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Intensive Care

BY VERONIQUE A. URBAN AND TED A. BERKOWITZ¹

Peninsula Hospital: Dissecting a Health Care Business Bankruptcy



Veronique A. Urban
Farrell Fritz PC
Uniondale, N.Y.



Ted A. Berkowitz
Farrell Fritz PC
Uniondale, N.Y.

Veronique Urban is an associate and Ted Berkowitz is a partner in the Bankruptcy and Creditors' Rights Practice Group of Farrell Fritz PC in Uniondale, N.Y.

The health care field has been one of the industries hit the hardest by the recent tumultuous economic climate. In the state of New York alone, countless hospitals and health care systems have filed for bankruptcy protection, including St. Vincent's Catholic Medical Centers (2005 and 2010), Victory Memorial Hospital (2006), Westchester Square Medical Center (2006), Auburn Memorial Hospital (2007), Caritas Health Care Inc. (2009), North General Hospital (2010), Interfaith Medical Center (2012) and, most recently, Sound Shore Health System Inc. (2013). In 2011, Peninsula Hospital Center landed in bankruptcy when an involuntary chapter 11 petition was filed against it in the U.S. Bankruptcy Court for the Eastern District of New York.² Peninsula Hospital's bankruptcy case illustrates the various elements that make health care and hospital bankruptcy cases so different from other cases.

An Unlikely Beginning

Peninsula Hospital, founded in 1908, and its affiliate, Peninsula General Nursing Home Corp., d/b/a Peninsula Center for Extended Care & Rehabilitation ("Peninsula Nursing Home" and, together with Peninsula Hospital, the "debtors") are New York § 501(c)(3) nonprofit corporations. Peninsula Hospital was a full-service teaching hospital with resident-training programs in orthopedics, general surgery and family practice. Peninsula Nursing Home is a skilled-nursing facility specializing in short-term respiratory rehabilitation, as well as dementia, hospice, long-term and traumatic brain injury care.

Section 303 of the Bankruptcy Code provides that an involuntary case may be commenced under

chapter 7 or 11 against a person that may be a debtor under the chapter under which such case is commenced. An exception to that general rule, however, is that an involuntary case may not be commenced against a corporation that is "not a moneyed, business or commercial corporation."³ As a result, nonprofit corporations are generally not targets of involuntary bankruptcy filings. Nevertheless, on Aug. 16, 2011, an involuntary bankruptcy petition was filed against Peninsula Hospital by three creditors. An examination of whether the involuntary filing was orchestrated to bypass a board of trustees deadlock is beyond the scope of this article, but it remains an issue of interest to the authors. On Sept. 19, 2011, Peninsula Hospital consented to the entry of an order for relief and Peninsula Nursing Home simultaneously filed for chapter 11 protection. The two bankruptcy cases are being jointly administered.

Role of State and Federal Agencies

One of the interesting aspects of a health care bankruptcy case is the interplay that occurs among the various state and federal regulatory agencies. Section 925(b) of title 28 of the U.S. Code requires that a debtor in possession manage and operate its property "according to the valid laws of the State in which such property is situated." As a result, a health care debtor must abide by federal, state and local laws, and the agencies enforcing those laws, in conducting its business. For example, the debtors' bankruptcy cases involved, among others, the New York State Department of Health (DOH), New York State Attorney General, the Public Health and Health Planning Council, and the Centers for Medicare and Medicaid Services.

The DOH in particular has played a large role in the debtors' bankruptcy cases. In July 2011, prior to

¹ Farrell Fritz PC represents the former corporate member of the debtors, MediSys Health Network Inc., and certain of its affiliates, in the debtors' bankruptcy cases.

² *In re Peninsula Hospital Center, et al.*, Case No. 11-47056 (Bankr. E.D.N.Y.).

³ 11 U.S.C. § 303(a).

the bankruptcy filing, the debtors submitted a plan of closure to the DOH that had been approved by the debtors' board of trustees. The plan, however, was withdrawn by the debtors on Aug. 9, 2011. On Aug. 19, 2011, 10 days after the withdrawal of the closure plan and three days after the involuntary filing against Peninsula Hospital, the DOH informed the debtors that it was "extremely concerned about the current ability of Peninsula to admit new patients in a manner that maintains patient safety and meets minimum standards required by the State Hospital Code."⁴ At that time, the DOH prohibited Peninsula Hospital from accepting new patients, although it subsequently allowed Peninsula Hospital to fully reopen on Sept. 2, 2011.

A few months later, in late February 2012, Wadsworth Center, a public health laboratory run by the DOH, conducted a survey at Peninsula Hospital's clinical lab and found "serious deficiencies in the administration and operation relating to the clinical laboratory operation."⁵ Following the survey, the DOH issued two summary orders. The first order suspended Peninsula Hospital's clinical laboratory permit for 30 days pursuant to § 577(3) of the New York State Public Health Law. The second summary order determined that the operation of Peninsula Hospital without its clinical lab services posed a danger to patients and essentially suspended operations at the hospital.⁶

The DOH's actions had a major effect on the debtors' bankruptcy cases. Upon issuance of the two summary orders, the U.S. Trustee filed a motion with the bankruptcy court requesting the appointment of a chapter 11 trustee pursuant to § 1104(a) of the Bankruptcy Code, pointing to the issuance of the summary orders as clear evidence that the debtors were being mismanaged.⁷ On March 6, 2012, Lori Lapin Jones, with the consent of all parties including the debtors' board of trustees and the DOH, was appointed as the trustee for the debtors' bankruptcy cases. Jones, a seasoned bankruptcy professional, was not a hospital operator but nonetheless had to be approved by the DOH in order to operate the debtors' facilities. The chapter 11 trustee submitted a formal plan of closure to the DOH for Peninsula Hospital on April 6, 2012, and in accordance with the closure plan, Peninsula Hospital's clinics were closed on the same day, and its emergency department and remaining ancillary services were closed on April 9.

Patient Care Ombudsman

Section 333 of the Bankruptcy Code requires the appointment of a patient care ombudsman (PCO) in chapter 7, 9 or 11 cases where the debtor is a health care business.⁸ The PCO is tasked with monitoring the quality of patient care and representing the interests of the patients during the course of the bankruptcy case.

Generally, the appointment of a PCO in health care bankruptcy cases is mandatory unless the court determines that the facts of the case demonstrate that the appointment is not necessary for the protection of the debtor's patients. Courts

will generally review the totality of the circumstances when determining whether the appointment of a PCO is necessary and might weigh the following factors: (1) the cause of the bankruptcy; (2) the presence and role of licensing or supervising entities; (3) the debtor's past history of patient care; (4) the ability of the patients to protect their rights; (5) the level of dependency of the patients on the facility; (6) the likelihood of tension between the interests of the patients and the debtor; (7) the potential injury to the patients if the debtor drastically reduced its level of patient care; (8) the presence and sufficiency of internal safeguards to ensure the appropriate level of care; and (9) the impact of the cost of an ombudsman on the likelihood of a successful reorganization.⁹

Daniel T. McMurray was appointed as the PCO for Peninsula Hospital and Peninsula Nursing Home on Sept. 22, 2011, and Oct. 19, 2011, respectively. In connection with his appointment, McMurray filed a motion with the bankruptcy court requesting access to confidential patient information pursuant to § 333(c)(1) of the Bankruptcy Code.¹⁰ Such approval was necessary in order for the PCO to remain in compliance with the Health Insurance Portability and Accountability Act of 1996 (HIPAA), which permits the disclosure of protected health information only in certain limited circumstances. Gaining access to the confidential patient records allowed McMurray to interview patients, gain a deeper understanding of the debtors' processes and develop a basis for the reports that he was to regularly file with the bankruptcy court pursuant to § 333(b)(2) of the Bankruptcy Code.¹¹ The PCO reports filed in the debtors' bankruptcy cases covered six general areas: (1) findings and reports of the DOH and related agencies; (2) the risk-management process; (3) health information management; (4) patient safety; (5) the use of communication networks to identify concerns and issues; and (6) quality- and performance-improvement measures.

It is not uncommon for PCOs to seek orders in the discharge of their duties that exculpate them from any wrongdoing and grant them prospective immunity from any potential discovery. The order discharging McMurray from his duties as the PCO for Peninsula Hospital is no exception to that general rule. The order contained a specific exculpation provision applicable to McMurray, his counsel and his firm, and also provides that any person, other than the trustee, seeking to initiate or serve any discovery request on McMurray must first file a motion with the bankruptcy court, on notice, to request permission to initiate or serve the discovery.¹² The PCO was discharged of his duties to Peninsula Hospital on April 23, 2013, following the closure of the hospital. McMurray continues to act as the PCO for Peninsula Nursing Home.

Sale of Assets

Health care bankruptcies often involve the sale of the debtor's assets. The sale of assets of a nonprofit debtor differs from the sale of assets of a for-profit debtor. Section

4 See "Chronology Peninsula" at www.health.ny.gov/events/public_hearing_reports/peninsula_hospital/docs/public_hearing_chronology.pdf (last visited July 23, 2013).

5 United States Trustee's Motion, Pursuant to 11 U.S.C. § 1104(a)(1) and (2), for Entry of an Order Appointing a Chapter 11 Trustee [Docket No. 438].

6 *Id.*

7 *Id.*

8 The term "health care business" is a defined term under § 101(27A) of the Bankruptcy Code.

9 *In re Alternate Family Care*, 377 B.R. 754 (Bankr. S.D. Fla. 2007).

10 Section 333(c)(1) of the Bankruptcy Code provides, in pertinent part, that the PCO "may not review confidential patient records unless the court approves such review in advance."

11 Section 333(b)(2) of the Bankruptcy Code requires the PCO to file reports at least every 60 days that detail the "quality of patient care provided to patients of the debtor."

12 Order Discharging the Duties of the Patient Care Ombudsman as They Relate to Peninsula Hospital Center Only and Granting Related Relief, Including a Release [Docket No. 1009].

363(b) of the Bankruptcy Code, which provides guidance on the sale of assets outside the ordinary course of business, may govern both types of transactions, but that is where the similarities end. The sale of assets of a nonprofit debtor will involve other discrete issues, such as whether the sale is compatible with the debtor's charitable mission and whether authorities other than the bankruptcy court, such as state and federal health agencies, must approve the transaction. In addition, § 363(d) of the Bankruptcy Code plays a role in the sale of a nonprofit debtor's assets. That section provides that a "[t]he trustee may use, sell or lease property under subsection (b) or (c) of this section only — (1) in accordance with applicable nonbankruptcy law that governs the transfer of property by a corporation that is not a moneyed, business or commercial corporation."¹³

The bankruptcy court, upon consent of the New York State Attorney General, entered an order on May 25, 2012, pursuant to which it approved the public liquidation sale of substantially all of the machinery, furniture and equipment (MF&E) of Peninsula Hospital. The sale subsequently occurred on June 27, 2012, and was crucial in the debtors' bankruptcy cases for a number of reasons that are common in health care bankruptcies. First, at the time that the trustee filed a motion for approval of the sale of the MF&E, Peninsula Hospital was no longer operating, and as a result, the MF&E was no longer needed or in use. Second, the trustee anticipated that the funds received from the sale of the MF&E would help to continue Peninsula Hospital's wind down. Lastly, the trustee intended to sell Peninsula Hospital's real property, so the MF&E contained within Peninsula Hospital would have to be disposed of before such a sale could occur.¹⁴

In addition, the trustee also successfully sought approval of the sale of all of the real property assets of Peninsula Hospital and substantially all of the real and personal property of Peninsula Nursing Home as a going-concern to four affiliated entities. In order to comply with § 363(d) of the Bankruptcy Code, the trustee needed the bankruptcy court's approval in order to sell these assets, as well as the approval of the New York State Attorney General, the New York State Supreme Court and the DOH, among others. The sale of the properties closed on May 8, 2013.

In connection with the sale of the debtors' assets, the trustee entered into a receiver agreement for Peninsula Nursing Home. Section 2810 of the New York Public Health Law permits the owner of any residential health care facility, such as a nursing home, to request that the DOH appoint a receiver to operate the facility on such terms and conditions as may be agreed to among the parties. In this case, the receiver arrangement allowed the purchaser of the Peninsula Nursing Home, Cardiff Bay Center LLC, to begin operating the facility for its own account while awaiting the completion

of the "certificate of need" approval of the sale and transfer. The DOH approved the receiver agreement on Jan. 30, 2013, and the purchaser, as receiver, assumed control of the operations of Peninsula Nursing Home, effective Feb. 3, 2013.¹⁵

Conclusion

The debtors' cases are ongoing and continue to present various issues common in nearly all health care bankruptcy cases. Going forward, it seems unlikely that the tide of health care bankruptcies will soon ebb as other hospitals and health care systems continue to struggle. At the time of this article, the focus in New York has turned to Long Beach Medical Center, which has been closed since Hurricane Sandy struck in October 2012. Long Beach Medical Center and the DOH are trying to devise a viable financial plan for the center, which had been suffering financial losses for years prior to the storm.¹⁶ Only time will tell if Long Beach Medical Center or another New York State hospital will be next in line at the bankruptcy court. **abi**

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¹³ 11 U.S.C. § 363(d)(1).

¹⁴ See Motion of Chapter 11 Trustee for Entry of an Order Scheduling Hearing on Shortened and Limited Notice, and for Entry of an Order: (I) Approving the Public Liquidation Sale of Substantially All of the Machinery, Furniture and Equipment of Peninsula Hospital Center, Free and Clear of All Liens, Claims and Encumbrances; (II) Approving the Employment of Great American Group as Liquidator to Conduct the Public Liquidation Sale of Substantially All of the Machinery, Furniture and Equipment of Peninsula Hospital Center; (III) Granting a Priming Lien and Super-Priority Claim in the Sale Proceeds to Great American Group, Authorizing the Trustee's Use of Cash Collateral and Approving a Carve-Out from the Sale Proceeds for Commissions, Fees, Costs and Expenses Associated with the Public Liquidation Sale; and (IV) Authorizing the Chapter 11 Trustee to Donate or Otherwise Dispose of Certain *De Minimis* Machinery, Furniture and Equipment and Miscellaneous Personal Property of Peninsula Hospital Center [Docket No. 565].

¹⁵ Notice of Approval of Receiver Agreement [Docket No. 917].

¹⁶ See Letter from Long Beach Medical Center to the DOH dated July 1, 2013, available at <http://libn.com/files/2013/07/shah-7-1-2013.pdf> (last visited July 23, 2013).