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WHAT'S GOING ON IN DELAWARE?

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The United States Bankruptcy Court for the District of Delaware has recently been a "hot bed" for healthcare bankruptcy filings. FPA Medical Management, Inc., [1] Vencor, Inc., [2] Sun Healthcare Group, Inc., [3] Lenox Healthcare Group, Inc., [4] Mariner Health Group, Inc., [5] Mariner Post−Acute Network, Inc. [6] and Integrated Health Services, Inc., [7] among others, have all filed for bankruptcy protection in Delaware. This article attempts to provide an overview of each of these cases against the background of general bankruptcy filings that have occurred in Delaware.

The first major healthcare filing in Delaware was FPA Medical Management, Inc., filed in July of 1998. [8] FPA was a national physician practice management company affiliated with approximately 7,900 primary care physicians. [9] Those physicians provided services to approximately 1,416,000 enrollees of 53 health maintenance organizations. [10] FPA administered assets of approximately $1.01 billion (book value), with long−term liabilities of approximately $796 million.

FPA attributed its downfall to its rapid expansion. In particular, FPA's acquisition expenditures, associated transaction costs, and integration of management services all led it to seek bankruptcy protection. The FPA case was filed as a prenegotiated bankruptcy case. [11] At the time of filing, FPA believed it would emerge from bankruptcy within one year.

Prior to filing, FPA had an estimated value in excess of one billion dollars. By the time bankruptcy proceedings were completed, FPA was sold for about $80 million, with unsecured creditors likely to get only pennies on the dollar. FPA's plan was confirmed in May of 1999. [12]

FPA provided the first glimpse of some of the issues that the Delaware Bankruptcy Court will have to address in a large healthcare case. Many of the pleadings in the subsequent large healthcare cases filed in Delaware are modeled after the pleadings found in the FPA filing.

Of particular interest are the comments of The Honorable Peter J. Walsh, Chief United States Bankruptcy Judge for the District of Delaware, at the end of the confirmation hearing on FPA's plan of reorganization. In overruling the Commissioner of the Division of Corporations of the State of California's objection that FPA's plan violated California's healthcare law, Judge Walsh stated:

I am going to overrule this objection. My view of the law hasn't changed from the early days of this case, and, quite frankly, I think if I acceded to this objection the bankruptcy lawyers out there would start stoning me and this would turn the Bankruptcy Code on its ear. My personal view is, and this is for Congress, I think serious consideration should be given to removing from the Bankruptcy Code purview certain aspects [of] the healthcare industry because they are so heavily regulated on a state basis.

But that's for Congress. That's for another day. I am dealing with a statute that makes no exception for healthcare entities and to accede to the State of California's view I think would create a nightmare not just for this case but for the industry in general, although I would hope that at some point Congress would address this and perhaps remove from Bankruptcy Code coverage these types of entities and leave them to the healthcare regulatory federal and state agencies. So the objection is overruled. [13]

FPA was a case where the debtors walked into the confirmation hearing and essentially said, we are not going to be able to reorganize on a stand−alone basis, we have buyers for the assets, but the final terms of those transactions have not been negotiated. What ensued was a four−day confirmation hearing, which the parties essentially used to negotiate a deal. Following the hearing, the Court allowed the sale of the assets to occur pursuant to the plan of reorganization. In closing, Judge Walsh added, "[w]ithout a doubt, this is an unprecedented case in terms of complexity, verbosity, prolix verbiage, code entanglements, confusion and fluidity." [14]

What made FPA so complicated (which appears to be true of all mega−healthcare cases that have filed in Delaware) was the number of constituencies that were involved in the case. First in the food chain were the pre−petition banks, which for the most part also acted as the debtor−in−possession lenders. The banks had $300 million in secured pre−petition debt. Pursuant to the plan, the banks were paid $3 million and received a waiver of all claims by any party against them. Once the banks realized that FPA was not going to be able to reorganize, their primary concern became obtaining such a waiver. Although many other constituencies sought similar waivers, all but the banks eventually conceded the issue.

The banks' position was, of course, understandable. FPA at one point had been valued in excess of one billion dollars, had filed what was supposed to be a pre−negotiated case, owed the banks over $300 million and was now being sold for a nominal amount. If the banks were going to take a Michael Jordan style haircut from $300 million to $3 million, they wanted, in return, at least a waiver of any claims against them.

The other traditional constituencies were also present in the FPA case, such as the creditors' committee and non−healthcare regulators, as well as others, and each had its own agenda. There were also the layers of non−traditional constituencies, such as the "Payors." The Payors asserted large administrative claims for payments they believed the debtors had failed to make. Three major Payors existed: Humana, Inc., Prudential Insurance Company of America and Pacificare Health Systems, Inc. One of the Payors, Humana, purchased assets during the sale of the debtors' assets, while others, such as Prudential, walked away.

Other non−traditional constituencies included the federal and state healthcare regulators. Many of these regulators took the position that their rules and regulations trumped the Bankruptcy Code. In the end, the debtors either addressed their concerns or, as discussed above, [15] they were overruled as part of the sale process. Additional non−traditional constituencies included hospitals, clinics, doctors, healthcare provider staffs, patients and their related associations. Some of these constituencies were organized and well represented, while others were not. In the middle were the debtors who were trying to satisfy all the parties and negotiate a consensual plan.

In the end, the debtors were unable to obtain the financing to confirm a plan, while the debtors' professionals overcame the Herculean task of closing the sale of the debtors' assets during the confirmation hearing. The case is currently in the claims resolution stage.

The lessons learned from FPA are several. The major issue brought to light, as recognized by the Court, is the tension that exists between the need to provide healthcare in an effective and cost efficient manner and the need to regulate the provision of such healthcare. Accomplishing this will not be easy considering the many constituencies involved as well as the difficulties created by their differing agendas.

The mega−healthcare cases in Delaware that have followed FPA have been a mix of hospital and post acute care filings. The first one of note was Vencor, Inc., which, along with 128 subsidiaries, filed for bankruptcy in September of 1999. [16] The Vencor petitioners' operations consisted of 56 long−term acute hospitals and 293 skilled nursing centers. [17] The long−term acute hospitals contained about 4,800 licensed beds and the skilled nursing centers about 38,000 licensed beds. [18] Vencor has over 50,000 employees. [19]

The next mega−case to file in Delaware was Sun Healthcare Group, Inc. [20] Sun Healthcare, filed in October of 1999, [21] provides inpatient facilities, rehabilitation and respiratory therapy services, pharmaceutical and medical supply services, and non−debtor international services. [22] At filing, it owned, leased or managed approximately 370 long−term and sub−acute care facilities with 42,166 licensed beds in the United States. In addition, Sun Healthcare operated twenty−nine assisted living facilities at filing with 3,239 beds, employing over 56,000 persons.

Sun Healthcare attributed its filing mainly to the Balanced Budget Act of 1997 (the "Act"). [23] Under the Act, Congress made numerous changes to the reimbursement policies applicable to exempt hospital services, skilled nursing, therapy and other ancillary services. The Act provides for a phase−in of a prospective payment system (known as "PPS") for skilled nursing facilities over a four−year period. [24] The result of PPS is a fixed cost basis payment system used for services. Prior to the implementation of PPS, costs of services were reimbursed on a "pass through" basis. The impact of the Act and PPS on Sun Healthcare, as well as the other healthcare companies, was obviously devastating. At this time, Sun Healthcare has not outlined any specific plan for emerging from bankruptcy.

Before and after Sun Healthcare filed, it was the belief of many people in the healthcare industry that an increasing number of cases would be filed. The prevailing view, whether right or wrong, was that the Act had put each of the companies in the position of having to trim its debt to survive. Given the effect of the Act on healthcare companies, the stigma normally associated with a company filing for bankruptcy protection was not present. To the contrary, the industry not only anticipated each of the filings, but generally held the view that the filing was good for the company, rather than detrimental.

The next healthcare case to file in Delaware was Lenox Healthcare Group, Inc. [25] Lenox was smaller than the earlier cases discussed, as the company is privately held, while both Vencor and Sun Healthcare are large public companies. Lenox described itself on the first day of its filing as the third largest privately−held provider of long−term healthcare services in the United States, with 86 skilled nursing, hospital and assisted living facilities employing 6,000 people.

Following Lenox, the next case to file was Mariner. [26] Mariner's filing presented a new twist: two separately administered sets of debtor entities. One set is known as the Mariner Post−Acute Network, Inc. case (the "MPAN case"), which consists of 87 debtors. [27] The other set is the Mariner Health Group, Inc. case (the "Mariner Health case"), consisting of 102 debtors. [28]

The Mariner Health case debtors are part of an affiliated group of corporations of which the ultimate parent is Mariner Post−Acute Network, Inc. The Mariner Health case and MPAN case are not being jointly administered due to the dual capital structure of the debtors present in the Mariner Health and the MPAN cases, as each set of debtors has its own separate pre−petition senior secured lending facilities and separate issues of senior subordinated debentures, as well as separate post−petition debtor−in−possession financing.

The Mariner companies are among the largest providers of long−term care and institutional pharmacy services in the United States. [29] As of November 30, 1999, Mariner, as a whole, operated 406 long−term care facilities, including skilled nursing and assisted−living facilities, with approximately 49,000 licensed beds. [30] Mariner has approximately 54,000 employees. [31] Mariner, like Sun Healthcare and Lenox is not a pre−negotiated case. Mariner is in the early stages of its case and what direction it will take is still not clear.

The latest mega−healthcare case to file in Delaware is Integrated Health Services, Inc., which filed in February of 2000. [32] Integrated's principal businesses are skilled nursing and sub−acute care facilities, contract rehabilitation and other contract services and home respiratory services. Integrated is publicly traded, with over 1,450 service locations in 47 states and the District of Columbia. At the time of filing, it had assets of approximately $3.6 billion and liabilities of $4.1 billion. Integrated operates 377 geriatric care facilities and 17 specialty hospitals, with approximately 46,000 licensed beds, and has in excess of 65,000 employees. Integrated was not a pre−negotiated filing and the company has not indicated how it intends to reorganize

Although most of the post−FPA cases are in their early stages, some important issues common to mega−bankruptcy cases have arisen, such as relief from stay [33] and utility payments. [34] In addition, issues more unique to bankruptcy cases have arisen, such as payors' rights of recoupment and setoff. [35]

In that regard, Judge Walrath of the United States Bankruptcy Court of the District of Delaware has established the "Lenox payor order" as the norm for what she will consider on the first day. In fact, in Mariner, a payor order was presented at the beginning of the first day hearing. Judge Walrath indicated that she would not sign the order unless it was consistent with the one she signed in the Lenox case. By the end of the hearing, the Mariner debtors presented an order to the Court substantially similar to the one found in the Lenox case, which was subsequently signed by Judge Walrath. In the Integrated case, the debtors handed up a payor order and informed the Court it was similar, if not identical, to the "Lenox Order," after which it was also approved.

Are there more healthcare filings on the horizon? The prevailing view is yes. When examining the reasons for such an increase, many have argued that healthcare companies who have not filed are not going to be able to compete. Like the companies in bankruptcy, most will need to file in order to trim their debt to respond to the Act's impact on revenues. In other words, one must restructure its debt and operations to compete with the companies who have filed for bankruptcy protection and are already restructuring.

This year Congress has given some relief from the impact of the Act and PPS. [36] Specifically, some payments have been increased (the Part A payments) in certain respects and the cap on certain services (the Part B cap) will be lifted to allow more revenue. Many of the companies currently in bankruptcy had built these possible changes into their forecasts and, subsequently, while they provide some relief, they will not cure the healthcare companies' woes. However, these changes, together with the balance sheet relief available to the healthcare companies through chapter 11, give reason for optimism about the future of the industry.

It will be interesting to see how these large cases in the same industry, all but one before the same Bankruptcy Judge, will play out. [37] Presently, it is hard to tell where these cases will end up, as most are in their early stages. All are large cases, with many constituencies and many complex issues. As Chief Judge Walsh suggested, these are not easy cases.

FOOTNOTES:

[*] The authors acknowledge and appreciate the assistance of Michael G. Busenkell, Esquire and Elaine J. McFarlane in the preparation of this article. Back To Text

[1] FPA Med. Management, Inc., Case No. 98−1596 (PJW) (July 19, 1998). Back To Text

[2] Vencor, Inc., Case No. 99−3199 (MFW) (September 13, 1999). Back To Text

[3] Sun Healthcare Group, Inc., Case No. 99−3657 (MFW) (October 14, 1999). Back To Text

[4] Lenox Healthcare Group, Inc., Case No. 99−4022 (MFW) (November 3, 1999). Back To Text

[5] Mariner Health Group, Inc., Case No. 00−00215 (MFW) (January 18, 2000). Back To Text

[6] Mariner Post−Acute Network, Inc., Case No. 00−00113 (MFW) (January 18, 2000). Back To Text

[7] Integrated Health Services, Inc., Case No. 00−00389 (MFW) (February 2, 2000). Back To Text

[8] FPA Med. Management, Inc., Case No, 98−1596 (PJW) (July 19, 1998). Back To Text

[9] FPA Med. Management, Inc., The Bankruptcy DataSource Plans of Reorganization 7/15/99 1999 WL 714166 (N.G.R.). Back To Text

10

Id. Back To Text

[11] FPA's president's first day affidavit stated that "[t]he Company commenced these Chapter 11 cases to implement the prenegotiated Plan of Reorganization, complete the consolidation and restructuring of the Company's business units and restructure their credit facilities . . . ." Back To Text

[12] FPA Med. Management, Inc., The Bankruptcy DataSource News Notes 6/15/99, 1999 WL 713904 (N.G.R.). Back To Text

[13] FPA Med. Management, Inc., Case No. 98−1596 (PJW) (May 26, 1998), Transcript of Hearing, pp. 70 − 71. Back To Text

[14] Id.

at 135. Back To Text

[15] See

supra note 13 and accompanying text. Back To Text

[16] Vencor Inc., Case No. 99−3199 (MFW) (September 13, 1999). Back To Text

[17] Vencor Inc., The Bankruptcy DataSource Datapage 9/15/99, 1999 WL 812230 (N.G.R.). Back To Text

[18]

Id. Back To Text

[19]

Id. Back To Text

[20] Sun Healthcare Group, Inc., Case No. 99−3657 (MFW) (October 14, 1999). Back To Text

[21]

Id. Back To Text

[22] Sun Healthcare Group, Inc., The Bankruptcy DataSource Datapage 10/15/99, 1999 WL 1315317 (N.G.R.). Back To Text

[23] Balanced Budget Act of 1997, Pub. L. No. 105−33, § 4714, 111 Stat. 251 (Aug. 5, 1997). Back To Text

[24] See

Greater Dallas Home Care Alliance v. Shalala, No. 3:98−CV−0768−H1998 U.S. Dist. LEXIS 18134, at *7 (N.D. Tex. June 8, 1998) (stating Home Healthcare Agencies will receive predetermined levels of reimbursement based on each patient's needs); *see also* Morris v. North Hawaii Community Hosp. & Adventist Health, 37 F. Supp.2d 1181, 1183 (D. Haw. 1999) (noting that PPS allows providers to ultimately share in savings to extent they keep their costs below prescribed amount). Back To Text

[25] Lenox Healthcare Group, Inc., Case No. 99−4022 (MFW) (November 3, 1999). Back To Text

[26] Mariner Health Group Inc., Case No. 00−00215 (MFW) (January 18, 2000). Back To Text

[27] Mariner Post−Acute Network, Inc., The Bankruptcy DataSource DataPage 1/15/00, 2000 WL 178131 (N.G.R.). Back To Text

[28]

Id. Back To Text

[29] Mariner Health Group, Inc., The Bankruptcy DataSource DataPage 10/15/99, 1999 WL 1315313 (N.G.R.). Back To Text

[30]

Id. Back To Text

[31]

Id. Back To Text

[32] Integrated Health Servs., Inc., Case No. 00−00389 (MFW) (February 2, 2000). Back To Text

[33] See

11 U.S.C. § 362(d) (1994) (providing methods by which creditor can obtain relief from stay). Back To Text

[34] See

11 U.S.C. § 366 (1994) (stating that utility may not alter, refuse, or discontinue service to debtor unless debtor gives adequate assurance of payment [i.e. deposit or other security] within 20 days after date of order for relief). Back To Text

[35] See

11 U.S.C. § 362(a)(7) (1994) (providing automatic stay against setoff of any pre−petition debt owing to debtor against debtor)*; see also In re* Sun Healthcare Group, Inc., 2000 Bankr. LEXIS 208, at *17−22, 28 No. 99−3657 (MFW) (February 25, 2000) (denying motion of twelve Medicaid agencies to vacate order prohibiting certain payors from recouping payments owed to debtors against any pre−petition claims). Back To Text

[36] S. Rep. No. 106−199 (1999) (noting increases over earlier years). Back To Text

[37] The FPA case had been assigned to Chief Judge Walsh but Vencor has been assigned to the other District of Delaware Bankruptcy Court Judge, The Honorable Mary F. Walrath. Sun Healthcare was also assigned to Judge Walrath, as have all subsequent mega−healthcare cases, Lenox, Mariner and Integrated. Back To Text