

Reducing Hospital Regulatory Burdens Through Bankruptcy Sales

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As the COVID-19 pandemic persists, hospitals across the country are feeling the pain. Many states have reduced or completely eliminated elective surgeries, and potential patients who historically would go to a hospital for medical issues are choosing to stay at home unless a hospital visit is absolutely necessary. Outside of the hardest-hit metropolitan areas of the United States, many hospitals are experiencing a substantial reduction in bed occupancy. Florida, for example, has almost 40% bed availability — and, with it, a substantial reduction in income. And while the states and the federal government are likely to begin easing restrictions in some states in the foreseeable future, the impact of COVID-19 will be felt for a long time.

Many hospitals are subject to burdensome and overbearing state-mandated regulatory conditions. While those conditions may have been workable pre-COVID-19, hospitals are now finding those restrictions financially unmanageable. A health care insolvency wave is coming.

However, with insolvency comes the potential to shed those restrictive conditions through a bankruptcy sale. Under 11 U.S.C. § 363(f), a debtor, acting as a Chapter 11 debtor in possession, can sell property “free and clear of any interest in such property,” with the purchaser taking ownership of the property without the underlying encumbrances that plagued the seller. Courts have specifically applied this provision to the sale of hospitals. *See In re Verity Health Sys. of Cal., Inc.*, No. 2:18-bk-20151, 2019 WL 5585007 (Bankr. C.D. Cal. Oct. 23, 2019) (*Verity II*); *In re Gardens Reg’l Hosp. & Med. Ctr., Inc.*, 567 B.R. 820 (Bankr. C.D. Cal. 2017); *In re Verity Health Sys. of Cal., Inc.*, 598 B.R. 283 (Bankr. C.D. Cal. 2018) (*Verity I*).

In *Verity II*, four Los Angeles area hospitals were financially distressed due, in part, to regulatory conditions imposed by the California attorney general in 2015. The conditions varied from requirements to provide a minimum level of charitable work to requiring that emergency rooms remain open 24 hours a day. When Verity sought to sell the hospitals in 2019 to a third party through a section 363 bankruptcy sale, the California attorney general imposed regulatory conditions on the buyer similar to the conditions that had been attached to the hospitals since 2015 – the same conditions that had proven to be financially unsustainable. The bankruptcy court approved the sale without the attorney general’s conditions attached, which were “interests in property” that could be stripped under section 363(f). Without the burden of the attorney general’s regulatory conditions, the purchaser would have the chance to operate the facilities profitably and without the constant need to cut costs and services.

The ability to sell a hospital facility free of regulatory conditions could be the difference between financial impossibility and financial viability, and could dictate whether the doors remain open. Likewise, a section 363 sale may produce a buyer to purchase and take over hospital operations where one may not otherwise exist. Any hospital operator suffocating from the financial burdens of state regulatory conditions in this post-COVID-19 reality should consider the possibility of a bankruptcy sale, which may be the only way to ensure the community continues to have access to the patient care it needs.

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