The Healthcare Restructuring Epidemic – Containing the Spread and Capitalizing on the Remains

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Rachael Smiley has advised businesses and public institutions in variety of transactions and disputes since 2008. Rachael currently practices commercial bankruptcy and business reorganization law at The Law Offices of Judith W. Ross in Dallas, Texas. From 2014-2017, she served as Manager of the Office of Contracts Management at UT Southwestern Medical Center, negotiating agreements on behalf of the University and its Hospitals. She received her J.D., cum laude, from Southern Methodist University in 2008, and her B.A., magna cum laude, from Texas Christian University in 1999. Ms. Smiley is also a Certified Texas Contact Manager (CTCM).
What defines a distressed situation?

“Vicious cycle”

- Reduced Receivables (from Customers/Patients)
- Price Pressure (from competitors or payors)
- Lender Pressure (makes borrowing difficult)
- Vendors Pressure (COD or discontinuation of service)
Why do distressed situations happened in the healthcare industry?

• Changes in provider pay structure
• Expansion/contraction of coverage availability to patients
• Payor efforts to limit obligations to pay for services
• Increased scrutiny by government oversight agencies (OIG and DOJ)
• Provider consolidation (mergers)
• Administrative burdens associated with compliance
• Increased patient demand for service (aging population)
• Litigation
• Uncertainties regarding the legal environment and marketplace
Why do distressed situations happened in the healthcare industry?

<table>
<thead>
<tr>
<th>CAUSES BY CATEGORY</th>
<th>PERCENTAGE OF INDEX COMPANIES CITING CAUSE²</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tort Litigation</td>
<td>24.10%</td>
</tr>
<tr>
<td>Payment Delay</td>
<td>21.69%</td>
</tr>
<tr>
<td>Bad Merger/Overexpansion</td>
<td>20.48%</td>
</tr>
<tr>
<td>Labor/Employee Litigation</td>
<td>20.48%</td>
</tr>
<tr>
<td>Management Issues</td>
<td>20.48%</td>
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<tr>
<td>Reimbursement Changes</td>
<td>20.48%</td>
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What is bankruptcy?

• Chapter 11 versus Chapter 7
• Purposes of bankruptcy
  • Obtain breathing room
  • Increased leverage with creditors – ability to get them to come to the table
  • Reorganize or liquidate the business in an orderly fashion
Alternatives to bankruptcy:

• State law proceedings
• Out-of-court restructurings (a “workout”)
• Only bankruptcy gives the debtor certain powers and leverage over its creditors that it otherwise does not have access to
What happens when the bankruptcy case is commenced:

- Petition – voluntary and involuntary
- Property of the estate
- “Bag of Goodies”
What’s in the “Bag of Goodies”?

1. Automatic Stay
2. Executory Contracts and Unexpired Leases
3. Avoidance of transfers
4. Asset sales
What’s in the “Bag of Goodies”?

- Automatic Stay
  - Automatic injunction that stays all:
    - Debt collection
    - Pending lawsuits
    - Creation, perfection, or enforcement of liens
  - Note – the stay does not apply to criminal proceedings, government regulatory actions, or the ability of the Secretary of HHS to exclude the debtor from participating in Medicare and other Federal health care programs
What’s in the “Bag of Goodies”? 

- Executory Contracts and Unexpired Leases
  - Contracts on which performance is still due from both parties
  - Debtor can assume (& assign) or reject
  - Examples:
    - Equipment leases
    - Real property leases
    - Employment agreements
    - Provider Agreements
    - Package Agreements (ex: equipment lease, maintenance agreement and software license)
  - Parties are obligated to continue performing during the bankruptcy
  - Can the Debtor be forced to assume or reject?
    - No – but it has a deadline to make a decision
What’s in the “Bag of Goodies”?

Avoid transfers:
- Preferences
- Fraudulent conveyances
What’s in the “Bag of Goodies”?

▪ Sell assets
  • Free and clear of claims and interests
  • Expeditious and inexpensive
  • Special considerations for healthcare asset sales in bankruptcy:
    o Assumption and assignment of certain contracts
    o Successor liability
    o Medicare and Medicaid reimbursement
    o Licensing and regulatory requirements
    o Non-profit organizations
    o Antitrust
Claims – secured and unsecured:

- Claimants file proofs of claim, which are prima facie valid

- In Chapter 11, claimants do not need to file if the claim is listed on the debtor’s schedules, and it is not in dispute
Constituencies in a Bankruptcy Case:

- Secured creditors
- Government regulators
- Unsecured creditors – official and unofficial committees
  - Trade creditors
  - Retirees
  - Patients/residents
What happens to Employees?

- “Don’t take away the toys in the first two weeks”
- File employee wage motion for payment of prepetition wages
- Key Employee Retention Plans (KERPS)
  - Limitations on retention incentives and severance payments
- Closings or mass layoffs
  - WARN Act – 100 or more employees
Plan of Liquidation or Reorganization – Chapter 11:

- Creditors are classified with similar claimants to receive treatment under the Plan
- Creditors vote on the Plan
  - Class Acceptance (2/3 in amount, more than ½ in number)
  - “Unimpaired” creditors are deemed to have accepted
- Plan Confirmation
  - If plan has been accepted by creditors and meets other legal requirements, it will be confirmed
  - Plan operates as a contract and a court order
    - Discharges the debtor’s prepetition debts
    - Makes the debtor accountable for performing obligations under the plan
  - Treatment of equity holders – cannot keep their ownership in the entity unless all creditors are paid in full, or they put in new value
Liquidation: Chapter 7

Chapter 7 Trustee:
• Liquidates assets
• Administers and pays claims
• Brings any litigation on behalf of the estate
Bankruptcy issues specific to the healthcare industry:

1. Eligibility
2. Patient Care Ombudsman
3. Medicare and Medicaid issues
4. Secured Lenders – healthcare receivables financing
5. CCRCs – Continuing Care Retirement Communities
Eligibility:  

Eligibility – is the entity a “domestic insurance company” or a municipality under the Bankruptcy Code?  

Non-profits are eligible, but not for having an involuntary petition filed against them.
Patient Care Ombudsman ("PCO"):  
- "Health Care Business" defined under the Bankruptcy Code  
- Court must appoint PCO to "monitor the quality of care and represent the interests of patients", unless the court finds the appointment is not necessary  
  - How the court determines whether a PCO is necessary?  
    - Cause of the bankruptcy  
    - Presence of licensing or supervising entities  
    - Cost  
    - Other issues  
- PCO must comply with HIPPA, but may also seek court authority for access to patient records  
- Must make reports to the court every 60 days  
- Compensated as an estate professional
Medicare and Medicaid Issues:

- Setoff and recoupment
- Reimbursement of post-sale expenses
Secured Lenders: Healthcare receivables financing

- Right to post-petition interest and fees
- Floating lien limitations
- Adequate protection
- Cash collateral
- Plan treatment
- Rights vis-à-vis government payors
CCRCs – Continuing Care Retirement Communities

- Resident contract types allow for varying access to stepped-up levels of care without additional cost (from IL to AL or SNF)
- Housing market affects ability to attract new residents (ability to pay entrance fee)
  - What if entrance fees are the main source of operating revenue?
- Entrance fee refundability
- Aging cohort of residents = increased cost of care (without ability to increase fees for care)
- Need to attract new residents while undergoing restructuring
Recent Healthcare Filings in North Texas/DFW:

- Adeptus Health
- Walnut Hill Medical Center
- Preferred Care
Adeptus Health

- Publicly-held, for-profit owner of 5 hospitals and 100+ freestanding emergency rooms in several states based in Lewisville, TX
- Filed for Chapter 11 in April 2017
- Had to offer refunds to patients who initiated a class-action lawsuit over facility fees
- Prominent issues with RCM provider and crisis communications management
- Successfully emerged from bankruptcy in September 2017, now privately-held
Walnut Hill Medical Center

- Independent, physician-investor-owned full-service upscale hospital located in Dallas
  - But able to accept Medicare and Medicaid patients because physicians did not have a direct financial relationship with the hospital
- Opened in April 2014. Abruptly filed for Chapter 7 in June 2017
- Opened underfunded and expended too much during startup
- Bank ceased to provide operating capital in May 2017, and facility was unable to find a buyer
- Lacked the patient volume and resources of a system-owned hospital that would have potentially allowed it cover its costs
Preferred Care

- Owner of over 100 skilled nursing, assisted-living and independent living facilities in 12 states, based Plano, TX
- Privately held
- Filed for Chapter 11 in November 2017
- Over 163 pending personal injury lawsuits, and a $28 million verdict
- Was the 12th largest nursing facility company in 2016, based on total operating revenue
Benefits of going through the restructuring process:

- Right-size the business to the current market and legal environment
- Do away with burdensome contracts and leases
- Create new opportunities for value
- Orderly and equitable liquidation of a business that cannot be saved
- Avoid adverse effects on vulnerable patients

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The fate of Valley Springs Manor:
Avoiding harm to vulnerable patients

A cook and a janitor who stood by residents of an assisted living facility when the state failed to, recently opened up again about their lifesaving roles in the ordeal.

In October 2013, the California Department of Social Services (DSS) closed the Valley Springs Manor Residential Care Facility for the Elderly for a number of violations, ABC 7 reported. The elderlty residents of the Castro Valley facility were supposed to have been relocated, but about 16 of them — some of whom were confined to their beds — were left behind to fend for themselves, according to an NPR report.

The department’s Community Care Licensing Division (CCL) served the suspension order on October 21, according to a statement released by the organization. But when it couldn’t place all of the occupants by the end of the month, the department decided that the unoccupied facility could still function for several

Questions???

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