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Health Care Insolvency Is on the Rise: The Treatment of WARN Act Obligations and Preserving Provider Agreements in Bankruptcy

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A Growing Trend of Hospital Bankruptcy Filings Since ACA

Despite the general upswing economy, hospital bankruptcy filings are on the rise since the enactment of the Affordable Care Act in 2010. Eleven hospitals filed for bankruptcy across the country in 2013, while 16 hospitals sought bankruptcy protection in 2014.[1] The numbers for 2015 are incomplete, but at least four hospitals have filed for bankruptcy in the last few months. Additionally, assisted living facilities, medical device companies, insurance providers, doctor groups, and medical clinics have shuttered their operations, administratively dissolved, been placed in receivership or conservatorship, or have themselves filed for bankruptcy, as applicable.

Smaller Insurance Networks and Increased Prices for Medical Care

Certain trends developed in these insolvency filings, separate from a few cases of fraud and mismanagement. Various industry representatives assert that financial distress is due to smaller insurance networks and increased prices for medical care, which has shifted the financial burden in some respects from the patient to the provider. Insurance companies now can charge lower premiums to the patient by buying in bulk from a smaller group of providers and physicians. This function controls costs of health care for many patients (but not for those who end up paying more for health care outside of their networks), while reducing choices for the patients. It also reduces profit margins for providers and recalibrates their economies of scale, leaving them scrambling to address their volume-based employees, contracts, assets, inventory, and debt. As a result, hospitals and other health care providers are faced more frequently with the prospect of their own insolvency proceedings or that of another provider counterparty, which may affect their business relationships and/or contracts. And, ultimately, while some bankruptcy filings are framed as reorganizations, the growing trend and reality of Chapter 11 proceedings are to best position the filing entity for liquidation or wind-down. At the very least, insolvent companies generally do not grow in bankruptcy, though they may be sold or perhaps shed some debt or other liabilities.

Health Care Industry Must Understand Its WARN Act Obligations and Ability to Preserve Provider Agreements in Bankruptcy

Two facets of health care-related bankruptcies must be better understood by the health care industry when considering these filings, be it from the perspective of the filing entity, the purchaser, a terminated employee, or other creditors who may be owed monies or are subject to certain contracts with the filing entity: (1) the treatment of WARN Act obligations in bankruptcy proceedings; and (2) the ability in bankruptcy to preserve provider agreements in default prior to termination like in the recent bankruptcy case of Bayou Shores SNF, LLC.[2]

WARN Act

What Is the WARN Act? How Does It Apply to the Health Care Industry?

The Worker Adjustment and Retraining Notification Act (WARN Act),[3] provides protection to employees and their families, by requiring employers to provide notification 60 calendar days in advance of plant closings and mass layoffs, which have their own definitions under the WARN Act. In general, employers are covered by WARN if they have 100 or more employees. Private, for-profit employers and private, nonprofit employers are covered by WARN, as are public and quasi-public entities that operate in a commercial context and are separately organized from the regular government. Employees entitled to notice under WARN include hourly and salaried workers, as well as managerial and supervisory employees. In other words, the WARN Act covers most hospitals and medium-to-large sized assisted living facilities and other health care provider companies.

As recently as May 14, 2015, in one of the 2015 health care-related bankruptcy cases, the employees of University General Health System filed a WARN Act class action relating to the closure of a Dallas, TX hospital facility.[4] This serves to underscore the interplay of WARN Act obligations in health care bankruptcy filings. Stay tuned.

WARN Act Obligations in Connection with a Sale of the Business

In the event of a sale of the business that implicates or occurs soon after mass layoffs or plant closing, WARN Act obligations still apply. This is important because many hospital bankruptcy filings, like the 2015 filing of Hollywood Pavillion Hospital in Florida, involve a bankruptcy auction sale.[5] In the event of sale, the seller is responsible for providing notice of any covered plant closing or mass layoff that occurs up to and including the date/time of the sale. The buyer is responsible for providing notice of any covered plant closing or mass layoff that occurs after the date/time of the sale. Those employees on the date/time of the sale become, for purposes of WARN, employees of the buyer immediately following the sale.

WARN Act’s Statutory Exceptions: Unforeseeable Circumstances and Faltering Company

Applicable to insolvency-related proceedings, the WARN Act includes certain explicit exceptions to its 60-day notice provisions; namely, natural disasters, unforeseeable business circumstances, and faltering company exceptions. The unforeseeable business circumstance exception is a less successful argument, as usually a bankruptcy filing is preceded by a period of financial decline, be it in the form of internal financial reports, warnings from secured lenders, etc. The faltering company exception applies to companies seeking capital, business, or a buyer that, if obtained, would have enabled the employer to avoid or postpone the shutdown. There must be a reasonable chance that the capital, financing, or sale will occur *and* the employer reasonably believed that giving the notice would have precluded the employer from obtaining the necessary capital, business, or buyer. The availability of either exception, however, does not excuse giving at least some notice of the closing. While the exceptions allow less than 60 days' notice, the employer is required to give as much notice as is practicable and must explain in the notice why less notice was given.

WARN Act’s Additional “Exception” Under Case Law: Liquidating Fiduciary Scenario—United Healthcare System Bankruptcy

Another exception has been recognized in the case law called a “liquidating fiduciary" exception. This exception addresses an entity that files for bankruptcy and is merely winding down its operations and/or preparing for a liquidation event—*not* operating as a going concern. In such situations, bankruptcy courts have found these bankruptcy entities are *not* an “employer” under the WARN Act.

The United Healthcare System bankruptcy case in the late 1990's was one of the seminal cases dealing with the interplay of the WARN Act and bankruptcy, as well as these various exceptions.[6] In reviewing the United Healthcare bankruptcy proceedings, the Court of Appeals found that United Healthcare was not an employer for WARN Act purposes because it filed for bankruptcy the same day as it surrendered its certificates of need, and it retained a subset of employees solely to ready itself for liquidation. Those employees were given 60-days' notice on the day of the bankruptcy filing and told to work until the company closed, which occurred 16 days later. The scope of back-pay wages for the 1,200 furloughed employees was approximately $7 million. Everyone agreed the employees would be paid $1.7 million for the 16 days of work done in the bankruptcy, but the question was as to the remaining 44 days, which were not worked but fell within the WARN Act period in the bankruptcy amounting to approximately $5.3 million. Based on the ruling that United Healthcare Systems was not an employer for purposes of the WARN Act, United Healthcare was able to shed itself of that $5.3 million entirely, which inured to the benefit of the company and its creditors. Generally, the scope of WARN Act obligations and the liquidated fiduciary exception are questions of fact subject to a full evidentiary hearing in each case.

<u>The Timing of WARN Act Claims Is Crucial</u>

More recently, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA),[7] addressed an additional issue of WARN Act obligations in bankruptcy with huge financial implications. Pre-BAPCPA, when the duty to give WARN notice arose prior to the bankruptcy—because the relevant hospital closing or layoff occurred prior to the filing—the back-pay award was at best a limited/capped wage priority under the Bankruptcy Code, with the vast remainder of the back-pay claim being a general unsecured claim, which either did not get paid or received pennies on the dollar depending on the finances of each case. When the duty to give WARN notice arose after the bankruptcy filing—because the layoff or closing was done in the bankruptcy and full notice was not given— the *entire* back-pay award was entitled to treatment as a high priority level administrative expense, which usually gets paid dollar for dollar. So, for cases where the notice of termination was given prior to the bankruptcy but had its 60-day notice period span into the bankruptcy period, the employees were given a capped partial payment of a few thousand dollars each for that bankruptcy period, and given a general unsecured claim (pennies on the dollar) for the remainder. Hospital bankruptcy filings tend to involve hundreds and thousands of employees, so *when* these claims are deemed to have accrued affects millions of dollars in these cases.

Under the updated provisions enacted under BAPCPA, attorneys representing these former employees have argued that, for WARN Act claims spanning beyond the bankruptcy divide, i.e., where employees were terminated before the bankruptcy but their 60-day notice entitlement carried over into the bankruptcy period, they now would be entitled to a first priority administrative expense in the bankruptcy proceedings (dollar for dollar). This would be so even if they did no work for the company during the bankruptcy period. Several bankruptcy cases in 2008 took up this issue and ruled against the employees, determining that to accept that position would undermine the bankruptcy framework, which otherwise requires a person to provide goods or render services during the bankruptcy for the benefit of the bankruptcy estate to be entitled to a dollar-for-dollar administrative expense priority claim.[8]

While WARN Act obligations in health care-related bankruptcies present varying permutations, the treatment of same in bankruptcy is nothing new. However, just last year a health care-related bankruptcy filing embarked on new territory with respect to preserving provider agreements in bankruptcy in the face of pending regulatory termination proceedings.

In re Bayou Shores SNF, LLC[9]

Preserving Medicare & Medicaid Provider Agreements in Bankruptcy

Bayou Shores SNF, LLC, owns and operates a 159-bed skilled nursing facility (SNF) in Florida. More than 90% of its revenue is derived from Medicare and Medicaid reimbursements. The Centers for Medicare & Medicaid Services (CMS) notified Bayou Shores of its intent to terminate its Medicare provider agreement based on a host of defaults under the provider agreement, which would also result in the termination of its Medicaid provider agreement with the state of Florida. In response, Bayou Shores filed an administrative appeal, an injunction action, and a Chapter 11 bankruptcy petition.

Termination of Provider Agreement Enjoined by Bankruptcy Stay

The crux of the bankruptcy litigation involved Bayou's motion early in the case to enforce the automatic stay found in bankruptcy to enjoin any further proceedings by CMS to terminate its provider agreements, which CMS argued fell under the police and regulatory exception of the automatic stay.[10] The Bankruptcy Court ruled in favor of Bayou finding that, by terminating Bayou's provider agreement, CMS only would be protecting its pecuniary interests and, therefore, its actions were subject to the automatic stay. By contrast, actions taken to close Bayou's facility conceivably would be actions taken to protect public health and safety and, for that reason, would be permitted by the "police powers" exception. As such, a final order was entered prohibiting CMS from taking any action in connection with terminating the provider agreements.

Non-Terminated Provider Agreement Can Be Cured and Assumed in Bankruptcy

With its provider agreement not yet terminated, Bayou then filed a Bankruptcy Plan on the basis of assuming its CMS provider agreements. CMS argued that its agreement cannot be assumed in bankruptcy because it was terminated prior to the bankruptcy and/or it could not be cured and assumed in the bankruptcy. The Bankruptcy Court overruled CMS' argument noting that the termination was subject to pre-bankruptcy administrative action and appeal by Bayou, so it found the provider agreement conceivably could be assumed going forward under the right circumstances. The Bankruptcy Court also heard evidence by the patient care ombudsman appointed in the bankruptcy case, corroborating Bayou's corrective measures in the bankruptcy case to cure the pre-bankruptcy defaults under its provider agreements.

The Florida Agency for Health Care Administration (AHCA), which oversees Florida's Medicaid program, also opposed the Bankruptcy Plan, arguing the Plan was not feasible since ACHA could revoke or refuse to renew Bayou's SNF license. Without that license, the Plan was not feasible. The Bankruptcy Court noted that AHCA's revocation of, or refusal to renew, Bayou's SNF license would be protected by the "police power" exception to the automatic stay. However, importantly, the Bankruptcy Court stated that confirmation of the Plan would collaterally estop AHCA from asserting that either of Bayou's provider agreements has been terminated as a basis for either revocation or non-renewal of the SNF license. The Bankruptcy Court went on to say that, based on Bayou's noted remediation efforts, it was not a foregone conclusion that AHCA would succeed in either revoking or denying Bayou a renewal of its SNF license. For that reason, AHCA's stated intentions did not preclude a finding that the Plan was feasible.

The Bankruptcy Plan was confirmed but now is on appeal by ACHA[11] as well as the U.S. government on behalf of CMS[12] for which the appellate court essentially acknowledged that equitable mootness would not limit the regulatory agencies' ability to prosecute their appeals. Additionally, ACHA's administrative proceeding to revoke or refuse to renew the SNF license remains pending. And all of these administrative proceedings and bankruptcy rulings are likely headed for additional appeals.

Bayou Implications

As the Bayou proceedings stand now on appeal, regulatory actions to terminate Medicaid and Medicare provider agreements *will* be *stopped* in a bankruptcy proceeding. While ACHA's separate proceeding to renew or revoke the SNF license remains pending (and we are reminded that regulatory actions to close a facility itself for health and welfare purposes are *not* stopped in bankruptcy), Bayou remains in the fight to sustain its business as a going concern. With the rulings from the Bayou bankruptcy case, a similarly situated facility could follow the Bayou path into bankruptcy and perhaps ready itself for sale as a going concern (especially to an existing license holder), which such sale likely would have a greater argument to render moot the regulatory agencies' appellate arguments and attack on the proceedings faced in Bayou. As the growing trend is to utilize Chapter 11 bankruptcies to effectuate sales of assets on a going concern basis, the path blazoned by Bayou in its bankruptcy proceedings likely will show others the way to address regulatory termination proceedings and maximize value for creditors.

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[1] *See* http://valuehealthcareservices.com/education/hospitals-that-filed-for-bankruptcy-in-2015/.

[2] Case No. 8:14-bk-09521-MGW (Bankr. M.D. Fla.).

[3] Pub. L. No. 100-379, 102 Stat. 890 (1988) (codified at 29 U.S.C. § 2101-2109 (1994); *see also* H.R. REP. No. 100-285 (1987).

[4] *Ann Love and Angela Marshall et al. v. University General Health System, Inc.,* Adv. Proceeding No. 4:15-3124, (Bankr. S.D. Tex.).

[5] *See In re Hollywood Pavilion*, Case No. 15-16390-JKO (Bankr. S.D. Fla.).

[6] *In re United Healthcare System, Inc.,* 200 F.3d 170 (3d Cir. 1999).

[7] Pub. L. No. 109–8, 119 Stat. 23, enacted Apr. 20, 2005).

[8] *See, e.g., In re First Magnus Fin. Corp.*, 390 B.R. 667 (D. Ariz. 2008); and *In re Powermate Holding Corp.*, 394 B.R. 765 (D. Del. 2008).

[9] Case No. 8:14-bk-09521-MGW (Bankr. M.D. Fla.).

[10] 11 U.S.C. § 362(b)(4).

[11] Case No. 8:15-cv-00128 (M.D. Fla.).

[12] Case No. 8:15-cv-00103 (M.D. Fla.).