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Tenn. Hospital Bankruptcy May Be The First Of Many

By **James Lagios, Robert Iseman and Stuart Gordon** (April 15, 2020, 5:16 PM EDT)

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The coronavirus hit the U.S. at a precarious time for our nation's hospitals, which in recent years have already been struggling to confront dynamic changes in the health care industry. This month has seen a Tennessee-based hospital system file for bankruptcy.

American hospitals have long relied on revenue streams from profitable medical and surgical services to support mandated safety net services to the uninsured. Recent technological developments in medicine have allowed many high-margin medical services to be delivered in nonhospital settings, leaving hospitals to chase after those disappearing revenue streams through horizontal and vertical merger and acquisition strategies, while still being saddled with their safety net obligations.

At the same time, trends in the payor industry have moved towards requiring hospital systems to assume financial risk by taking contractual responsibility to meet the medical needs of their local populations.

Meanwhile, regulators have been encouraging hospitals to reduce operating costs by shedding excess capacity and eliminating redundancies in the market, while other regulators warn that rationalizing service may create antitrust liability.

Ironically, the 2021 budget recently adopted by the New York state Legislature, which was largely developed before the coronavirus pandemic arrived in New York state, contemplates $400 million in cuts to hospital Medicaid payments.

Thus, the pre-COVID-19 economic environment for hospitals in New York state is among the most financially challenging anywhere. New York hospitals have operated (and continue to operate) on some of the narrowest financial margins in the country. In fact, many have negative operating margins and rely on nonoperating revenue sources to make ends meet.

In this challenging economic setting, the coronavirus hitting New York state so heavily has created a perfect financial storm. To clear their decks for the anticipated onslaught of patients suffering from COVID-19, hospitals are forced to delay nearly all elective procedures upon which they depend for revenues based on their profitability. Hospital census counts have dropped dramatically, and at the same time hospitals have incurred enormous expenses to ramp up for the expected deluge of coronavirus patients. This has created a perilous financial predicament.

Hospital systems around the country are not immune from the same financial challenges being experienced in New York. On April 7, Quorum Health Corp., a publicly held chain of 24 hospitals and outpatient facilities based in Brentwood, Tennessee, commenced a bankruptcy proceeding in the U.S. Bankruptcy Court for the District of Delaware.[1]

Bloomberg reports that Quorum had been struggling with many of the same challenges discussed above. As recently as December 2019, it had been considering an out-of-court recapitalization with an investor group that would have paid $1 per share to stockholders.[2] That deal, however, fell through, and the advent of the coronavirus left the system with no choice but to restructure through bankruptcy.

The bankruptcy court will hold an expedited hearing to get the reorganization process started, known as a first-day hearing. The motions being heard at the Quorum first-day hearing indicate that the system is entering bankruptcy with a restructuring support agreement in place which provides for a prepackaged plan of reorganization that would reduce the system's debt by $500 million, with bondholders expected to receive most of the equity in the reorganized system.

The Bankruptcy Code provides powerful mechanisms for large hospital systems to address serious financial problems and restructure their finances. In addition to reducing existing debt, Quorum's proposed plan of reorganization also contemplates an additional new equity infusion of $200 million, coming from certain existing creditors. The system will also finance its reorganization-related expenses and operations as a debtor-in-possession with a new $100 million debtor-in-possession credit facility entitled to superpriority over certain other creditor claims.

The Bankruptcy Code also provides numerous other tools to allow hospital systems to restructure their operations and shed money-losing divisions. Quorum has announced that each of its hospitals will remain open to provide critically needed care for their patients, and to confront the challenges presented by the coronavirus.

Many other hospital systems, however, may be operating under failed business plans and could benefit from the Bankruptcy Code's tools to shed assets that are no longer needed in the enterprise, or to escape economically inefficient contractual relationships. At the same time, the sale of assets may present opportunities for other players in the health care industry to expand the scope of their enterprises.

When bankruptcies become prevalent on an industrywide basis, they can have a ripple effect on ancillary businesses that support the industry. In the health care space, a string of bankruptcies could have a widespread impact on contractual relationships between hospital systems and pharmaceutical companies, medical equipment manufacturers, third-party payors, real estate concerns and labor, to name just a few.

It is too early to tell whether the Quorum filing is the first of many bankruptcy proceedings to follow, or an isolated case of a financially weak system simply succumbing to the pressures of prior failed business plans. In addition, the severity of the problem may require industry-wide governmental action.

In New York, where there are no proprietary hospitals (at least none that are investor owned, such as

Quorum in Tennessee), there is a potential problem with large tax-exempt financings that have supported the capital needs of New York hospitals for many years. Default on these financings would be very serious.

The Coronavirus Aid, Relief and Economic Security Act includes a substantial cash infusion for our health care system.[3] The Department of Health and Human Services is presently distributing to hospitals the first $30 billion of a total of $100 billion to help defray the costs of treating COVID-19 patients.[4] But significant additional capital will likely be required to restore our hospital system to a sound financial footing after the pandemic abates.

Given its extraordinary financial impact on our economy, the coronavirus pandemic should be a catalyst for significant structural changes in the American health care industry, particularly with respect to our struggling hospitals.

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[1] Case # 20-10766, Hon. Karen B. Owens.

[2] Jeremy Hill, Quorum Hospital Chain Seeks Bankruptcy Amid Covid Onslaught, Bloomberg Law, Health and Business News, April 7, 2020.

[3] Coronavirus Aid, Relief, and Economic Security Act, Public Law 116–136S. Division D, Title I.

[4] Jacquie Lee, HHS Rolls Out Initial $30 Billion for Hospitals From CARES Act, Bloomberg Law, Health & Business News, April 10, 2020.