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THE UNHEALTHY STATE OF HEALTHCARE

▸ Sills Cummis & Gross insolvency specialist Andrew H. Sherman discusses an industry plagued with uncertainty and struggling to get back on its feet.

CCBJ: As chair of your firm's Creditors' Rights/Bankruptcy Reorganization practice, you're seeing a fair amount of activity in the healthcare industry. Can you give us an overview of the current landscape?

Andrew Sherman: The healthcare industry continues to be challenged on many levels, and there will continue to be healthcare insolvencies and restructurings across the nation. Certain of these cases will be the result of increased competition and decreased revenues, while others will be caused by mismanagement or other external forces. As healthcare systems become larger and larger, that size and scope put more stress on the smaller systems, which may lead to a loss of revenue while expenses remain static or increase. Other insolvency cases may be rooted in more strategic reasons, such as if a larger institution wants to take over a smaller institution. In those instances, a bankruptcy transaction may be favorable in order to minimize liabilities. Then, in addition to the hospitals, you have nursing homes and continuing care and retirement types of entities that will file for similar reasons. The industry continues not to be completely healthy – it's going to need some time to work its way through things.

What direction do you see the industry taking in 2018 and beyond?

It's not easy to answer that question, simply because it is unknown as to what's going to happen with the Affordable Care Act. There's been an evolution as the Affordable Care Act has been implemented in terms of how hospitals and healthcare institutions rationalize their expenses and revenues based upon the streams of income affected by the Affordable Care Act. Whatever happens with the act will have a significant impact on the stability of the industry. It's difficult for institutions to react when they're not sure about their revenue stream because of the uncertainty of legislation. Once there is more certainty in the legislation, you'll have a clearer picture of what the industry is going to look like.

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How have changes to the Bankruptcy Code and the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) affected healthcare?

BAPCPA was instituted in 2005, and it's become something of a mature statute, having been utilized for the past 10-plus years. BAPCPA has had an impact on healthcare cases. For example, the creation of patient care ombudsmen in bankruptcy cases, a different level of oversight, the way medical records are disposed of or treated, and then some issues related to privacy and consumer protection came through the BAPCPA amendments.

Right now, we're in the process of working through how the changes implemented through BAPCPA are being construed by courts. Courts have had some time to deal with the issue, so there's some precedent that they can work from, and there's some stability as it relates to how those amendments have affected the Bankruptcy Code.

Much of the healthcare industry involves government contracts. What are some key factors in that aspect of the industry?

A better way to look at it is

government receivables. In healthcare institutions, there are generally different mixes of receivables through different payers for medical services. Government-based receivables, typically Medicare or Medicaid, are based upon government programs that provide health insurance for specific populations that might otherwise have difficulty obtaining coverage. But there are other types of receivables referred to as self-pay, with individuals actually paying, or private pay through insurance companies. A hospital's payer mix is an important statistic in understanding its financial viability. In various parts of the country, that payer mix changes. In more rural areas or more urban areas, there may be a predominant amount of government receivables coming in through Medicaid and Medicare, while in other areas, you'll have a little less reliance on government receivables and more private party or self-pay.

Hospitals rely upon various subsidies, such as Disproportionate Share, to cover uncompensated care costs and underpayments by Medicaid. When the Affordable Care Act came in, that changed the landscape of how hospitals were reimbursed for the uninsured or underinsured, simply because you'd have more insured patients as a result of the Affordable Care Act. In effect, the Affordable Care Act contemplated that insurance expansion would increase a hospital's revenues and reduce the need for subsidies. In practice, the charity care that hospitals were providing went down after the Affordable Care Act was implemented.

Now, with the potential pushback on the Affordable Care Act, it's questionable how certain healthcare providers are going to be reimbursed for that care. Government contracts are a significant source of revenue for hospitals.

It goes back to what I said before: The way that the Affordable Care Act is ultimately addressed is going to have a significant effect on payer mix and reimbursement for uninsured or underinsured patients and the continued financial stability of various healthcare institutions.

Can you talk about some of the critical aspects of a wind-down in the industry?

Each wind-down faces its own challenges. Certain wind-downs of not-for-profits are caused by a loss of a revenue stream or impact by competition. The board and the hospital man-

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A hospital's payer mix, including its government receivables, is important to understanding its financial viability.

agement may have done a great job; they just had declining revenues. In that case, everybody's working toward the same goal of trying to maximize value for creditors. In other instances, wind-downs are caused by mismanagement or other types of external challenges, such as Medicare fraud, that negatively impacted the hospital's revenue stream or ability to continue. When you have that kind of overlay, whether it's mismanagement, fraud or otherwise, a wind-down is much more challenging.

There are other types of cases that are also quite critical that involve the potential loss of a safety-net hospital or rural hospital. Safety-net hospitals include public hospitals that are providers of last resort in their communities and medical centers that serve vulnerable populations. These types of cases are important because the loss of a safety-net or rural hospital has broad consequences for the community as a whole.

Another critical aspect of a wind-down includes balancing the interests of current management, the community and creditors. In certain instances, these interests may compete and need to be balanced, while in others, all these interests may coalesce. Balancing these potential tensions takes experienced professionals so that the parties do not spend significant resources on litigation. When you do a healthcare wind-down, the key to maximizing value is to keep your eye on the ball to make sure that the various interests are balanced so that there can be a continuity of healthcare in the community and creditors are assured that they will receive the most money in the shortest period of time. If people have that as the main goal, the wind-down can get done properly. But if people have other ulterior motives, then the wind-down becomes much more difficult and expensive.

Protecting and preserving the privacy of medical records in healthcare insolvency cases is also an important issue. When there is a sale of assets, the disposition of medical records and how people address privacy issues should be addressed through the way the transaction is structured. The difficulty comes when there's a lack of funding to address medical records and potential privacy issues. In some instances, the parties may be facing a Chapter 7 liquidation, and then the disposition of medical records and privacy issues becomes more difficult due to a lack of funding.

The BAPCPA amendments we talked about earlier provide certain protections and address how a hospital has to treat medical records and privacy issues in connection with a wind-down. But when Congress created the legislation, it didn't legislate the money to do it. So in an institution that doesn't have the money to preserve its medical records or address privacy issues, people have to be creative and understand how to best maximize the dollars that are there for the benefit of all parties. When there's a lack of funding, you need to put your heads together in a collaborative way to make sure that those records are preserved and the privacy issues are addressed for the benefits of patients and the community at large.

What else should our readers be aware of?

Healthcare insolvencies aren't going away. Bankruptcy professionals should be aware of the issues in healthcare restructuring because hospitals and healthcare institutions are a significant part of the economy. The loss of a hospital to a community can be catastrophic. It really affects people's lives. So, when looking at a healthcare case, all parties should be aware that there are broader implications for the community and all creditors. ■