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HEALTHCARE AMENDMENTS TO THE BANKRUPTCY REFORM LEGISLATION HEALTHCARE LAW UPDATE

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On October 17, 2005, the majority of the provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "Act") went into effect. Certain provisions of the Act went into effect immediately upon signing on April 20, 2005. While the Act has garnered substantial attention for the reform to consumer bankruptcy, little attention has been given to the impact of the Act on the healthcare industry. Congress sought to promote the interests of patients and governmental entities by granting them new rights, while imposing additional duties on healthcare business debtors. However, the end result of Congress' efforts was the substantial enlargement of costs to be borne by the healthcare business debtor.

Healthcare Business Bankruptcy Defined

With the Act, the Bankruptcy Code for the first time defines a "healthcare business" as a public, private, for-profit or not for profit entity "that is primarily engaged in offering to the general public facilities and services for the (a) diagnosis or treatment of injury, deformity or disease or (b) surgical, drug treatment, psychiatric or obstetric care." This Act identifies specific examples of health care businesses and includes hospitals, home health agencies, nursing homes and skilled nursing facilities. Included within this list are health maintenance organizations, which could include providers of linens, meals, and other suppliers to healthcare businesses. The definition appears to exclude a group of doctors operating a private practice.

Patient's Rights

Because patients generally do not have an independent standing to appear in a bankruptcy case, Congress sought to preserve the quality of patient care during the course of a bankruptcy case by (1) requiring the appointment of a patient ombudsman, (2) establishing a duty to transfer patients from a health care business debtor being closed, and (3) ensuring the proper handling of medical records.

Appointment of Ombudsman as Patient Advocate

The most significant change in the Act, as it relates to healthcare bankruptcies, is the requirement of the appointment of a patient ombudsman. The Act mandates the appointment of a patient ombudsman in cases where the debtor is deemed to be a healthcare business, not later than 30 days after the bankruptcy filing unless the bankruptcy court finds a patient ombudsman is not necessary for the protection of patients. The ombudsman is authorized to receive compensation from the estate for services rendered and may employ professionals (such as lawyers and accountants) who must also be paid by the estate.

The Act contemplates two types of ombudsman: (a) those appointed to assess long-term care facilities who will be the state long-term case ombudsman, or (b) patient ombudsmen appointed to assess facilities other than long-term care facilities, who need not, but may be, the state long-term care ombudsman.

The patient ombudsman is required to monitor the quality of patient care and will report to the bankruptcy court every 60 days. If the ombudsman finds that the quality of patient care is "declining significantly or is otherwise being materially compromised," the

ombudsman must report to the bankruptcy court immediately. The ombudsman will use objective criteria to determine whether care is declining significantly or is being materially compromised, but the Act fails to establish standards for the ombudsman to follow.

Certain decisions within the discretion of the debtor's business judgment may now be subjected to scrutiny by the patient care ombudsman. These decisions may include the rejection of certain equipment leases, the closure of certain practice areas, and even the termination of certain employees. Only time will determine the full authority an ombudsman will have on healthcare bankruptcies.

Transfer of Patients

Often times when a healthcare business debtor seeks bankruptcy protection, certain of its facilities need to be shut down to reduce its expenses. The Act imposes a statutory duty on trustees and debtors to use all "reasonable and best efforts" to transfer patients from a healthcare business debtor that is being closed to an appropriate health care facility (1) in the general vicinity that (2) provides substantially similar services and (3) maintains a reasonable quality of care. The Act provides a statutory definition for such "appropriate healthcare business." All of the costs associated with statutorily required patient transfers will be afforded administrative priority status. This places an enormous economic and logistical burden on a debtor or trustee, and presumably an ombudsman.

Disposal of Patient Records

The Act establishes procedures for disposing of patient records in a healthcare business bankruptcy. The Act mandates the consideration of several patient interests: (a) it is critical to preserve a patient's medical history, (b) insurance companies may not pay for services if there is an absence of historical documentation, and (c) insurance companies may decline coverage absent full disclosure of pre-existing medical conditions. Cognizant of the burden placed on a healthcare debtor to retain medical records, the Act allows for the alternate storage or destruction of patient medical records in cases where the debtor is unable to pay the cost of record maintenance.

If this option is chosen, the debtor must comply with stringent notice requirements. Specifically, the trustee/debtor/ombudsman must: (1) promptly publish notice that if patient records are not claimed by the patient or an insurance provider by a specified date at least one year after issuance of the notice, those patient records will be destroyed, (2) diligently attempt to notify "directly" each patient for whom the debtor maintains patient records and their appropriate insurance carrier at the most recent known address of that patient, or a family member or contact person for that patient during the first 180 days of the required one-year period, (3) notify, by certified mail, at the end of the specified 365-day period, each appropriate federal agency requesting permission from that agency to deposit unclaimed patient records with that agency, and (4) destroy all unclaimed patient records by shredding or burning if the records are written, or mutilating those records "so that those records cannot be retrieved if the records are magnetic, optical or other electronic records."

The costs associated with disposing of patient records are given administrative priority status and are likely to have a significant economic impact on healthcare bankruptcies.

Modification of Automatic Stay for Federal Government

Generally, the filing of a petition in bankruptcy automatically stays creditors and parties in interest from collecting amounts due to them or taking actions against the debtor or the estate. The Bankruptcy Code has always provided certain excepts to this automatic stay. The Act creates a new exception, applicable to healthcare cases. This new exception allows the Secretary of Health and Human Services to exclude a debtor from participation in the Medicare program or any other federal healthcare program, without violating the automatic stay.

Healthcare bankruptcies often involve battles over whether the government can cut off the supply of federal funds when healthcare businesses wind up in bankruptcy. At the same time, healthcare businesses rely heavily on participation in governmental healthcare programs for a large share of their revenue stream. This new exclusion does not automatically operate to exclude a debtor from a federal healthcare program, but it enables to federal government to proceed with its administrative functions without the need to go into bankruptcy court to seek relief. The change is of great significance as it shifts the leverage from the debtor to the Department of Health and Human Services, making it a powerful force in virtually all healthcare bankruptcies with expanded collection powers.

Limitations on Sale of Nonprofit Entities

Prior to the enactment of the Act, assets owned by nonprofit entities could be transferred to a for-profit entity, without having to meet the regulatory requirements of non-bankruptcy law. As such, any non-bankruptcy law restrictions were invalidated by the filing of a bankruptcy case and could not preclude a proposed sale.

When the Act was signed on April 20, 2005, a provision concerning the transfers of assets by nonprofit entities went into effect immediately. The Act places a restriction on the transferability of property belonging to nonprofit entities. Property belonging to a nonprofit entity that is tax-exempt under Internal Revenue Code § 501(c)(3) can only be transferred to another § 501(c)(3) tax-exempt entity. However, 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." This is a restriction on the debtor's ability to transfer assets of § 501(c)(3) entities. The debtor must now show that any transfer of assets is in compliance with applicable non-bankruptcy law.

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