and the Children's Hospital of New Jersey in Newark. In early 1997, United notified the Commissioner of Health and Senior Services of New Jersey that it was suffering serious financial difficulties and was on the verge of closing. United engaged in a process to sell its assets prior to the initiation of a bankruptcy case and held discussions with each of the bidders. United selected St.

Barnabas Health Care System as the winning bidder. 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.

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. 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. 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.

The District Court reversed the Bankruptcy Court's Order. *In re United Healthcare System, Inc.*, Civil Action No. 97-1159, 1997 WL 176574, (D.N.J. Mar. 26, 1997). The District Court 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 health care 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."

The amendments set forth in BAPCPA are consistent with the District Court's decision in *United* and provide state regulators a mechanism to enforce state law limitations on the transfer of assets of nonprofit entities. The amendments place restrictions on the transferability of property belonging to nonprofit entities by adding a new subsection (f) to Section 541 of the Bankruptcy Code. Property belonging to a nonprofit entity that is tax-exempt under Internal Revenue Code Section 501(c)(3) can only be transferred to another 501(c)(3) tax-exempt entity provided that the bankruptcy court may allow a transfer to an entity that is not a 501(c)(3) entity "only under the same conditions as would apply if the debtor had not filed a case under this title." Under this new section the debtor must now show that any transfer of assets is in compliance with applicable nonbankruptcy law.

Section 363(d) has been amended to explicitly provide that sales of assets of a nonprofit debtor are now subject to "non-bankruptcy law that governs the transfer of property" of nonprofit entities. As a result, state law will now become a significant consideration in the transfer of assets belonging to nonprofit entities. Further, section 1129(a)(16) contains a similar limitation on the transferability of assets. For a bankruptcy court to confirm a Chapter 11 plan, the court must find that all transfers of property under the plan were made in accordance with applicable provisions in nonbankruptcy law

that govern the transfer of property by a nonprofit. BAPCPA also requires that bankruptcy courts not confirm a plan under Chapter 11 without consideration of the possibility that BAPCPA's changes would substantially affect the rights of a party in interest who first acquired rights with respect to the debtor after the commencement of such a pre-enactment case.

Patient Records

Section 351, which has been added to the Bankruptcy Code, contains specific provisions for the disposal of patient records in a bankruptcy case. The new section provides that if a health care business commences a case under Chapter 7, 9, or 11, and the trustee does not have a sufficient amount of funds to pay for the storage of patient records in the manner required under applicable federal or state law, additional requirements are imposed. The amendment fur-

ther provides that if patient records are not claimed during a 365-day period, the trustee shall mail, by certified mail, at the end of such 365-day period a written request to each appropriate federal agency to request permission from that agency to deposit the patient records with that agency, except that no federal agency is required to accept patient records. If, following the 365-day period, patient records are not claimed by a patient or insurance provider, or request is not granted by a federal agency to deposit such records with that agency, the trustee shall destroy those records by, if the records are written, shredding or burning the records; or if the records are magnetic, optical or other electronic records, by otherwise destroying those records so that those records cannot be retrieved.

Duty of Trustee to Transfer Patients

Section 704 of the Bankruptcy Code was amended to add to the

duties of a trustee or debtor-in-possession a requirement to use all "reasonable and best efforts" to transfer patients from a health care business debtor that is closed, to a health care business or other entity in the same general vicinity that provides substantially similar services and maintains a reasonable quality of care.

Exclusion from Participation

The Bankruptcy Code was further amended to allow the Secretary of Health and Human Services to exclude a health care company from participation in the Medicare program or any other federal health care program.

On balance, BAPCPA created much needed protections for patients and further protections for the community at large in bankruptcy cases. As the health care industry continues to evolve and mature, the bankruptcy process may play a more prevalent and influential role. ■

