Overcoming the obstacles and realizing the benefits of a chapter 11 healthcare restructuring

Healthcare Alert
Restructuring Alert
6 JAN 2017
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Many healthcare businesses, both for-profit and not-for-profit, have faced financial distress. Among the factors that may contribute are lower reimbursement rates, changes in the delivery of services, regulatory shifts, and the need for capital improvements to adopt the latest technology. Coupled with these factors are issues that have always been endemic to the industry, such as the struggle to maintain a profitable payor mix and collect receivables. In order to obtain relief, many companies are considering chapter 11 restructuring.

The process of restructuring a healthcare company, however, can present unique challenges. In particular, the process includes not only the typical adjustment of debtor-creditor relationships, the negotiation and execution of a restructuring plan and the need to achieve profitability, which are found in all restructurings, but also certain challenges caused by healthcare regulatory requirements, patient care concerns and the involvement of a broad range of constituents, including patients, doctors and families. These challenges have led many to believe that the restructuring of a healthcare company, especially through a chapter 11 filing, is difficult, if not impossible. However, as will be discussed in this article, with careful planning and preparation, a healthcare company can overcome the obstacles that may arise in a chapter 11 restructuring.
While it is never the preferred course, if it becomes necessary, a chapter 11 restructuring can provide a number of immediate and long-term benefits to a company in distress. Most importantly, a restructuring can provide an organization with relief from burdensome debt obligations and help it establish a plan to improve, among other things, profitability and efficiency moving forward. A chapter 11 restructuring can also help a company:

- identify areas of underperformance
- reduce debt and improve its balance sheet
- improve its cash position
- provide for a sale of assets free and clear of liens, claims and encumbrances
- eliminate restrictive debt covenants
- resolve outstanding claims and
- reject burdensome contracts and leases.

While there are other options available to a healthcare organization in distress, a chapter 11 restructuring should not be discounted simply because of its perceived complexity and concerns about reputational impact. Rather, companies should consider a chapter 11 restructuring because those that are able to successfully navigate the process not only improve their financial condition but are able to ensure a continuity of care to the patients, residents and communities they serve.

Below, we identify a few of the key considerations that a healthcare organization should keep in mind in order to ensure a successful restructuring.

**Formulate a way out before you get in**

Healthcare providers of all types, ranging from skilled nursing facilities and diagnostic centers to continuing care retirement communities and hospitals, depend on the continued confidence of their patients, residents, families, referring physicians and the community in the services they provide. In order to ensure a successful restructuring, it is critical that a healthcare company maintain that confidence. To that end, a healthcare company considering a chapter 11 restructuring should prepare a detailed communications plan that can be implemented at the commencement of the case to alleviate any concern caused by the chapter 11 filing. The communications plan should reassure the company's various constituents that the chapter 11 filing is not evidence of a failure, but is instead a means to implement a sensible business solution. Additionally, as part of its communications plan, the company should articulate its strategy for emerging from bankruptcy and how the various constituents will be impacted by the restructuring, if at all.

The key to formulating a successful exit strategy is to retain experienced and competent professionals, including legal, financial and communications professionals, early in the process. For example, if it is determined that a sale of the company is advisable, an investment banker should be hired long before liquidity concerns become critical. Additionally, a "stalking horse" buyer should be identified early in the process, particularly because the sale of a healthcare company involves a lengthy regulatory approval process. If, on the other hand, a balance sheet restructuring is in order, the company should take steps to ensure the confirmation of a plan of reorganization by either garnering the support of relevant parties or identifying ways to overcome objections to the restructuring plan.

**Time is of the essence**

Restructuring cases typically follow a similar sequence of events – a petition is filed to commence the bankruptcy case, certain "first day" relief is obtained that allows the organization to continue operating as a "debtor in possession," a company may seek financing to fund operations during the course of the case and a plan of reorganization is proposed. In many instances, this timeline of events can span well over a year. This sequence, however, can be accelerated by the debtor with proper exit planning.

In the case of a healthcare restructuring, time is of the essence even more so than in most cases. As long as a company remains in bankruptcy, it will continue to accrue administrative costs, including significant professional fees, thereby depleting cash available for creditors and raising an even larger hurdle for the company to overcome in order to emerge from bankruptcy. Additionally, a long, drawn-out process can cause high levels of stress and uncertainty for the patients, residents and communities who rely on the services provided by the organization as well as the physicians, nurses and other staff who provide such services. A prolonged bankruptcy process will
also discourage prospective patients and residents from seeking services from the company, which will disrupt the flow of revenue that is critical to healthcare companies. Therefore, a speedy restructuring process is essential. To avoid a long restructuring process, companies should establish an expedited timeline at the beginning of the case and encourage the court and key constituents to commit to that timeline so that all parties are working quickly and efficiently toward the same goal. Once again, the key to achieving a successful restructuring is proper advance planning.

**Keep regulators informed and be aware of your obligations**

Unlike a general corporate restructuring, a healthcare restructuring is unique in that it typically involves legal issues that extend beyond the Bankruptcy Code and implicates the jurisdiction of state, federal and local agencies. In fact, during the course of a chapter 11 case, healthcare companies are often required to address issues related to HIPAA, Medicare, Medicaid and state laws. For example, the sale of a healthcare company in bankruptcy often raises questions regarding the transferability of provider numbers, recoupment liability and patient privacy. In order to ensure compliance with these laws, federal and state agencies will become involved in the bankruptcy proceedings. At the state level, a healthcare company may find the Department of Financial Services, the Department of Health, and the Office of the Attorney General taking positions with respect to a wide range of issues, such as the health and safety of patients or the use of charitable funds. Additionally, companies should anticipate that the bankruptcy court will appoint a patient care ombudsman who will be responsible for monitoring the company to ensure that patients and residents are not negatively impacted by the proceedings. For this reason, it is essential for healthcare companies to seek the advice of professionals with respect to, among other things, the duties of board members, the issues that may arise in an asset transfer, and, with respect to a not-for-profit company, the use of restricted funds.

In order to ensure a smooth restructuring, healthcare companies and their advisors should consider ways in which they can instill confidence in governmental agencies overseeing the proceedings. One such way to build confidence is by engaging the appropriate agencies early and often with respect to all major actions being taken by the company during the bankruptcy. By doing so, a healthcare company can avoid unwelcome surprises and delays.

**The additional complexity for not-for-profit companies**

There is a mix of ownership structures in the healthcare industry, but the not-for-profit model remains the most common. In fact, nongovernment, not-for-profit community hospitals in the US account for 50 percent of all US registered hospitals. The distinctive structure and purpose of not-for-profit companies can add additional complexity to the restructuring process. For example, in a for-profit restructuring, the primary goal is to maximize distributions to creditors. Conversely, in a not-for-profit restructuring, the focus often shifts to ensuring the continuity of the organization’s charitable mission for the benefit of the public good. In addition, because not-for-profit companies are governed by state law, such companies should anticipate that their state attorney general will carefully monitor and, if necessary, become involved in the proceeding.

**The challenges are not insurmountable**

As this article highlights, a healthcare restructuring can present a number of unique challenges. These challenges, though, are not insurmountable if organizations carefully prepare and plan for them by, among other things, involving key constituents at the beginning of the case, formulating an expedited timeline and anticipating legal issues that will arise during the pendency of the proceedings. With adequate planning and preparation, a healthcare company can overcome all obstacles and emerge as a financially stable organization focused on its mission, services, patients and community.

To learn more about healthcare restructurings, please contact the authors.

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