



# COVID – Induced Stress Bankruptcy and Other Solutions for HC Providers

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***Presented by:***

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# 1. Special Bankruptcy Code Provisions Governing Healthcare Businesses.

## a. What is a “Healthcare Business?”

### (1) Defined in 11 U.S.C. § 101(27A):

A. Public or private entity (whether “for profit” or “non-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.

B. Includes-- any—

- (i) general or specialized hospital;
- (ii) ancillary ambulatory, emergency, or surgical treatment facility;
- (iii) hospice;
- (iv) home health agency;
- (v) other health care institution that is similar to any of the foregoing entities; and
- (vi) any long-term care facility, including any—
  - (a) skilled nursing facility;
  - (b) intermediate care facility;
  - (c) assisted living facility;
  - (d) home for the aged;
  - (e) domiciliary care facility; and
  - (f) health care institution that is related to a facility referred to above, if that institution is primarily engaged in offering room, board, laundry, or personal assistance with activities of daily living and incidentals to activities of daily living.

## 2. When Bankruptcy Should be Considered.

- a. COVID-19 / Declining Patients: Fewer patients seeking medical care due to fears of contracting COVID-19.
- b. Reimbursement Challenges: Reductions in Medicare and Medicaid payments.
- c. Exit Strategy: Ideal vehicle to acquire distressed assets without assuming liabilities and minimizing litigation risk.
- d. Mismanagement or Fraud: Opportunity to replace management and instill trust in reorganization or sales process.
- e. Competition with other local hospitals or specialty practices. (E.g., Century City Doctor's Hospital).

### 3. Benefits of Bankruptcy.

#### a. The Automatic Stay.

- (1) Stops, with certain exceptions, all pending lawsuits and proceedings.
- (2) Prevents creditors holding pre-petition claims from attempting on to collect outside of bankruptcy.
- (3) NOTE: With limited exceptions, the automatic stay does not stay litigation against non-debtor parties.

#### b. Debtor-in-Possession (DIP).

- (1) Chapter 11 DIP generally remains in possession and control of the assets and business operations.
- (2) Officers and Directors continue to make decisions within the confines of the Bankruptcy Code unless a Trustee is appointed for cause.
- (3) DIP is treated as a new entity as of the petition date, and owes fiduciary duties to all creditors.
- (4) DIP may engage in ordinary course of business transactions.
- (5) DIP may file lawsuits to recover money paid or property transferred to creditors and other parties pre-petition, because the transfers were preferential or fraudulent.

## 4. Potential Downside of Bankruptcy.

- a. Appointment of Chapter 11 Trustee or Examiner for cause including mismanagement or fraud.
- b. Case may convert to Chapter 7 if debtor is administratively insolvent or unable to confirm a plan.
  - (1) Chapter 7 Trustee is appointed to take control and possession of the estate's assets. The Chapter 7 Trustee may seek authority to operate the debtor's business, but this is done rarely.
  - (2) Trustee can pursue claims against insiders as well as other creditors.
- c. Case may be dismissed for "cause" including bad faith.
- d. Chapter 11 is expensive.

5. Key Events During Bankruptcy Case.
  - a. Financing a Chapter 11.
    - (1) Use of Cash Collateral.
      - A. Consensual.
      - B. Contested.
    - (2) DIP Financing.
      - A. Consensual.
      - B. Contested.
      - C. Priming Liens and Roll-ups.

## b. Sale of Assets Outside Chapter 11 Plan.

- (1) Allowed under Section 363 of the Bankruptcy Code; often used.
- (2) Sales can be piecemeal or include substantially all assets.
  - A. Court-Approved Auction Process: The Bankruptcy Court establishes bidding procedures and bid protections in advance of the auction. Bid protections often include:
    - (i) approval of a stalking horse bid;
    - (ii) minimum bid and bidding increments;
    - (iii) break-up fee or expense reimbursement for the stalking horse bidder;
    - (iv) earnest money deposits;
    - (v) bid qualification procedures; and
    - (vi) scheduling an auction and sale hearing.
- (3) Credit Bid Rights: Secured creditor may credit-bid its secured debt at an auction.
- (4) Role of State Attorney General in approving sale of hospital assets.
- (5) Role of federal agencies and licensing authorities – Medicare/Medicaid.
- (6) Role of state agencies and licensing authorities.

c. Chapter 11 Plans.

- (1) Plan of Reorganization.
- (2) Plan of Liquidation.
- (3) DIP has exclusive right to file a plan during the exclusivity period. This period is the first 120 days after the petition date, but may be extended by court order. If DIP files a plan during the 120 days after the petition date, then DIP has the exclusive right to seek approval of that plan for the 180 days following the petition date. No other entity may file a plan or seek approval of a plan during the exclusivity period.

d. Executory Contracts and Leases.

- (1) DIP may assume, assume and assign, or reject most executory contracts.
- (2) Contracts are executory where material obligations remain unperformed by each party.
- (3) DIP must “cure” all monetary defaults as a condition to assumption.
- (4) Assumption results in payment in full.
- (5) Counterparty to executory contract and unexpired leases may demand adequate assurance of future performance by buyer.
- (6) Rejection of executory contracts and unexpired leases enables the DIP to rid itself of unprofitable contracts and exit leased properties for minimal cost.
- (7) Exceptions to Assignability – 11 U.S.C. § 365(c)
  - A. Personal service contracts.
  - B. Intellectual property licenses.
  - C. Some government contracts.

e. Medicare and Medicaid Provider Agreements.

- (1) Medicare is governed by 42 C.F.R. § 489.18(c), which provide that when “there is a change of ownership ... the existing provider agreement will automatically be assigned to the new owner.”
  - A. New owner assumes obligation to repay the Department of Health & Human Services for any of the (debtor) assignor’s accrued Medicare or Medicaid overpayments at the time the overpayments were made or discovered.
  - B. Bankruptcy limitations.
    - (i) A Medicare or Medicaid Provider Agreement as executory contract. If a Medicare and Medicaid provider agreement is determined to be an executory contract under 11 U.S.C. § 365, DIP may assume or reject the agreement, but DIP may not assume the agreement unless all defaults are cured or DIP provides adequate assurance of prompt cure. 11 U.S.C. § 365(b).
    - (ii) Provider Agreement as non-executory. If the Medicare or Medicaid provider agreement is determined to be non-executory, the buyer would presumably acquire all assets free and clear of such obligations under Section 363.

## (2) Split Authority:

- A. Third Circuit. *In re University Medical Center*, 973 F.3d 1065 (3d Cir. 1992) (holding without analysis that “a Medicare provider agreement is an executory contract. *But see Germantown Hosp. & Med. Ctr. v. Heckler*, 590 F. Supp. 24, 30-31 (E.D. Pa. 1983) (“There is no contractual obligation requiring [the DHHS] to provide Medicare reimbursement. Rather, upon joining the Medicare program, providers gain a statutory entitlement to reimbursement. Thus the amount of reimbursement is governed not by contract but by statute; specifically the Medicare Act’s “reasonable cost” provisions.”), *aff’d sub nom. Germantown Hosp. & Med. Ctr. v. Schweiker*, 738 F.2d 631 (3d Cir. 1984); *In re Ctr. City Healthcare LLC*, Case No. 19-11466 (KG) (Bankr. D. Del. Sept. 10, 2019) (unpublished) (holding that Debtor’s Medicare provider agreement did not meet the definition of an “executory contract,” but was a statutory entitlement capable of being sold free and clear of all interests and successor liability under 11 U.S.C. § 363).
- B. Second Circuit. *In Hollander v. Brezenoff*, 787 F.2d 834 (2d Cir. 1986) (holding that nursing home operator’s claims under Medicaid did not fall within the six-year limitations period for contract claims under New York law because claims under the Medicaid program are statutory claims rather than contract claims)
- C. Eleventh Circuit. *Mem’l Hosp. v. Heckler*, 706 F.2d 1130, 1136 (11th Cir. (1983) (rejecting hospitals’ contention that their Medicare Provider Agreements were contracts: “Upon joining the Medicare program, however, the hospitals received a statutory entitlement, not a contractual right.”); *In re Bayou Corp.*, 525 B.R. 160, 168 (Bankr. M.D. Fla. 2014), *aff’d*, 2015 U.S. Dist. LEXIS 83390 (M.D. Fla. June 26, 2015).
- D. Ninth Circuit. *Guzman v. Shewry*, 552 F.3d 941 (9th Cir. 2009) (holding in a non-bankruptcy matter that a Medi-Cal Provider Agreement was not a contract); *In re Verity Health Systems of California, Inc.*, 606 B.R. 843, 848-51, and 852-54 (Bankr. C.D. Cal. 2019) (holding that because Medi-Cal provider agreements are not contracts, they were not governed by Section 365 of the Bankruptcy Code and could be transferred free and clear of liens under Section 363(f)(5) of the Bankruptcy Code), *vacated*, 2019 WL 7288754, \*1 (Bankr. C.D. Cal. Dec. 9, 2019) (Order Approving Stipulation re: Assumption and Assignment of Medi-Cal Provider Agreements to Strategic Global Management, Inc.).

### (3) Rights of Recoupment and Setoff.

- A. Ability of Medicare to recoup pre-petition overpayments from post-petition obligations, essentially cutting off a DIP's lifeline of Medicare reimbursement.
- B. Split of Authority.
  - (i) No recoupment permitted.
    - (a) *University Medical Ctr. v. Sullivan*, 973 F.2d 1065 (3d Cir. 1992); *In re Consumer Health Servs., Inc.*, 171 B.R. 917 (Bankr. D.D.C. 1994), appeal dismissed, Civ. Act. No. 94-2029 SSH (D.D.C. Mar. 18, 1996) (appeal pending); *In re Kings Terrace Nursing Home and Health Related Facility*, 1995 WL 65531, \*7-8 (Bankr., S.D.N.Y. Jan. 27, 1995) (Medicaid relationship not appropriate for recoupment), aff'd., 184 B.R. 200 (S.D.N.Y. 1995).
  - (ii) Recoupment permitted.
    - (a) *In re Gardens Regional Hosp. & Med. Ctr., Inc.*, \_\_\_ F.3d \_\_\_, 2020 WL 5541387 (9th Cir. Sept. 16, 2020)(California may recoup overdue tax called HQAF assessments, by reducing supplemental Medi-Cal payments owed to debtor funded by the tax, but state may not recoup Medi-Cal fee-for-service payments based on hospital's unpaid HQAF assessments); *In re TLC Hospitals Inc.*, 224 F. 3d 1008 (9th Cir. 2000) (government can recoup pre-petition overpayments from post-petition Medicare reimbursements); *U.S. v. Consumer Health Services of America Inc.*, 108 F.3d 390 (D.C. Cir. 1997); *In re Heffernan Memorial Hosp. Dist.*, 192 B.R. 228 (Bankr.. S.D. Cal. 1996); *In re St. Johns Home Health Agency, Inc.*, 173 B.R. 238 (Bankr.. S.D., Fla. 1994) (Medicare adjustment to ongoing payments to recover prior overpayments is properly characterized as recoupment and is not subject to the automatic stay); *In re Visiting Nurse Ass'n.*, 121 B.R. 114 (Bankr. M.D. Fla. 1990); *In re Homecall of S.W. Va.*, 1990 WL 278658 (Bankr. W.D. Va. 1990); and *In re Yonkers Hamilton Sanitarium Inc.*, 34 B.R. 385, 387-88 (S.D.N.Y. 1983); *Mount Sinai Hospital, Inc. v. Weinberger*, 517 F.2d 329 (5th Cir.), modified, 522 F.2d 179 (5th Cir. 1975), cert. denied, 425 U.S. 935 (1976); *Lowry Hospital Ass'n v. Blue Cross*, 415 F. Supp. 589 (E.D. Tenn. 1976) (Medicare has common law right to recoup earlier overpayments from ongoing payments outside of bankruptcy).

## f. Patient Care Ombudsman.

- (1) Bankruptcy Code requires the appointment of a patient care ombudsman within 30 days after commencement of a bankruptcy case by a health care business unless the court finds that, under the specific facts of the case, appointment of an ombudsman is not necessary for the protection of patients. 11 U.S.C. § 333(a)(1).
- (2) An ombudsman may be appointed in every Chapter 7, 9 or 11 filed by a health care business.
- (3) The ombudsman monitors the quality of patient care and represents the interests of patients of the health care business. 11 U.S.C. § 333(a)(1). The ombudsman is required to prepare and file a report with the bankruptcy court every 60 days regarding the quality of patient care. 11 U.S.C. § 333(b)(2). If any serious matters arise and the quality of patient care declines significantly or otherwise is materially compromised, the ombudsman may notify the Court. 11 U.S.C. § 333(b)(3).
- (4) The ombudsman must be disinterested and is paid by the bankruptcy estate. 11 U.S.C. § 333(a)(2)(A).
- (5) An ombudsman may help facilitate a sale or reorganization by helping to maintain patients at the facilities and give patients and their family comfort knowing that the quality of care will continue.

## g. Consumer Privacy Ombudsman.

- (1) If DIP has a privacy notice that prohibits transfers of personally identifiable information, the Bankruptcy Court must order the United States Trustee to appoint a Consumer Privacy Ombudsman prior to a sale involving such personally identifiable information. 11 U.S.C. § 332.
- (2) Consumer Privacy Ombudsman may appear and be heard at the sale hearing.

## 6. Questions.

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# Thank You.

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