

Chapter 9: A Tool for Ailing Healthcare Districts

By Sandy Haskins

*Managing Director, Executive Search and Interim Management
HFS Consultants*



Healthcare districts, like many quasi-government organizations, continue to face serious financial challenges that have resulted in hospital closures, affiliation with other entities, or a downsizing from a full-service facility to a strictly outpatient focused organization. Some of the “red flags” of potential serious financial distress include: failure to meet debt coverage covenants; late or limited financial statements; large swings in contractual allowances and bad debts; the need for accelerated property tax receipts; declining days of cash on hand, along with

large increases in accounts payable.

Sometimes, despite the “red flags, filing for protection under the federal bankruptcy section Chapter 9 may be the only way to buy the time to avoid financial ruin. Chapter 9 often has a very negative connotation. In reality, however, it is useful for a health care district to think of it as merely a tool, or a “timeout,” to afford time to implement cost efficiencies, revenue improvement initiatives, affiliation with another organization, or a combination of these efforts. This is often done when attempts to negotiate terms with vendors have been unsuccessful. Chapter 9 may also provide an opportunity to keep or reject contracts, preferably with the advice of legal counsel.

Use Chapter 9 To Gain Time

Chapter 9 should not be viewed as a solution, but merely a way to gain time to pursue plans to make the organization viable. There are several districts across California that have filed for protection under Chapter 9, some more than once,

and there are some that have exited bankruptcy with a district that successfully continues to meet the health needs of its community.

The provisions of Chapter 9 look very complex to a layperson and it is quite important that an organization contemplating such a step have the advice of an experienced bankruptcy counsel. It is also helpful, particularly for district boards and management, to have the perspectives of senior executives, especially CEOs and CFOs who have previously been through the process.

Considerations Prior to Chapter 9 Filing

In addition, educational initiatives for governance, leadership, and the community should be undertaken in advance of any Chapter 9 filing.

Key considerations in the educational process include:

- A working understanding of the Chapter 9 process
- Consideration of alternatives

- Development of a “survival” strategy that considers operational improvement opportunities
- Communication plans for district stakeholders (community, physicians, staff)
- Key operational requirements of the filing e.g. requirement to remain current on obligations incurred after filing, so called “post petition” debt
- The treatment of employees as unsecured general creditors under Chapter 9
- Possible requirement of the Court to engage an ombudsperson during the course of the bankruptcy proceeding.
- An estimate of the professional fees and other costs related to the filing

There are additional issues to consider beyond those listed above. The key message to remember is that Chapter 9 is not a solution in itself. It should be considered as the “time out” to help the organization take other steps, strategic and operational, as part of its effort to continue to operate the hospital to the benefit of the community.

Case Study: Chapter 9 Provides Hospital With Life Support

One example of a District Hospital

that used Chapter 9 as a strategic tool to allow it to survive and thrive is that of Sierra Kings District Hospital (Sierra Kings) in Reedley, California.

The hospital found itself on “life support” in the autumn of 2009. The 49-bed facility was faced with possible closure as operating losses and negative cash flows had taken their toll. It was having difficulty obtaining supplies and other resources as many vendors put it on a “cash only” basis.

In October 2009, Sierra Kings filed for bankruptcy under Chapter 9. Obligations to creditors totaled more than \$4 million while cash reserves were less than \$1 million. The Chapter 9 filing bought the District valuable time as it looked at the combination of cost and revenue enhancement alternatives together with an affiliation strategy to keep the hospital afloat.

The governing board engaged HFS Consultants, which provided interim CEO and CFO services and Walter & Wilhelm Law Group, a well-known bankruptcy counsel in Fresno. The team of Riley Walter and HFS’s Sandy Haskins, along with general counsel Michael Goldring, guided the District through a two-year process that led to the hospital

being financially viable today.

The team developed a financial plan, which, together with an affiliation with Adventist Health Central Valley Network, provided the resources that have resulted in the District being able to meet the financial goals set out in its bankruptcy Plan of Adjustment. This has resulted in payments over the past three years in accordance with the Plan. In January 2016, the District will make the final installment to the unsecured general creditors. At that time, every creditor claim allowed by the court will have been paid in full at 100 cents on the dollar.

This is an example where Chapter 9 was used as means to an end, which together with other “survival” strategies has preserved the hospital.

Sandy Haskins is managing director of HFS’s Executive Search and Interim Management practice area. He has over 35 years in the healthcare industry, and has extensive healthcare executive experience, both as an interim hospital CEO and in recruiting CEOs, CFOs, and other senior leadership positions for hospitals and healthcare organizations. Sandy can be contacted at: sandyh@hfsconsultants.com

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