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Health Care Law

HIPAA's Potential Impact on Bankruptcy Sales

Respect patient privacy during reorganization of a health-care business

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In recent years, Chapter 11 has increasingly become a merger-and-acquisition practice. Debtors regularly "reorganize" by selling some (e.g., Nortel, Lehman Brothers) or all (e.g., Chrysler, GM) of their business. The health-care industry is not exempt from this trend. Sound Shore Medical Center filed its Chapter 11 bankruptcy case intending a sale of its business and assets to Montefiore Health System—a sale that closed last fall. Similarly, St. Francis Hospital of Poughkeepsie, N.Y., filed its Chapter 11 bankruptcy petition on Dec. 17, 2013, with the stated goal of selling its business and assets to Health Quest Systems (which owns Vassar Brothers Hospital in Poughkeepsie) or the bidder making the highest and best offer.

The sale of so-called "covered entities" that are subject to the Health Insurance Portability and Accountability Act (HIPAA) and the HIPAA Privacy Rule (45 CFR §§ 164.500, et. seq.), particularly health-care providers like hospitals, necessarily includes the sale or transfer of the protected health information (PHI) of patients to the purchaser. However, the HIPAA Privacy Rule generally conditions the sale of PHI on the prior written authorization of each affected patient (or the patient's personal representative). 45 CFR § 164.508(a)(4). Obviously, a blanket application of the HIPAA Privacy Rule to the sale of a covered entity, or even a part thereof, would effectively preclude such sales. Obtaining authorizations from all of a covered entity's patients—or even the patients of only a division of the covered entity—would be impossible, particularly because HIPAA's protection of PHI extends for 50 years after the patient's death. See 45 CFR § 164.502(f).

To facilitate the sales of covered entities, the HIPAA Privacy Rule excludes from the definition of "sale" the disclosure of PHI "[f]or the sale, transfer, merger, or consolidation of all or part *of a covered entity* and for related due diligence as described in… the definition *health-care operations*" contained in the HIPAA Privacy Rule. 45 CFR § 164.502(a)(5)(ii)(A)(2)(iv) (emphasis added).

For purposes of the HIPAA Privacy Rule, "health-care operations" include "[t]he sale, transfer, merger or consolidation of all or part of the covered entity *with another covered entity, or with an entity that following such activity will become a covered entity* and the due diligence related to such activity." 45 CFR 164.501 (paragraph (6)(iv) of the definition of "health-care operations").

In sum, the HIPAA Privacy Rule expressly facilitates the sale of all or a part of a covered entity (but not a pure asset sale) to either another covered entity or an entity that will become a covered entity following the sale. It follows that the HIPAA Privacy Rule thereby facilitates "reorganizations" by sale. A recent case, however, suggests that the HIPAA Privacy Rule may not facilitate sales of all or a portion of the debtor's business or assets in business reorganization cases.

Laboratory Partners, a clinical laboratory network with operations in eight states and several subsidiaries (collectively, "MedLab"), filed Chapter 11 petitions with the United States Bankruptcy Court for the District of Delaware in Case No. 13-12769-PJW, on Oct. 25, 2013. MedLab provides clinical laboratory and anatomic pathology services to: (i) a number of skilled nursing facilities (Long-Term Care Division); (ii) physicians, physician offices and medical groups; and (iii) Union Hospital in Terre Haute and Clinton, Ind. As health-care providers that billed Medicare electronically, some or all of the MedLab debtors con-

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stitute "covered entities" under HIPAA and the HIPAA Privacy Rule. See the definition of "covered entity" contained in 45 CFR § 160.403. Consistent with the trend in bankruptcy cases, MedLab has proposed to "reorganize," in part, by selling, inter alia, the Long-Term Care Division. To that end, on Oct. 30, 2013, MedLab filed a motion for authority to, inter alia, sell the Long-Term Care Division. In its sale motion, MedLab acknowledged that, although several potential buyers had expressed interest in purchasing the Long-Term Care Division, none of them agreed to be a stalking horse bidder. In sum, the sale motion does not identify a specific purchaser of the Long-Term Care Division.

The proposed form of asset purchase agreement, attached as Exhibit B to the sale motion, provides for the sale of, inter alia, "all customer lists, machinery and equipment records, mailing lists, quality control records and procedures, employment and personnel records…and display materials" related to the Long-Term Care Division. It is beyond dispute that the customer lists (as well as some of the other assets listed) include PHI.

On Dec. 18, 2013, the United States Department of Health and Human Services (HHS) filed a protective objection to MedLab's motion for sale. HHS objects to what it characterizes as "an authorized sale of their customer's [PHI] that violates federal law." HHS specifically objects to the sale of customer lists which, according to HHS, "almost certainly contain [PHI]." HHS surmises that MedLab had not obtained authorizations from all patients of the Long-Term Care Division before filing the sale motion. HHS's primary concern arises out of MedLab's failure to identify a purchaser of the Long-Term Care Division. HHS acknowledges that if the Long-Term Care Division is sold to a covered entity, HIPAA and the HIPAA Privacy Rule likely permits the sale of the customer lists. Absent being able to identify a purchaser, MedLab could not, as of Dec. 18, 2013, provide HHS the assurance it sought that the purchaser of the Long-Term Care Division would be a covered entity, although it appears unlikely that an entity that is not a covered entity would purchase the division.

The hearing on the sale of the Long-Term Care Division has been continued without a date, although hearings on the sales of other MedLab business units are scheduled for this month. Nevertheless, HHS's objection to the sale of the Long-Term Care Division raises questions concerning the potential impact of HIPAA and the HIPAA Privacy Rule on bankruptcy sales. The provisions of the Privacy Rule, including the provisions governing sales, are complex. They lend themselves to careful parsing by creative counsel. In that regard, HHS's interpretation of the sale provisions of the Privacy Rule seems to require an identified stalking horse bidder that is or will become a covered entity as a result of the purchase of all or a portion of a debtor "covered entity." Such an interpretation would, for example, effectively preclude straight auction sales of all or a portion of a covered entity in bankruptcy.

The crucial goals of HIPAA and the Privacy Rule, however, can be achieved without resorting to a hyperliteral reading of the definition of "sale" in the Privacy Rule. Debtors or trustees should simply include in the bidding procedures for the sale a requirement that the bidder either be a covered entity or become one as a result of the sale. Objections should be lodged to bidding procedures that do not contain such a requirement. In that way, bankruptcy can remain a useful tool for transferring a health-care business to more viable owners and the crucial policies underlying HIPAA and the Privacy Rule can be effectuated. ■