2024 Complex Financial Restructuring Program

American Bankruptcy Institute

Case Study

First-Day Issues

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The Art of Restructuring

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Real Estate Issues in Senior Care Restructurings

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Confirmation Issues: How Do We Exit Gracefully?

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2024

Background Information

October-November 2023

Rivers Senior Living Downtown, Inc. ("Downtown”)

- Continuing care retirement community (“CCRC”) located near historic Fountain Square in downtown Indianapolis, IN.
- High-end, “resort” living with top-level health care and support services for seniors aged 62 and up.
- Includes 143 independent living units, 44 assisted living apartments, 22-room memory care facility, and a 70-unit skilled nursing facility.
- Organized as a nonprofit nonstock corporation.
- **RSL Foundation** is owner and sole member. Appoints board overseeing company.

RSL Foundation

- Qualified non-profit entity formed and controlled by James Rivers (“JR”) and family for purposes of owning and operating six RSL-brand CCRCs, including Downtown.
- Appoints the board of directors running each property.
- Each RSL-branded property is in trendy neighborhoods of thriving, wealthy midwestern cities.

RSL Senior Living, Inc. ("RSL Main")

- Delaware corporation founded in 2010 by James Rivers.
- Focused on serving the retirement and elder care needs of the top 1% of aging baby-boomers in Midwestern cities.
- Built the six RSL-branded CCRCs, including Downtown, using locally sourced municipal financing.
- Properties managed by **RSL Management**, a wholly owned subsidiary of RSL Main.
- RSL Management charges monthly service fee of 6% of Downtown revenue, plus coverage of executive salaries and other management costs.

RSL Downtown Balance Sheet (9/30/2023)

ASSETS	2019	2018
Cash and cash equivalents	$ 238,343	$ 535,476
Accounts receivable	341,541	349,890
Entrance fees receivable	967,183	990,827
Inventory	21,081	21,597
Prepaid expenses	96,744	99,109
Resident deposits	68,308	69,978
Buildings, land, property, and equipment, net	56,365,150	58,153,233
Investments	4,220	1,456,769
Assets limited as to use	12,938,907	13,255,211
Contract acquisition costs -- net	3,049,027	3,836,321
Total assets	$ 74,090,505	$ 78,768,412

LIABILITIES AND NET DEFICIT	2019	2018
Accounts payable -- trade	$ 210,430	$ 168,242
Accounts payable -- related party	1,802,499	1,208,896
Accounts payable -- other	6,942	7,380
Resident refunds due	115,346	57,673
Resident deposit liabilities	20,029	21,293
Accrued expenses -- related party	522,865	399,500
Accrued interest	784,716	784,853
Currently maturing debt	1,040,220	1,040,220
Notes payable and accrued interest -- related party	9,000,000	9,000,000
Bonds outstanding	82,560,130	83,600,350
Refundable entrance fee liability	39,349,680	36,966,107
Deferred revenue from entrance fees -- net of amortization	6,301,447	6,699,306
Future service obligation	12,035,930	12,795,852
Total liabilities	$ 153,750,235	$ 152,749,673
NET DEFICIT		
Unrestricted	(79,659,730)	(73,981,261)
	$ 74,090,505	$ 78,768,412

RSL Downtown Income Statement (9/30/2023)

REVENUES	2019
Resident services, including amortization of entrance fees	$ 21,579,371
Less contractual adjustments, rate allowances and bad debt expense	(4,611,862)
Net resident services	16,967,509
Other operating revenues	196,745
Total Revenues	17,164,254
PROGRAM SERVICES EXPENSES	
Lifestyle	296,744
Assisted living services	1,350,965
Building maintenance	519,319
Dining	2,786,840
Emergency system services	105,070
Grounds maintenance services	123,204
Housekeeping	433,754
Skilled nursing	3,946,010
Transportation	80,415
Utilities	523,553
Insurance	128,953
Depreciation and amortization	2,575,377
Total program service expenses	12,870,204
GENERAL AND ADMINISTRATIVE EXPENSES	
Administrative services	2,755,876
Marketing	948,034
Management fees and reimbursed expenses	1,924,957
Total general and administrative expenses	5,628,867
LOSS FROM OPERATIONS	(1,334,817)

NON-OPERATING INCOME (EXPENSE)	
Future service obligation adjustment	(12,035,930)
Unrealized depreciation of investments	(9,431)
Realized loss from sale of investments	(77,774)
Interest income	331,934
Interest expense	(6,370,347)
	(18,161,548)
EXPENSES OVER REVENUES AND CHANGE IN NET DEFICIT	(19,496,365)

RSL Downtown Statement of Cash Flows (9/30/2023)

CASH FLOWS FROM OPERATING ACTIVITIES	
Change in net deficit	$ (19,496,365)
Adjustments to reconcile change in net deficit to net cash used in operating activities	
Turnover from entrance fees	4,183,008
Amortization of bond discount and issuance costs	127,102
Amortization of entrance fees	(908,965)
Amortization of contract acquisition costs	787,294
Bad debt recoveries	(61,372)
Depreciation	1,788,083
Unrealized depreciation of investments	9,431
Realized loss from sale of investments	77,774
Future service obligation adjustment	12,035,930
Changes in operating assets and liabilities, net	
Accounts receivable -- trade	69,721
Entrance fees receivable	23,644
Inventory	515
Prepaid expenses	2,365
Resident deposits	1,670
Accounts payable -- trade	42,188
Accounts payable -- related party	593,603
Accounts payable -- other	(438)
Resident refunds due	57,673
Resident deposit liabilities	(1,265)
Accrued expenses -- related party	123,365
Accrued interest	(137)
Notes payable and accrued interest -- related party	-
Net cash used in operating activities	(545,176)

CASH FLOWS FROM INVESTING ACTIVITIES	
Additions to buildings, land property and equipment	(312,110)
Purchases of investments	
Proceeds of sales on investments	1,452,550
Purchases of assets limited as to use	(16,591,399)
Proceeds on sales of assets limited as to use	16,275,095
Net cash provided by (used in) investing activities	824,136
CASH FLOW FROM FINANCING ACTIVITIES	
Proceeds from initial entrance fees	318,907
Payments on long-term debt	(895,000)
Net cash provided by (used in) financing activities	(576,093)
CHANGE IN CASH AND CASH EQUIVALENTS	(297,133)
Cash and cash equivalents at beginning of period	535,476
Cash and cash equivalents at end of period	238,343
Supplemental disclosure of cash flow information:	
Cash paid for interest	6,370,347

Liabilities: Secured Bonds (1)

- $83.6 million of municipal bonds issued by City of Indianapolis with proceeds provided to Downtown via a Loan Agreement.
- Secured by Downtown's real property assets, including an assignment of rents generated by the property.
- Weighted average coupon rate on issuances = 7.62%; Annual interest costs = $6.37 million.
- Roughly $1 million of principal coming due over next 12 months.
- Additional $9 million notes issuance to RSL Main.

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Liabilities: Secured Bonds (2)

- **Water Street Bank & Trust**, a well-regarded and experienced Midwestern bank, is indenture trustee.
- Bonds enhanced by a standby letter of credit obtained by RSL Main as part of a master operating line of credit provided by **Iron Mountain Bank**, in Minneapolis.
  - Covers two payments of principal and interest due under the bonds; the LoC may be drawn by the Indenture Trustee forty-five days after giving notice of its intent to do so to RSL Main and to Iron Mountain Bank.
- Substantial portion (73%) of bonds held by **Goliath Asset Management**, a large investment management company specializing in municipal bond investments

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Liabilities: Resident Refunds

- Residents pay entrance fee (currently $483,000) prior to moving into Downtown.
- 90% of entrance fee is refundable to exiting residents, typically through death or voluntary termination.*
- Expected resident refunds currently represent $39.35 million of liabilities, with $8 million coming due within the next year

*Entrance fees are refundable at the later of: (i) the effective date of termination of the Continuing Care Contract, or (ii) the date a new Entrance Fee and executed Continuing Care Contract has been received by Downtown for the exiting resident's unit, and the new resident has entered the facility.

Operational Economics

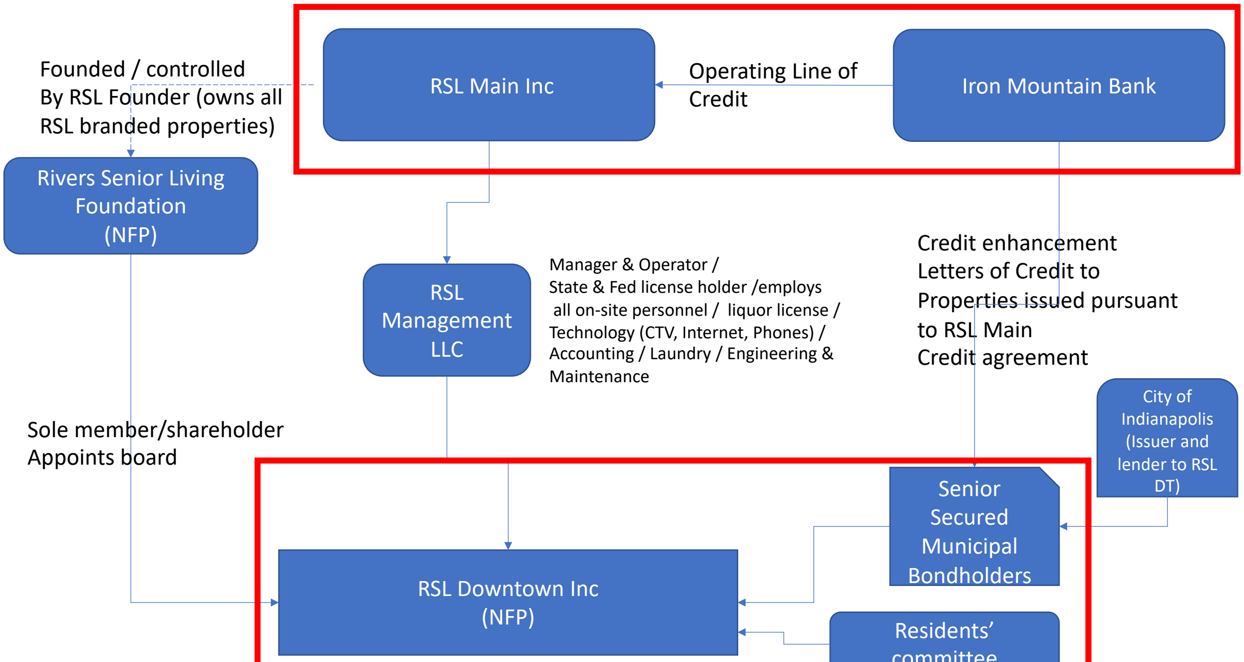
Occupancy & Occupancy Rates (as of 9/30/2019)

	Independent Living	Assisted Living	Memory Care	Skilled Nursing
Residents	143	44	22	70
% Occupancy	86%	88%	92%	70%

2019 Fees charged per resident*

Entrance Fee**	Monthly Service Fee **	Per Diem Fee for skilled nursing
$ 483,000	$ 5,200	$ 350

Monthly Per Resident ProgramService Expense	$ 5,534
Daily Per Resident Skilled Nursing Expense	$ 216



Case A – November 2023

Lunch Discussion

Current Challenges – Case A (1)

- Market for premium senior living competitive in Central Indiana. Currently, more than a dozen senior care facilities inside I-465 beltway.
- Increasing operating and staff-related costs have eroded Downtown's ability to generate cash flows sufficient to operate as a premium senior living facility.
- Management under pressure to discount entrance and monthly fees.
- Operating expenses continue to exceed revenues. Liquidity concerns are in the forefront, given current cash position.

Current Challenges – Case A (2)

- Downtown may not be able to make its next required bond payment and still meet operating budgets and upcoming refund obligations.
- Flow of resident exits higher than expected.
- RSL Management has dispatched a new management team to Downtown.
- New team instructed to adjust operations to reduce costs, but not at the expense of resident services or RSL Management fee structure.
- Residents – including prominent attorneys, doctors, and a former governor -- have formed committees to raise complaints and 'oversee' operations and management at Downtown

Discussion questions

- Strategic stance of stakeholders:
  - Bondholders?
  - Residents?
  - Management?
  - RSL Main?
  - RSL Foundation?
- Practical remedies available outside court?
- Value of Downtown (E.g., to a potential acquirer)?

Case B February 2024

Combined CFRP/VALCON session

February 15, 2020 … The Situation is worse

- Made its December principal and interest payment. . . barely.
- Entered into a 120-day forbearance agreement with the Indenture Trustee and agreed to have RSL Management develop a rolling 13-week proforma cashflow model to share among the parties.
- RSL Management failed to deliver the proforma model and the forbearance agreement has expired.
- The Indenture Trustee has declared a default under the relevant documents and has threatened to seek the appointment of a state court receiver for the Downtown property.

Problems Mount

- The bondholders have had several confrontations with RSL Management, who assert that they cannot be displaced by any receiver and they owe no duty to cede control to the receiver. To date, they have not relinquished control of the Downtown property to the indenture trustee, bondholders or any receiver they may seek to appoint.
- Through informal discovery obtained during the forbearance period, the bondholders have obtained financial documents that strongly indicate that Downtown is insolvent both on a cash flow basis (it cannot meet its obligations as and when they come due) and on a balance sheet basis (the bond debt plus the entrance fund refund liabilities exceed the value of Downtown's assets).
- Worst of all, there are allegations and strong indications that RSL Management does not segregate entrance fees generated by the properties it manages – it accounts for them by property but deposits them in a single lockbox account for the benefit of RSL Main at Iron Mountain Bank, together with all monthly and other fees generated from the properties.

The End is near…

- Resident committees have lodged a range of regulatory grievances, including
  - complaints of declining service quality,
  - poor upkeep of facilities, and
  - reduced staff attention and capabilities.
- Two resident groups have filed legal actions against Downtown, RSL Management and RSL Main, alleging fraud, breach of contract and breach of duty by Downtown's board related to the Company's relationship to RSL Main and RSL Management.
- The legal actions allege that the fees charged to Downtown by RSL Management are unconscionable, have rendered Downtown insolvent, and represent an effort to enrich RSL Main at the expense of residents.

RSL Downtown Financials
As of September 30, 2023

Balance Sheets as of September 30

ASSETS	2023	2022
Cash and cash equivalents	$ 238,343	$ 535,476
Accounts receivable	341,541	349,890
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Inventory	21,081	21,597
Prepaid expenses	96,744	99,109
Resident deposits	68,308	69,978
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Cash and cash equivalents at end of period	238,343

Supplemental disclosure of cash flow information:

Cash paid for interest	6,370,347

Statement of Operations and Changes in Net Deficit
last 12 months as of September 30

REVENUES	2023
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Less contractual adjustments, rate allowances and bad debt expense	(4,611,862)
Net resident services	16,967,509
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EXPENSES OVER REVENUES AND CHANGE IN NET DEFICIT	(19,496,365)

Help Center

American Bankruptcy Institute

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The Impact of COVID-19 on the Nursing Care Industry: Threats and Signs of Recovery

Committee: Health Care

George Mesires

Faegre Drinker Biddle & Reath LLP; Chicago

Date Created: Fri, 2021-03-12 13:25

Of all the industries most adversely affected by the global pandemic, the nursing care sector — comprised of both post-acute and long-term-care providers — has suffered greatly. The pandemic presented unthinkable operational challenges to the skilled-nursing sector in particular, resulting in significant adverse financial consequences. Despite these challenges, the sector has demonstrated continued resilience and modest signs of recovery that provide cautious optimism for the continued vitality of the sector.

Things were not all rosy for the skilled-nursing sector pre-pandemic. The industry was experiencing headwinds, including aging infrastructure, rising labor costs and turnover, payor pressure and increased competition.[1] With the pandemic came additional challenges, both operational and financial, which have had a significant impact on both revenues and costs. On the revenue side, the American Health Care Association has estimated that the skilled-nursing sector will lose an estimated $34 billion in revenues through 2021 due to COVID and the occupancy challenges it has presented.[2]

Not surprisingly, occupancy rates in nursing homes plunged from a pre-pandemic rate of 84.9% in February 2020[3] to below 70% on Jan. 31, 2021, with an average occupancy rate at that time of below 80% in all 48 continental states.[4] These declines were caused by a number of factors, including the ban on new admissions, a drop-off in elective surgery discharges from hospitals and resident deaths. Moreover, the ban on new admissions has caused a diversion of potential residents to home-health providers.[5]

On the expense side, the costs of personal protective equipment (PPE) skyrocketed during the pandemic, and some operators still struggle to attain adequate levels of supply. For example, “3M N95 masks had by far the largest markup in price from pre-COVID-19 days, jumping in price from $0.11 to $6.75,” a markup of over 6,000%.[6] Supply challenges remain, with some providers reporting ongoing shortages of PPE.[7]

Despite their heroic efforts to combat the disease, many skilled-nursing operators are bracing for COVID-19-related litigation. Although “COVID-related claims to date are limited,” insurance industry specialist Willis Towers Watson expects such claims to increase. “Many insurers are mandating the addition of a COVID-19, pandemic or communicable disease exclusion on renewals and new business.”[8] Willis Towers Watson has noted that COVID-19 has caused “massive market disruption in all facets of this market sector: coverage, capacity and rate.” Adding additional pressure on cost structures, Willis Towers Watson predicts that rates will increase in 2021 between 15% and 50%+ for general and professional liability insurance.[9]

Although some states have passed executive orders or liability-immunity laws that may provide some protection to SNFs from COVID-related liability, this state law patchwork has not allayed the concerns of providers, who are advocating for a federal liability-immunity law.

The industry contends that federal legislation is needed because without prophylactic protection, providers face uncertain and potentially financially draining tort litigation related to their conduct during the pandemic.

An additional threat to the industry is the expected increase in federal and state scrutiny, if not knee-jerk legislation intended to address perceived abuses in the sector. For example, there are recent “reform” initiatives calling for a host of measures, including the banning of new licenses issued to for-profit operators,[10] and the limiting of executive compensation and company profits.[11] A more measured review is warranted for meaningful reform.

Such challenges are daunting, and two recent headlines underscore the financial peril some providers face. On March 1, 2021, certain affiliates of Consulate Health Care that manage and operate 140 SNFs filed petitions for relief under chapter 11.[12] Although the filing of the bankruptcy cases was explicitly “precipitated” by the partial reinstatement of a more than $250 million *qui tam* false-claims judgment, the debtors did note that its aggregate census at the 140 SNFs that are managed by the debtors saw occupancy drop approximately 14% during the pandemic “due to decreased intake volume from the COVID-19 pandemic.”[13] Moreover, despite soliciting 40 third-party lenders for debtor-in-possession (DIP) financing, the “process did not yield any indications of interest for financing … from third parties.”[14] Ultimately, the debtors concluded that a DIP loan from an affiliate of the debtor “was and remains the best available under the circumstances.”[15]

On March 2, 2021, health care real estate investment trust (REIT) Welltower Inc. distanced itself from beleaguered operator Genesis HealthCare (Genesis) by, among other things, terminating leases for 51 properties in an effort to “de-risk Welltower’s portfolio.”[16] On March 3, 2021, Genesis, the largest skilled-nursing operator in the country, announced steps to restructure its business, including a voluntary delisting from the New York Stock Exchange and a $50 million cash infusion from ReGen Healthcare.[17] Explaining the need for the restructuring (which follows a going-concern opinion in August 2020), Genesis’s CEO stated: “The severity of the pandemic dramatically impacted patient admissions, revenues and costs, compounding the pressures of our long-term, lease-related debt obligations.”[18]

But there is light at the end of the tunnel. On March 2, 2021, the Biden administration announced that there would likely be enough vaccine available in the U.S. to vaccinate every adult by the end of May.[19] This is welcome news to the skilled-nursing industry. Indeed, since the rollout of the vaccine to nursing care facilities, both the death and new case rates have dropped dramatically, greater than the national average declines. Specifically, for the time period between late December 2020 and February 2021, new cases in nursing homes have declined 80%, which is better than twice the number of declines in the general population. Similarly, deaths in nursing homes are down 65% over the same time period.[20] The vaccine is working. Without a doubt, the sector has been buoyed by the billions of dollars of stimulus money that has been provided through the CARES Act public health and social services emergency fund (Provider Relief Fund).[21]

Acquisition activity, while subdued in volume, is showing resilience in pricing. For deals that did trade in 2020, estimates are of valuations of about $100,000 per bed, which is solid and in line with recent years’ valuations.[22] Investor interest appears to be driven by the need-based nature of skilled nursing assets, as well as the continued support of government payers.[23]

Further, there is evidence that occupancy is steadying, according to some providers. For example, Wendy Simpson, CEO of LTC Properties, a health care REIT, said during a recent earnings call, “We do believe industry census is close to or has hit bottom…. As the current vaccines — and a third from Johnson & Johnson — become more widely available and utilized, visitation opens up, communities and facilities continue to aggressively market their services, and consumer confidence in these settings improves, we should see the current census stabilize and even improve.”[24] Moreover, it is likely that the skilled-nursing sector will recover lost occupancy quicker than other senior housing asset classes as voluntary procedure discharges uptick.

The skilled-nursing industry has weathered tumult over the years, but none as serious as COVID-19. Despite the operational and financial challenges many providers face, there is some evidence that the sector is recovering, which is long-overdue good news for the industry and, most importantly, for the most vulnerable cohort of the population among us.

[1] *See* Louis E. Robichaux and Russell A. Perry, "What's Happening with Long-Term Skilled Nursing Care Providers?," *ABI Journal* (July 30, 2017), *available at* https://s3.amazonaws.com/abi-org-corp/journals/intensive_07-17.pdf (unless otherwise specified, all links in this article were last visited on March 4, 2021) (identifying numerous "headwinds" including, but not limited to, declining occupancy and shorter stays, government payment pressure, labor shortages, heightened federal and state regulatory scrutiny, and professional liability exposure); *see also* Howard Gleckman, "Why are So Many Nursing Homes Shutting Down?," *Forbes* (March 2, 2020), *available at* https://www.forbes.com/sites/howardgleckman/2020/03/02/why-are-so-many-nursing-homes-shutting-down/

[2] Alex Spanko, "Nursing Home Industry Projects $34B in Revenue Losses, 1,800 Closures or Mergers Due to COVID," *Skilled Nursing News* (February 10, 2021), *available at* https://skillednursingnews.com/2021/02/nursing-home-industry-projects-34b-in-revenue-losses-1800-closures-or-mergers-due-to-covid/#:~:text=Nursing%20Home%20Industry%20Projects%20%2434,to%20COVID%20%2D%20Skilled%20Nursing%20News

[3] Alex Spanko, "NIC: Stalled Skilled Nursing Occupancy of 74% 'Threatens Long-Term Survival' of Facilities," Skilled Nursing News (December 2, 2020), *available at* https://skillednursingnews.com/2020/12/nic-stalled-skilled-nursing-occupancy-of-74-threatens-long-term-survival/. Notably, the high-water occupancy rate was 89% in 2015.

[4] Maggie Flynn, "With COVID-19 Cases Plummeting, Nursing Homes 'May have Seen the Bottom" of Record-Low Occupancy," *Skilled Nursing News* (February 17, 2021), *available at* https://skillednursingnews.com/2021/02/with-covid-19-cases-plummeting-nursing-homes-may-have-seen-the-bottom-of-record-low-occupancy/

[5] Anna Wilde Mathews and Tom McGinty, "Covid Spurs Families to Shun Nursing Homes, a Shift that Appears Long Lasting," The Wall Street Journal (December 21, 2020), *available at* https://www.wsj.com/articles/covid-spurs-families-to-shun-nursing-homes-...

[6] Maggie Flynn, "PPE Prices Jump More than 1,000% for Nursing Homes — with Markup on Some Masks Exceeding 6,000," *Skilled Nursing News* (April 9, 2020), *available at* https://skillednursingnews.com/2020/04/ppe-prices-jump-more-than-1000-fo....

[7] Andrew Jacobs, "Health Care Workers Still Face Daunting Shortages of Masks and Other P.P.E.," *The New York Times* (Dec. 20, 2020), *available at* https://www.nytimes.com/2020/12/20/health/covid-ppe-shortages.html.

[8] Willis Towers Watson, "Senior living and long-term care — Insurance Marketplace Realities 2021," presented at the 2021 Argentum Public Policy Institute (Feb. 22-24, 2021).

[9] *Id.*

[10] Alex Spanko, Lawmakers Mull State-Level Ban on New For-Profit Nursing Home Licenses, Expansions,"

Skilled Nursing News (March 1, 2021), *available at* https://skillednursingnews.com/2021/03/lawmakers-mull-state-level-ban-on....

[11] Maggie Flynn, "Cuomo Targets Ownership Transparency, Caps on Profit and Executive Pay in Nursing Home Reform Push," *Skilled Nursing News* (Feb. 22, 2021), *available at* https://skillednursingnews.com/2021/02/cuomo-targets-ownership-transpare....

[12] *See In re CMC II LLC, et al.*, Bankr. D. Del. (March 1, 2021), Case No. 21-10461.

[13] *See id.*, Dkt [2] Declaration of Paul Rundell in Support of Chapter 11 Petitions and First Day Papers, ¶15 (indicating that census dropped from 14,000 residents to 12,000 residents at its 140 SNFs "due to decreased intake volume resulting from the COVID-19 pandemic").

[14] *Id.* at ¶ 30.

[15] *Id.* at ¶ 31.

[16] Welltower Inc. press release (March 2, 2021), *available at* https://www.prnewswire.com/news-releases/welltower-announces-substantial-exit-of-genesis-healthcare-operating-relationship-301239097.html.

[17] Genesis press release (March 3, 2021), *available at* https://www.globenewswire.com/news-release/2021/03/03/2186244/0/en/Genesis-HealthCare-Announces-Strategic-Restructuring-Steps-to-Strengthen-Balance-Sheet-and-Chart-Path-for-Recovery.html.

[18] *Id.*

[19] Sheryl Gay Stolberg, Sharon LaFraniere, Katie Thomas & Michael D. Shear, "Biden Vows Enough Vaccine 'for Every Adult American' by End of May," *The New York Times* (March 2, 2021), *available at* **https://www.nytimes.com/2021/03/02/us/politics/merck-johnson-johnson-vaccine.html**.

[20] Matthew Conlen, Sarah Mervosh & Danielle Ivory, "Nursing Homes, Once Hotspots, Far Outpace U.S. in Covid Declines," *The New York Times* (February 25, 2021), *available at* **https://www.nytimes.com/interactive/2021/02/25/us/nursing-home-covid-vaccine.html**; *see also* Maggie Flynn, "COVID-19 Cases Among Nursing Homes Residents Drop 82% as Plans for Future Clinics Emerge," *Skilled Nursing News* (March 2, 2021), *available at* **https://skillednursingnews.com/2021/03/covid-19-cases-in-nursing-home-residents-drop-82-as-plans-for-future-clinics-emerge/?euid=bdd12051fa&utm_source=snn-newsletter&utm_medium=email&utm_campaign=a1357da794**.

[21] Maggie Flynn, "HHS Nominee Becerra Says More Nursing Home Aid 'Top Priority' — but Faces No Question on SNF Reform," *Skilled Nursing News* (Feb. 23, 2021), *available at* **https://skillednursingnews.com/2021/02/hhs-nominee-becerra-says-more-nursing-home-aid-top-priority-but-faces-no-questions-on-snf-reform/?euid=bdd12051fa&utm_source=snn-newsletter&utm_medium=email&utm_campaign=3cd03ed464** (summarizing prior rounds of federal aid).

[22] Alex Spanko, "COVID Hasn't Caused Flood of Distressed Nursing Homes Transactions, but Deals Reflect Lower Bed Counts," *Skilled Nursing News* (Feb. 26, 2021), *available at* **https://skillednursingnews.com/2021/02/covid-hasnt-caused-flood-of-distressed-nursing-home-deals-but-pricing-reflects-lower-bed-counts/**; *see also* "Is There an Investment Case for Skilled Nursing in the Intra-and Post-Pandemic World?," NIC Leadership Huddle (March 1, 2020), *available at* **https://blog.nic.org/is-there-an-investment-case-for-skilled-nursing-in-the-intra-and-post-pandemic-world?utm_campaign=NIC%20Notes%20Blog&utm_medium=email&_hsmi=113528667&_hsenc=p2ANqtz-9549GJFOi8O2mQL8WayWClr8EkHXSE-u5w31yPX4DKlS6s79IE4U4ev3W6F1Sk4azYqa6lXAC3TraAWGTusG4ZeNW7pAX92Eh281HZRZ2kv0ZXjeU&utm_content=113528667&utm_source=hs_ema**

[23] *Id.*

[24] Kimberly Bonvissuto, "LTC continues to focus on operator support as occupancy 'is close to or has hit bottom,'" *McKnight's Senior Living* (Feb. 22, 2021), *available at* **https://www.mcknightsseniorliving.com/home/news/ltc-continues-to-focus-on-operator-support-as-occupancy-is-close-to-or-has-hit-bottom/**.

[+] FEEDBACK

Intensive Care

By Jerry Seelig, Cecily Dumas and Scott Prince

Operating Nursing Homes: Is the Worst Behind Us?

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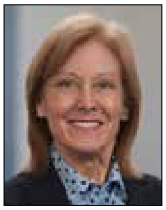

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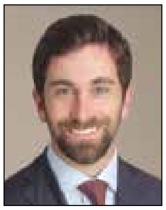

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The coronavirus crisis is not over.[1] COVID-19 brought disease, increased costs and death to nursing homes, which provide care and housing for many elderly, disabled and most vulnerable. Two years into the pandemic, more than $20 billion in federal funding[2] and a loosening of regulatory compliance[3] have delayed much of the nursing home care industry turnaround. In 2022, the federal funds spigot will close and regulatory enforcement will expand, which will bring an increase in turnaround engagements and filings. This article examines the key challenges faced by those participating in the financial restructurings happening within the nursing home industry.

By November 2021, we believed that the pandemic was waning, but the omicron variant arrived. In January 2022, the omicron-fueled number of new cases had increased to more than 750,000 daily,[4] average daily hospitalizations were at 158,000, and deaths averaged 1,800 per day. In early March 2022, the seven-day daily average of new cases had dropped to 44,000, average daily hospitalizations were at 40,000, the daily deaths' average was 1,500, and more than 960,000 have died from COVID-19.[5]

The total number of U.S. nursing home resident and staff deaths now exceeds 185,000.[6] Before the COVID-19 vaccine, with less than 4 percent of the U.S. population vaccinated, nursing home residents and staff made up 35 percent of the deaths. Vaccination of residents nationwide reduced the cases and death, yet omicron and the need for boosters[7] meant that nursing homes were still in the eye of the pandemic storm.[8] On Jan. 14, 2022, *The Hill* reported that "long-term care facilities' coronavirus cases have skyrocketed over three weeks due to the omicron variant.[9] Nursing home staff cases went from 5,919 on Dec. 19 to 57,243 on Jan. 9."[10]

Tragically, one report has found that the "case rate among residents with an additional primary or booster rate remains over 10 times lower than among other groups."[11] In February 2022, *The Atlantic* reported that even with a booster cutting risks dramatically, age "continues to be the driver of COVID's brutal math with Omicron.... In 2022 so far, three-quarters of COVID deaths in America have been in people 65 and older, 93 percent in people 50 and older."[12]

Professionals involved in skilled nursing cases and consulting engagements will find an industry with over two years of financial losses that have identified three key *potential or real threats to the nursing home industry*. First, the skilled-nursing arena is a highly regulated and litigious industry, and pre-COVID, many providers failed to meet mandated resident care and safety standards.[13] The second threat is a worker shortage in a vaccine-mandated industry. Third, many new clients and debtors are overleveraged.

First Threat

The first threat is litigation resulting from claims made as to exposure to or contraction of COVID-19. As summarized herein, there are both state and federal efforts to provide immunity to nursing home operators and other health care providers.

A review in the *ABA Journal* reported that as of Sept. 1, 2020, "more than a dozen states (including Georgia, Louisiana, North Carolina, Oklahoma, Utah and Wyoming) have passed protective legislation of their own. Many more states have similar protective legislation."[14] In addition, Westlaw Resource offers a "50-state survey of state liability shield laws that give businesses immunity

1 Jerry Seelig, David Hoffman & Louis J. Cisz, III, "Painful Impact of COVID-19 on the Troubled Skilled-Nursing Industry," XXXIX *ABI Journal* 9, 28, 64-65, September 2020, *available at* abi.org/abi-journal (unless otherwise specified, all links in this article were last visited on Feb. 25, 2022).

2 Nancy Ochieng, Jeannie Fuglesten Biniek, MaryBeth Musumeci & Tricia Neuman, "Funding for Health Care Providers During the Pandemic: An Update," Kaiser Family Found. (Jan. 27, 2022), pp. 3-4.

3 David Stevenson & Audrey Chang, "Nursing Home Oversight During the COVID-19 Pandemic," *Journal of the Am. Geriatrics Soc'y* (Feb. 12, 2021).

4 Daily updates on U.S. and global COVID-19 data have been reported by the *New York Times*, *available at* nytimes.com/interactive/2021/us/covid-cases.html.

5 The *Washington Post*'s "Coronavirus Section" is updated daily and includes links to its pandemic coverage, *available at* washingtonpost.com/coronavirus. Mr. Seelig's firm also publishes an e-newsletter called *Revitalize*, which offers a summary of data and reporting on long term and health care issues.

6 "Nearly One-Third of U.S. Coronavirus Deaths Are Linked to Nursing Homes," *New York Times* (updated June 1, 2021).

7 Mihir Zaveri, "Once Again, Nursing Homes Are Under Scrutiny," *New York Times* (Dec. 28, 2021).

8 Aliza Aufrichtig & Amy Schoenfeld Walker, "Who Had COVID-19 Vaccine Breakthrough Cases?," *New York Times* (Oct. 28, 2021); "Coronavirus in the U.S.: Latest Map and Case Count," *New York Times* (link *supra* n.4).

9 Lexi Lonas, "Long-Term Care Facilities' Coronavirus Cases Skyrocketed in Three Weeks Due to Omicron," *The Hill* (Jan. 14, 2022).

10 "Report: Nursing Homes See Spike in New Covid Cases," Am. Health Care Ass'n/Nat'l Ctr. for Assisted Living (Jan. 12, 2022).

11 "Nursing Home COVID-19 Vaccination Data Dashboard," Ctrs. for Disease Control and Prevention, *available at* cdc.gov/nhsn/covid19/ltc-vaccination-dashboard.html.

12 Sarah Zhang, "The COVID Strategy America Hasn't Really Tried," *The Atlantic* (Feb. 14, 2022).

13 Letter to the Committee on Finance, United States Senate, Infection Control Deficiency, U.S. Gov't Accountability Office (May 20, 2020), *available at* gao.gov/assets/gao-20-576r.pdf.

14 Paul Dowdell, "Immunity from Liability in the Age of COVID-19: A New Reality for Trial Lawyers?,"Am. Bar Ass'n (July 31, 2020).

from civil liability for claims of personal injury, loss, or death from customers, patrons, visitors, or other third parties related to exposure to or contraction of" COVID-19.[15]

Enacted in 2015, the federal Public Readiness and Emergency Preparedness Act (PREP Act)[16] offers sweeping immunity for state and federal legal liability. In the PREP Act, Congress made the judgment that "in the context of a public health emergency, immunizing certain persons and entities from liability was necessary to ensure that potentially life-saving countermeasures will be efficiently developed, deployed and administered." The Congressional Research Service "reviews the structure of the PREP Act and the [Department of Health and Human Services] Declaration to explain the scope of this liability immunity as it applies to COVID-19 countermeasures, [and] explains and offers COVID-19 pandemic amendments to the Prep Act.''

Garcia v. Welltower OpCo Grp. LLC[17] provides a significant ruling for the senior-living and post-acute industry, as it establishes that the PREP Act provides broad immunity from civil liability when a facility employs countermeasures to prevent the spread of the virus. Furthermore, the decision indicates that the countermeasures implemented by such facilities do not need to be flawless to be covered by the immunities conveyed in the PREP Act.

Taken together, these state legislative efforts do, in some instances, protect nursing home operators and other health care providers from significant exposure. However, it is the PREP Act that provides the strongest protection. Litigation or attempts at it have just begun, and be it an administrative law hearing, or state or federal court, the law remains unsettled.[18]

Second Threat

The beta, delta and omicron variants revealed the second threat: The nursing home industry is dependent on low-wage workers with few job rewards and limited advancement. Furthermore, workers[19] with the lowest wages are the most resistant to getting vaccinated.[20]

On Jan. 7, 2022, the *Washington Post* reported that "the departure of 420,000 employees over the past two years has narrowed the bottleneck at nursing homes and other long-term care facilities."[21] On Jan. 24, 2022, the same publication quoted Harvard Medical School long-term care expert David Grabowski, who found that the "long-standing issue of underinvesting and undervaluing this workforce is coming back to bite us."[22]

A September 2021 survey of its members by the American Health Association and National Center for Assisted Living found that nearly every U.S. nursing home is facing a staffing shortage. More than 70 percent of respondents said that they lack qualified candidates, have turned to the far more costly temporary staffing agencies, their staffs are working overtime, and they have added shifts.[23] The AARP and California Advocates for Nursing Home Reform (CANHR) add that labor shortages "were a chronic issue in nursing homes because of relatively low pay, difficult working conditions, and limited benefits for staff.... Many of these facilities, particularly the 70 percent that are for-profit entities, have been underfunded for years."[24]

In 2022, vaccine denial among nursing home staff has been far greater than the residents they serve,[25] with unvaccinated-worker cases surging in the first week of January 2022 to 50,000 new worker cases and 70 new worker deaths.[26] The U.S. Supreme Court upholding mandates for health care facilities staff will save lives in and out of health care and skilled-nursing settings. However, with every health care setting and better-paying jobs demanding a vaccine, the Court's decision overruling the more-than-100-employee workplace mandate may drive a nursing home or at-home aide to get a job stocking retail shelves instead.

Third Threat

The third threat is the rising cost of capital in an industry where private investors own approximately 70 percent of the nursing homes.[27] A recent study of a 200-facility nursing home chain found that for-profit homes "had low registered nurse and total nurse staffing levels and regulatory violations with below-average ratings, and they had high COVID-19 infection rates during the pandemic."[28] With less revenue and greater costs, the industry will suffer at a time that the Federal Reserve is set to start increasing the federal funds rate.

A 2019 report on skilled-nursing facilities found that the median operating margin was in the negative, with roughly half of U.S. skilled-nursing facilities operating at a loss. Recent projections estimate 2021 margins of negative 4.8 percent.[29] These margins are further threatened by New York, Massachusetts and New Jersey setting rules that nursing homes must spend no less than 70 percent of their total revenue on resident care, with New York demanding that at least 40 percent of that direct-care spending must pay for staff members involved in hands-on care.[30]

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15 "State Liability Shield Laws for Businesses Charts: COVID-19 Immunity: Overview," West Law.
16 "The PREP Act and COVID-19: Limiting Liability for Medical Countermeasures," Cong. Research Serv. (Jan. 13, 2022).
17 2021 U.S. Dist. LEXIS 25738 at *1-26 (C.D. Cal. 2021).
18 Selena Simmons-Duffin, "New Federal Funds Spur Expansion of Home Care Services for the Elderly," NPR (Oct. 21, 2021). Reed Abelson, "Biden Promised to Fix Home Health Care for Seniors," *New York Times* (Nov. 1, 2021).
19 Maggie Fox, "Nursing Home Staff Who Are Closest to Patients Are Least Likely to Be Vaccinated, Study Finds," CNN (July 29, 2021).
20 Reed Abelson, "At U.S. Nursing Homes, Aides Were the Least Likely Workers to Be Vaccinated, a Study Shows," *New York Times* (Sept. 16, 2021).
21 Lenny Bernsteion & Andrew Van Dam, "Nursing Home Staff Shortages Are Worsening Problems at Overwhelmed Hospitals," *Washington Post* (Dec. 18, 2021).
22 Rebecca Tan, "Low-Wage Workers Prop Up the Nursing Home Industry. They're Quitting in Droves," *Washington Post* (Jan. 22, 2022).
23 "Survey: Nearly Every U.S. Nursing Home and Assisted Living Community Is Facing a Workforce Crisis,"Am. Health Care Ass'n/Nat'l Ctr. for Assisted Living.
24 "Nursing Homes Can't Find Workers: How that Affects Care," *Healthline*.
25 Rhitu Chatterjee, "The Nursing Home Staffing Crisis Right Now Is Like Nothing We've Seen Before," NPR (Jan. 20, 2022). Priya Chidambaram & Rachel Garfield, "Nursing Homes Experienced Steeper Increase in COVID-19 Cases and Deaths in August 2021 than the Rest of the Country," Kaiser Family Found. (Oct. 1, 2021).
26 Rhitu Chatterjee, "What Nursing Homes Have Been Like with the Spread of Omicron," NPR (Jan. 13, 2022).
27 Nina A. Kohn, "Nursing Homes, COVID-19 and the Consequences of Regulatory Failure," *Georgetown Law Journal* (April 2021); Matthew Goldstein, Jessica Silver-Greenberg & Robert Gebeloff, "Push for Profits Left Nursing Homes Struggling to Provide Care," *New York Times* (May 7, 2020). *See also* Seelig, Hoffman & Cisz, *supra* n.1.
28 David E. Kingsley & Charlene Harrington, "Financial and Quality Metrics of a Large, Publicly Traded U.S. Nursing Home Chain in the Age of COVID-19," *Int'l J. of Health Servs.* (2022).
29 Danielle Brown, "'Much Worse Than Expected': Nursing Home Margins Projected to Hit Negative 4.8%," *McKnight's Long-Term Care News* (March 3, 2022), *available at* mcknights.com/news/nursing-home-margins-projected-to-hit-negative-4-8.
30 Susan Jaffe & Kaiser Health News, "Three States Limit Nursing Home Profits in Bid to Improve Care," *Fortune* (Oct. 25, 2021).

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On March 1, 2022, the White House joined this effort when they "rolled out a comprehensive set of intended nursing home reforms," which includes a "crackdown on bad actors." Proposed federal rules will set minimum staffing requirements and take aim at private-equity ownership of nursing homes.[31]

Nursing home operators are stuck between rising costs and unchanging government reimbursement rates, yet a profound irony exists with cash flow down, merger and acquisition transactions up and lending returning to pre-COVID levels.[32] Even with bad margins, high labor costs and a reduced census, investment firms, banks and equity funds continue to favor the industry.[33]

The return of investment and lending offers *greater leverage, albeit this is a short-term solution*. In addition, more than two years of COVID-19 illnesses and deaths have led families and hospitals to decide that a family member and/or patient does not belong in a nursing home.[34] Past and pending stimulus programs[35] and the March 1, 2022, White House Nursing Home Reform Package[36] are forged out of President Joe Biden's commitment "to expand services for seniors so families can get help from well-trained, well-paid professionals to help them take care of their parents at home — to cook a meal for them, to get their groceries for them, to help them get around, to help them live in their own home with the dignity they deserve to be afforded."[37] As summarized in a leading trade publication, "[s]killed-nursing operators are trying to adjust to how the COVID-19 pandemic changed the care continuum, with patients now embarking on different pathways after hospital stays. Not only are more patients going directly to home health, but long-term acute-care hospitals and inpatient rehabilitation facilities also have started to play more prominent roles."[38]

Conclusion

A significant number of Americans agree with President Biden that nursing homes do not provide their loved ones with "the dignity they deserve to be afforded."[39] Consumers of nursing home services will not forget the failures that led to 200,000 deaths. However, for so many family, friends and community members, post-hospital skilled care, long-term care, mental illness, dementia and chronic disease cannot be managed at home. Many more are at a level of acuity that is not best treated at a hospital, inpatient rehabilitation facility and long-term acute-care hospital, and will therefore be best treated in a nursing home.

Significant demand for nursing home care is very much alive, and that is why we write not to eulogize the death of the nursing home industry, but rather to caution those who will do the industry's restructuring about its significant litigation, staffing and access-to-capital challenges. What also remains is that when the COVID-19 pandemic becomes "endemic" and the funding spigot is turned off, those living and working in nursing homes deserve far better treatment, so we must all do more than merely restructure.[40] abi

31 "White House Unveils Major Nursing Home Reform Package, Targets Private Equity Ownership," *Skilled Nursing News* (March 1, 2022), *available at* skillednursingnews.com/2022/02/white-house-unveils-major-nursing-home-reform-package-targets-private-equity-ownership; "Fact Sheet: Protecting Seniors and People with Disabilities by Improving Safety and Quality of Care in the Nation's Nursing Homes," White House (Feb. 28, 2022), *available at* www.whitehouse.gov/briefing-room/statements-releases/2022/02/28/fact-sheet-protecting-seniors-and-people-with-disabilities-by-improving-safety-and-quality-of-care-in-the-nations-nursing-homes.

32 Amy Stulick, "SNF Lending Competition Heats Up as 'Core Group' Returns After a Year on the Sidelines," *Skilled Nursing News* (Feb. 14, 2022).

33 "Are Senior Living Investments Recession Proof?," Lloyd Jones LLC (Oct. 29, 2021); Julie Ferguson, "The Senior Living Sector Is Poised for Growth," NAIOP (Fall 2021).

34 Alex Zorn, "SNFs Battle for Post-Acute Market Share as Competitors Rise," *Skilled Nursing News* (Feb. 15, 2022).

35 Eric Bradner & Sarah Mucha, "Biden Unveils 'Caregiving Economy' Plan for Expanded Child Care and Home Care," CNN (July 21, 2020).

36 Op cite at fn.33.

37 Abelson, *supra* n.18.

38 Alex Zorn, "Skilled Nursing Operators Are Trying to Adjust to How the COVID-19 Pandemic Changed the Care Continuum, with Patients Now Embarking on Different Pathways After Hospital Stays," *Skilled Nursing News* (Feb. 15, 2022).

39 Abelson, *supra* n.18.

40 David Hoffman & Jerry Seelig,"Nursing Homes Still Deserve Better, a Year Into the Pandemic," *Philadelphia Inquirer* (Feb. 22, 2021).

Intensive Care

By Ken Mann

Senior Care in Distress: Challenges, Evaluation, Opportunities and Alternatives

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In recent months, there has been an increase in distress among long-term care facilities (LTCFs). These consist predominantly of skilled-nursing facilities (SNFs), assisted-living facilities (ALFs) and memory care facilities. This is a trend that special situations M&A advisors suspect will continue to provide work for insolvency professionals. This article provides a primer on the LTCF challenges that existed prior to the COVID-19 pandemic and how it has exacerbated the issues while adding new complexities. The article also explores how to evaluate opportunities, various concepts of valuation and potential alternative uses for unviable facilities.

Presenting a positive backdrop for the senior care industry is the growing number of seniors and their longer life expectancies. According to the U.S. Census, in 2030 (when all baby boomers will be older than 65) older Americans will make up 21 percent of the population, up from 15 percent today. By 2060, one in four Americans will be 65 years and older, the number aged 85 years or older will triple, and the country will add a half-million centenarians.[1] Of course, as people age, their likelihood of requiring long-term care increases.

Challenges Giving Way to Distress

Despite these favorable trends, trouble in the LTCF space has been predicted for years. As a broken, overburdened system with a bad business model, the sector had already suffered pre-existing conditions pre-pandemic. Most notable, those needing the services are incapable of paying for them.

A bed in a nursing home costs $93,000 for a shared room and $105,000 for a private room annually.[2] SNFs can be profitable when reimbursed at that level, but despite the high demand, most families cannot afford this expense. Such out-of-pocket payments, combined with private long-term-care insurance payments, account for only around 40 percent of the total spend in LTCFs in the U.S. According to one report, "Medicaid is the primary payer for nursing homes, covering more than 60 percent of all nursing home residents and approximately 50 percent of costs for all long-term care services. However, Medicaid reimbursement only covers 70 to 80 percent of the actual costs of nursing home care. This chronic gap in funding has resulted in shoestring budgets and ongoing operating losses for nursing home providers."[3] In other words, the most common payment scheme for the services provided in SNFs pays *significantly less* than the cost of the service. Recent changes in reimbursement models from fee-for-service to value-based have only made matters worse.

While what Medicaid covers varies by state, it does not, however, cover the costs of room and board anywhere. As such, ALFs enjoy a higher level of private pay than SNFs, but the lack of government help means that fewer prospective residents have the means to pay, so many will end up staying at home with relatives or seek the least expensive option in their ALF market.

Furthermore, there is too much supply in some markets. Investors followed baby boomers as the generation approached retirement age. In response, more facilities were built, and certain areas are now over-bedded. As new facilities come online, it is harder for older facilities with dated décor, layouts and amenities to enroll new residents.

Competition does not just come from other like-facilities; lifestyle choices as people age change with each generation and with other trends and technological advancements. While some seniors are forced to age at home due to costs, many prefer not to leave their homes. In many respects, technology will become the great competitor to senior-living facilities and, to a lesser degree, senior-care facilities. Telehealth allows medical appointments to occur virtually. A smartphone can summon a ride to an appointment or provide on-demand food delivery. Voice-activated assistants like Alexa, being commonplace in the homes of more tech-savvy boomers, can remind seniors to take medications and accomplish daily

1 "The U.S. Joins Other Countries with Large Aging Populations," U.S. Census Bureau (Oct. 8, 2019), *available at* census.gov/library/stories/2018/03/graying-america.html (unless otherwise specified, all links in this article were last visited on May 23, 2022).

2 "Long-Term Care Insurance Cost: Everything You Need to Know," *MarketWatch* (Oct. 10, 2021), *available at* marketwatch.com/picks/guides/insurance/long-term-care-insurance-cost-everything-you-need-to-know.

3 "Financial Struggle of Nursing Homes Puts Medicaid Reimbursement Rates Back in the Spotlight," AHCA/NCAL (Oct. 28, 2020), *available at* ahcancal.org/News-and-Communications/Press-Releases/Pages/Financial-Struggle-of-Nursing-Homes-Puts-Medicaid-Reimbursement-Rates-Back-in-the-Spotlight.aspx.

tasks. Inexpensive home security systems, wearable medical-monitoring devices and fall alerts can give family members the peace of mind they once relied on an institution to provide.

Another major challenge for the industry over the last 30 years has been the difficulty in recruiting and retaining quality labor. The limited supply of qualified nurses has driven their wages up, creating an imbalance and pushing nurses to other areas of health care.

A Pandemic to Seal the Fate

As if the industry did not have enough to overcome, the COVID-19 pandemic has inflicted devastating consequences, including an estimated 200,000 deaths in LTCFs. In addition to the unthinkable human toll, this has ultimately led to shrinking occupancy. According to the National Investment Center for Seniors Housing & Care, skilled-nursing occupancies plummeted to 70.7 percent, down from the pre-pandemic level of 86.6 percent. More broadly, senior-housing occupancy in the U.S. reached a record low of 78.8 percent in the first quarter of 2021, falling nearly nine percentage points from the previous year.[4]

Early in the pandemic, when hospitals limited procedures, referrals to SNFs plummeted. As deaths mounted, seniors and their families became justifiably scared of the apparent risks. Likewise, many hospitals began to discharge more patients to home health in 2020 rather than to skilled-nursing facilities to avoid those that were overrun by the virus.

The skilled-labor shortages and wage pressures of the health care industry have been made even worse by the Great Resignation. According to the Bureau of Labor Statistics, "[o]verall, long-term care workforce levels are at their lowest in 15 years, with 409,100 jobs lost between February 2020 and January 2022. The decline has been especially noticeable in skilled nursing, which experienced a 15 percent workforce decline during that time."[5]

More than half of all nursing homes have had to turn away new residents due to an inability to staff at the required levels. So, even where demand exists, labor shortages minimize the ability to capture it. The cost of labor is increasing dramatically, as are the costs for goods and services needed for operations, including new costs associated with policies and equipment related to virus containment.

As a result of these factors, 17 of the 33 chapter 11 filings by LTCFs since 2016 were filed in the two years since the beginning of the pandemic.[6] Distress is now more visible in the long-term-care space because operators are running out of various forms of government funds. Simultaneously, with recent upticks in interest rates, creditors are beginning to take a hard look at their underperforming assets, and generous "wait-and-see forbearance" is transitioning to "forbearance with a plan for exit." Furthermore, LTCF operators may face COVID-related litigation, which will increase the number of chapter 11 filings in this space.

4 "U.S. Seniors Housing Occupancy Reaches New Low," Nat'l Inv. Ctr. for Seniors Housing & Care (2021), *available at* nic.org/news-press/u-s-seniors-housing-occupancy-reaches-new-low.

5 "The Employment Situation," Bureau of Labor Statistics (April 2022), *available at* www.bls.gov/news.release/pdf/empsit.pdf.

6 *Debt Wire* (Feb. 10, 2022).

Evaluating LTCF Opportunities

Even a nonexpert can ask questions to determine whether a facility is viable and can obtain new financing, sell as a going concern or successfully reorganize. To start, it is important to understand the 13-week cash flow projection and whether the runway to operate and execute a plan exists. The following provides a snapshot of current performance and are standard diligence requests: (1) state survey information and status of licensing and staffing levels/certifications; (2) census, payer mix and net operating income (NOI); and (3) operational key performance indicators, such as case mix index and average cost of care are telling, and referral sources care about things like average length of stay, infection rates and readmission rates. As one attempts to determine the likelihood of reorganization, refinancing or a turnaround, there are key considerations:

- *Demand:* Are there competitors in the area that are thriving? This is the easiest and fastest way to determine whether the struggling facility can be revived with time and the right operator and marketing team.
- *Strength of the Sales and Marketing Team:* Is there a systematic way to consistently generate referrals/leads, and is it well documented? If so, and there is adequate demand and runway, reorganization may be plausible. If not, this can explain deficient performance and be remedied with a change in management.
- *Supply:* Are there newer facilities, particularly at the same price point, or any scheduled to be built?
- *Perceptions:* How has the subject fared through the COVID-19 pandemic, and are there red flags that could chill the ability to rebuild census (accidents or other incidents with or without litigation)?
- *Financials:* When was the subject last profitable? Using conservative assumptions regarding census, what is the available cash flow to service the debt? Are there existing rent concessions that will expire soon, or anything else that will cause a bump (or decline) in revenue? Are there other opportunities for revenue enhancement, such as increasing ancillary services, increasing the level of acuity handled or adding memory care?

Viable Solutions to Persist

Most LTCF owners will want to pursue a solution that allows them to maintain equity. If refinancing is the goal, a new lender will require a debt-service-coverage ratio of 1.3 to 1.5x depending on variables such as term, amount of equity and the type of services offered at the facility. Absent that cashflow, the borrower has two alternatives to live to fight another day: a bridge loan or sale-leaseback. If management can show a path to profitability in two years or less, the business may be able to borrow 50 to 70 percent of fair market value and pay interest only (or accrue it) as a "bridge" to stabilization, capitalizing on the ability to refinance or sell.

The practice of having an operating company (Op Co) and a property company (Prop Co) for each LTCF is common, so a sale-leaseback of the property, or Prop Co, may allow the troubled operator to keep the Op Co while paying off some

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Intensive Care: Senior Care in Distress

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debt and buying time for a turnaround. There are numerous real estate investment trusts (REITs) focused on acquiring these facilities. They will require earnings before interest, taxes, depreciation, amortization and rent (EBITDAR)-to-rent coverage of 1.1 to 1.5x depending on the type of care and other factors. Troubled facilities tend not to be Class A (which is what REITs are after) and do not have much EBITDAR, so the buyer pool is often limited for distressed LTCFs.

For most, the next best option is to sell the asset and business together as a going concern to a strategic or financial buyer. Selling the facility for its intended use will almost always maximize value. Despite thin margins, LTCFs continue to garner interest from investors and lenders and, if not in rural areas, enjoy attractive valuations.

Valuation Considerations

While detailed explanations of valuation are beyond the scope of this article, the following may shed light on the basics and provide guideposts. The most common way that income-producing real estate is valued is using the income-capitalization method in which NOI is divided by a "cap rate" to get approximate value. The lower the cap rate, the higher the valuation.

Over the last decade, cap rates for LTCFs have been compressed (valuations high) due to easy and cheap money, the aging population and other factors. Current valuations are driven in part by the high costs of real estate and construction. The cost of building new facilities has inflated dramatically, making buying existing facilities more attractive. Furthermore, rising housing prices provide seniors with confidence and cash for entry fees and expenses, creating demand and room for higher rents. However, we are now in a rising-interest-rate environment, which tends to increase cap rates and stall housing markets.

Within senior living and care, cap rates vary broadly. The following exhibit shows current cap rates for different types and classes of LTCFs, as provided by CBRE's Seniors Housing Investor Survey.[7] Appraisals and values arrived at from cap rates are often very different than selling prices for distressed properties for many reasons, including shorter marketing periods, deferred maintenance, saturated markets and a lack of NOI.

Potential Alternative Uses

Senior-living and care facilities do not lend themselves well to being converted to an alternative real estate asset class without substantial capital and time investment. If a facility is going to be closed and liquidated, its value is only about 50 percent of what it was as a profitable and operating LTCF. If a buyer is not found that wants to improve and reopen the facility for its original purpose, the most common repositioning is to convert some (or all) ALF beds to other related senior-care uses to better meet a market need. The seller's advisors should investigate the local market to determine the need for related uses, such as behavioral health care, specialized dementia, independent living or other specialty units.

SNFs and ALFs are not easily convertible to typical residential uses, but some asset classes such as affordable senior housing, which do not require larger units, can make sense. Various states and cities are being generous about the availability of tax credits and other funding to support such conversions as affordable or workforce housing, particularly in urban

7 "U.S. Seniors Housing & Care Investor Survey 2022," CBRE (April 5, 2022), *available at* cbre.com/en/insights/reports/us-seniors-housing-and-care-investor-survey-2022.

Exhibit: Senior Housing & Care Capitalization Rates

		Class A			Class B			Class C		
		Low - High (%)	Avg. (%)	Change (bps)	Low - High (%)	Avg. (%)	Change (bps)	Low - High (%)	Avg. (%)	Change (bps)
Core	Active Adult	3.0 - 8.0	**4.6**	-26	4.0 - 8.0	**5.7**	-7	5.0 - 10.0	**6.8**	2
Core	Independent Living	3.0 - 8.0	**5.3**	0	4.0 - 9.0	**6.3**	-12	5.0 - 10.0	**7.3**	-9
Core	Assisted Living	4.0 - 9.0	**6.1**	-1	5.0 - 10.0	**7.1**	-9	6.0 - 11.0	**8.3**	-12
Core	Memory Care	5.0 - 10.0	**7.0**	-9	5.0 - 10.0	**7.6**	-16	6.0 - 11.0	**8.7**	-16
Core	Skilled Nursing	9.0 - 14.0	**10.7**	-17	9.0 - 14.0	**11.5**	-17	11.0 - 16.0	**13.3**	-2
Core	CCRC/LPC	5.0 - 10.0	**7.0**	0	6.0 - 11.0	**8.0**	-23	7.0 - 12.0	**9.0**	-25
Non-Core	Active Adult	3.0 - 8.0	**5.2**	-31	4.0 - 9.0	**6.2**	-12	5.0 - 10.0	**7.2**	4
Non-Core	Independent Living	4.0 - 9.0	**6.2**	-5	5.0 - 10.0	**7.1**	1	6.0 - 11.0	**8.1**	-2
Non-Core	Assisted Living	5.0 - 10.0	**6.8**	-10	5.0 - 10.0	**7.4**	-19	6.0 - 11.0	**8.5**	-7
Non-Core	Memory Care	5.0 - 10.0	**7.3**	-20	5.0 - 10.0	**7.9**	-19	6.0 - 11.0	**9.0**	-1
Non-Core	Skilled Nursing	9.0 - 14.0	**11.2**	-35	9.0 - 16.0	**11.7**	-38	11.0 - 16.0	**13.6**	-8
Non-Core	CCRC/LPC	6.0 - 11.0	**8.0**	-12	6.0 - 11.0	**8.4**	-26	7.0 - 12.0	**9.4**	-31
Avg. Change Per Class				-14			-17			-9

Source: 2022 CBRE Seniors Housing Investor Survey results, change from 2021.

areas. Likewise, there is public and charitable funding to ease homelessness in certain areas, and smaller units can fit that use.

If there is a college or university nearby, targeting buyers for conversion to student housing may be a consideration. Depending on the size of units and construction of dividing walls, in some cases LTCFs can be converted into apartments. Although they generate less revenue per unit than LTCFs, apartments have lower cap rates, and their prices have climbed steadily over the last 10 years. Some of the typical configurations for LTCFs work well for medical offices if they are situated in an area with demand. Conversion to general office space is less likely since the work-from-home movement, but it is possible. Finally, for facilities located in vacation destinations, depending on supply and demand and the configuration and amenities of the subject facility, hospitality operators may be potential buyers.

For all these alternative uses, buyers will value the property by comparing the purchase and repurposing costs to building or buying something already properly configured. Their valuation will be based on their estimated NOI and the cap rates appropriate to their intended use, adjusted for the cost of the repurposing. As a result, these valuations will be much lower than the existing use appraisal.

Conclusion

It is expected that distressed LTCFs are going to need help from this publication's readership. There are options to preserve the going concern, including refinancing, sale-leaseback or a sale of the business and property, and there are many ways to get a sense for the viability of each of those options. In the worst-case scenario, the real estate assets themselves often have value for alternative uses. abi

Value & Cents

By Paul Hinton and Dr. Adrienna Huffman

Mass Torts Gap in Contingent-Liability Valuation Guidance

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In mass torts, litigation-liability[1] valuation often plays a significant role in the assessment of proposed plan funding, third-party contributions, indemnification and settlements.[2] This has been seen in recent years in several large mass tort multi-district litigation and bankruptcy cases, including those involving LTL Management, Purdue Pharma, the Boy Scouts of America and Aearo Technologies.

Neither the Bankruptcy Code nor accounting standards provide specific guidance on how mass tort claims should be valued. However, courts have adopted a framework of estimating mass tort litigation claims at their expected present value,[3] both in connection with estimation proceedings under § 502(c) of the Bankruptcy Code, and (2) in avoidance actions involving tests of insolvency under § 547. These precedents provide guidance that fills in the gap left by the Bankruptcy Code and accounting standards.[4]

Valuation of Contingent Liabilities

The Bankruptcy Code defines "insolvent" as a condition in which liabilities exceed an entity's assets,[5] but it is not prescriptive as to how an entity's nonfinancial liabilities are to be valued. Contingent liabilities, which for accounting purposes include mass tort claims, are included in the Code's definition of an entity's liabilities,[6] but again, the Code — including §§ 502(c) and 547 — is silent on how contingent liabilities are to be valued.

The U.S. Generally Accepted Accounting Principles (GAAP) codifies contingent liabilities, referred to as loss contingencies, Accounting Standards Codification (ASC) Topic 450-20, but these rules do not employ the fair-value standard as a measurement basis.[7] Contingent liabilities are measured using the "most likely amount"[8] if it is likely that the associated contingent event is probable[9] and the amount of the loss can be reasonably estimated.[10] "Probable" is defined as "likely to occur," but no threshold or measurement basis is specified.[11]

The most specific GAAP guidance in relation to valuing mass tort claims is found in the contingent-liability rules related to litigation, claims and assessments, and is limited to the assessment of the reporting threshold.[12] It does not address the particular valuation issues related to mass tort claim liabilities.[13] Indeed, the bankruptcy courts have long recognized that GAAP rules do not provide applicable metrics for solvency determinations.[14]

Learning from Major Asbestos Bankruptcy Decisions

The use of bankruptcy to achieve the resolution of asbestos mass torts has resulted in significant cases in which expert issues relating to liability valuation were adjudicated. The expert testimony, cited authorities and courts' assessments of this testimony define a framework for estimating claims and show how the expected value approach can be used to value mass tort claims. The framework accepted by courts in these cases involves developing an exposed popu-

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1 The Third Circuit has defined a contingent claim as one that "the debtor will be called upon to pay only upon the occurrence or happening of an extrinsic event." *Frenville*, 744 F.2d at 336, n.7. A debt subject to default risk would not be a contingent liability, since a credit event is intrinsic to the lending relationship, not extrinsic.

2 *See, e.g.*, the bankruptcy of Johnson & Johnson's subsidiary LTL Management related to talc claims, Case No. 3:21-bk-30589 (Bankr. D.N.J.); Purdue Pharma LP bankruptcy related to opioid claims, Case No. 7:19-bk-23649 (Bankr. S.D.N.Y.); Boy Scouts of America bankruptcy related to sexual-abuse claims, Case No. 20-10343 (LSS) (Bankr. D. Del.); and Aearo Technologies bankruptcy related to claims of hearing loss claims, Case No. 1:22-bk-02890 (Bankr. S.D. Ind.).

3 This valuation method is typically implemented using discounted-cash-flow (DCF) models. A widely referenced exposition of the economic and finance theory of expected present value method is described in *Principles of Corporate Finance* by Richard Brealey, Stewart Myers, Franklin Allen and Alex Edmans (McGraw Hill).

4 The relevant literature spans disparate disciplines involved in claims estimation and valuation in mass torts. The bulk of the relevant literature is distributed across a number of areas of research: the estimation and demography of exposed populations; the estimation of hazard risks and injury rates, including epidemiology and studies in public health and occupational safety; the economics of claiming activity, including claimant recruitment and the propensity to sue; and the study of the tort system, including cost of compensation, which is encompassed within the field of law and economics.

5 11 U.S.C. § 101(32)(A) ("[A] financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation.").

6 The Bankruptcy Code's definition of "claim" is a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." *See* 11 U.S.C. § 101(5)(A).

7 "Fair value" is defined in ASC Topic 820 as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." This standard does not provide any guidance specific to mass torts.

8 According to ASC-450-20-30-1, "If some amount within a range of loss appears at the time to be a better estimate than any other amount within the range, that amount shall be accrued. When no amount within the range is a better estimate than any other amount, however, the minimum amount in the range shall be accrued."

9 Under GAAP, "the single most likely outcome within the range is used without consideration of the other possible outcomes." *See* "Accounting for Legal Claims: IFRS Compared to U.S. GAAP," KPMG (Feb. 28, 2019), *available at* kpmg.com/us/en/articles/2023/measuring-provisions.html (last visited on Jan. 2, 2024).

10 ASC 450-20-25-2.

11 "While there is diversity in practice ... the threshold for 'probable' would need to be at least 70 percent." *See* "Roadmap: Contingencies, Loss Recoveries and Guarantees," Deloitte (March 2023), p. 21.

12 ASC 450-20-55-10.

13 *Id.*

14 *See, e.g., Babcock & Wilcox Co. v. Babcock & Wilcox Co.*, 274 B.R. 230, 259 (Bankr. E.D. La. 2002) ("Virtually all of the cases that discuss GAAP in the context of a solvency analysis recognize that the court is not bound by GAAP in making a solvency determination.").

lation,[15] as well as estimating expected claiming rates and related per-claim expected values.

The first step in the framework involves methods of modeling exposed populations that were developed by epidemiologists working in the field of industrial hygiene. Perhaps the most widely cited is one from a seminal 1982 paper by epidemiologist Dr. William Nicholson and his colleagues.[16] He forecasted future injuries from an existing exposed population using an epidemiological dose-response function. This work was relied on by liability valuation experts in the 1995 *Eagle-Picher Industries* bankruptcy estimation, and Dr. Nicholson was hired in that case to update his original study through the bar date.

In its decision on estimation, the court accepted the four experts' estimates that were each based on Dr. Nicholson's forecast approach.[17] In addition to using the Nicholson method to forecast future injuries, the court endorsed a discounted-expected-value approach and identified factors that it considered important to estimate the value of future claims, including using the history of claim filings against the debtor and past settlement values.

In the *Babcock & Wilcox* bankruptcy in 2002, other related methods were also evaluated and relied on. The debtor's expert, Dr. Frederick Dunbar, testified on various methodologies — described in his 1996 book, *Estimating Future Claims* — for determining future asbestos liabilities.[18] Another expert in the case, Dr. Thomas Florence, used an alternative approach for estimating the size of an exposed population from known claims data. This approach, known as the Walker method (after Harvard epidemiologist Alexander Walker, who developed it in a 1983 article), involves estimating "the effective number of asbestos-exposed workers required to produce the current national incidence of mesothelioma."[19] The court ruled that the contemporaneous forecasts developed by the company were reasonable based on Dr. Dunbar's expert assessment, even though these forecasts — unlike the Nicholson and Walker approaches — did not rely on epidemiology.

The question of how to estimate expected claiming rates and the corresponding expected value of claims was also adjudicated in both the 2006 *Owens Corning* and the 2014 *Garlock* bankruptcies. These courts deviated from the *Eagle-Picher* court's view that the volume of claim filings and the value of settlements close to the bankruptcy date determine the value of the liability. In these later decisions, the courts found that claim liabilities could, in certain circumstances, be artificially inflated if recent settlement values and filing rates were used to compute claims-liability estimates.

In *Owens Corning*, the court found that tort reforms indicated that expected values would be lower than historical claim values.[20] The court reasoned that historical trends in filings and settlement costs were not indicative of future claim liability as of the petition date, but rather that "adjustments should be made to historical values."[21]

Later, in *Garlock*, the court found that improper plaintiff-litigation strategies, including selective disclosure of other sources of claimant exposures to asbestos, had inflated historical tort settlement values. The court ruled that the company's past settlement history was so distorted as to "make [Garlock's] settlement history an unreliable predictor of its true liability." Instead, the court endorsed an estimate of "true liability" based on Garlock's share of liability relative to other defendants overall. The debtor's expert referred to this as the "legal liability" approach.

Guidance from Fraudulent-Transfer Cases

Court decisions in fraudulent-transfer cases also provide guidance on the valuation of mass tort liability in the context of solvency. The most recent cases described herein treat mass tort liabilities as certain rather than contingent liabilities for solvency purposes. These cases also have endorsed the same estimation framework and discounted expected value approach.

Mass Tort Liabilities Are Not Contingent

In 2002, the court in the *Sealed Air* case was asked to rule on the "legal standards applicable to determining the debtor's solvency" as a result of a transfer of asbestos-claim liabilities.[22] In contrast to treatment under the GAAP, the court ruled that the future mass tort claim liabilities are not contingent liabilities[23] for the purposes of solvency analysis because mass tort liabilities arising from past exposures do not depend on a future extrinsic event.[24] Instead, the court found that unasserted future claims arising from pre-existing asbestos exposures impose liabilities that are certain; only their magnitude is uncertain.[25]

From an economic valuation perspective, the injury incidence and propensity to claim together generate the average probability of occurrence of individual future claims from the exposed population. The certainty equivalent value of the claims liabilities in the aggregate equals the expected value of individual claims across the entire population. In this way, the expected value calculations implicit in the standard-esti-

15 Sources of data from which exposed populations can be developed include employment data, sales data, claims data or population census data. *See, e.g.*, Lucy P. Allen, Denise N. Martin, Simona Heumann, Paul Hinton & Faten Sabry, "Forecasting Product Liability by Understanding the Driving Forces," Global Legal Group, *The International Comparative Legal Guide to Product Liability 2006: A Practical Insight to Cross-Border Product Liability Work* (June 2006).

16 William J. Nicholson, George Perkel & Irving J. Selikoff, "Occupational Exposure to Asbestos: Population at Risk and Projected Mortality — 1980-2030," *Am. J. of Industrial Medicine* 3:2S9-311 (1982).

17 *In re Eagle-Picher Indus.*, 189 B.R. 681, 690 (Bankr. S.D. Ohio 1995).

18 Frederick C. Dunbar, Denise Neumann Martin & Phoebus J. Dhrymes, *Estimating Future Claims: Case Studies from Mass Tort and Product Liability* (Andrews Professional Books 1996).

19 Alexander M. Walker, *et al.*, "Projections of Asbestos-Related Disease 1980-2009," *J. of Occupational Medicine* 25(5) (May 1983). In *Babcock & Wilcox*, Dr. Florence used a version of this method developed by Prof. Julian Peto.

20 The *Owens Corning* bankruptcy estimation hearing involved four expert estimates of asbestos-claim liabilities, which differed from lowest to highest by more than a factor of five. *Owens Corning v. Credit Suisse First Boston*, 322 B.R. 719 (D. Del. 2005).

21 The features of historical tort system settlements that one judge identified as requiring adjustments included the following: (1) forum-shopping; (2) overpayment to unimpaired claims; (3) group lawsuits; and (4) punitive damages. These adjustments are discussed further in Frederick C. Dunbar, Paul J. Hinton & Faten Sabry, "Forecasting Asbestos Liability After Recent Bankruptcy Decisions: How Forecasts Must Adjust for Changes in the Tort System," NERA Working Paper (June 8, 2006).

22 "The [plaintiff] committees maintained that the debtor's potential mass tort liability for future asbestos claims was known at the time of the transfer [to have been transferred] for less than fair value, and the debtor was thus insolvent at the time of the transfer, rendering the transfer fraudulent.... [T]he parties applied for a ruling *in limine* to determine the legal standards applicable to determining the debtor's solvency at the time of the transfer." *Official Comm. of Asbestos Pers. Injury Claimants v. Sealed Air Corp. (In re W.R. Grace & Co.)*, Case Nos. 01-1139 through 01-1200, Adv. No. 02-2210, Adv. No. 02-2211 (Bankr. D. Del. 2002).

23 This view was not shared in the earlier *Babcock & Wilcox* case, since the court in *Babcock & Wilcox* treated the asbestos claims as contingent liabilities. The *Sealed Air* court concluded that "it is difficult to satisfactorily explain why the *Babcock* court found that the post-transfer claims were contingent in the first place."

24 A contingent claim as defined as one in "which the debtor will be called upon to pay only upon the occurrence or happening of an extrinsic event." *Frenville*, 744 F.2d.

25 *In re Sealed Air*.

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mation framework incorporate the appropriate likelihood that individual claims will be filed, whether the unasserted claims are legally considered contingent or not.

Estimates Using the Expected-Value Approach

In the more recent *Tronox* fraudulent-transfer decision from 2013, the court endorsed the *Sealed Air* view that unasserted future mass tort claims are not contingent.[26] However, it also endorsed the plaintiff's expert's expected-value analysis based on the likelihood that future lawsuits would arise. Thus, the *Tronox* court agreed with the *Sealed Air* assessment that the liability associated with the future as-yet-unasserted claims is not contingent, and also endorsed the discounted expected-value approach.

26 *In re Tronox Inc. v. Kerr McGee Corp., et al.*, Case No. 09-10156 (ALG) (2013).

Conclusion

The Bankruptcy Code and GAAP do not provide specific guidelines in relation to the contingent liability valuation of mass torts. Fortunately, the specialized literature on estimating future claims — along with the expert analyses in prior cases that rely on these authorities and associated court decisions — provide valuation guidance. Such guidance is critical to determining the most appropriate methodology in each case, how to use past empirical evidence to calibrate forecasts, and how to account for changing conditions or distortions in the tort system that affect the value of mass tort liabilities. abi

OCTOBER 17, 2023

Supreme Court to Hear a Third Bankruptcy Case this Term: Standing Under § 1109(b)

Listen to Article 0:00 / 9:48

> Supreme Court to decide whether a creditor has standing to object to any provision in a chapter 11 plan, even provisions that don't affect the creditor.

To resolve a split of circuits, the Supreme Court agreed on Friday to hear a third bankruptcy case in the term that began this month. The justices will decide whether any creditor may object to confirmation of a chapter 11 plan, even if the creditor has no financial stake underpinning the objection. In other words, may creditors object to provisions in plans that do not affect them?

The Supreme Court will expound on the meaning of Section 1109(b). The subsection provides that:

> *A party in interest, including* the debtor, the trustee, a creditors' committee, an equity security holders' committee, *a creditor*, an equity security holder, or any indenture trustee, *may raise and may appear and be heard on any issue in a case under this chapter*. [Emphasis added.]

The insurance company taking the appeal to the Supreme Court from the Fourth Circuit is aiming for the justices to rule that the "party in interest" standard in Section 1109(b) for conferring standing in bankruptcy cases is equivalent to Article III standing, also known as constitutional standing. Typically, a litigant establishes Article III standing by showing (1) an injury in fact that is concrete, particularized and actual or imminent; (2) an injury fairly traceable to the defendant's conduct; and (3) an injury that can be addressed by a favorable decision. Ordinarily, the pivotal requirement is injury in fact. In this case, however, the issue may be whether the alleged injury was due to the debtor's conduct.

In the Supreme Court, the insurance company-petitioner wants the justices to rule that anyone who is a creditor in any capacity has the statutory right under Section 1109(b) to object to any aspect of a chapter 11 plan. Some courts have adopted a so-called prudential standard limiting objections to creditors affected by an allegedly offending feature of a plan.

Conceivably, the justices might side with the Fourth Circuit by holding that the insurance company didn't have Article III standing. If the Court finds Article III standing, the justices presumably will decide whether Section 1109(b) has a different and higher standard blocking objections except from creditors who are directly affected.

Conversely, if the Supreme Court concludes there was no Article III standing, the justices presumably will decide whether Section 1109(b) permissibly announces a lower standard permitting any creditor to object to anything in a plan.

Another way of looking at the case is to say that the Supreme Court is being asked to decide whether a creditor, to have standing in a bankruptcy case, must also be a "party in interest" with respect to the substance of the objection.

The Asbestos Plan

Faced with 14,000 pending lawsuits, the corporate debtor proposed a chapter 11 plan under Section 524(g) to create a trust dealing with present and future asbestos claims. All asbestos claims were to be channeled to the trust.

The principal asset for the trust was the debtor's primary insurance policy, which had a $5,000 deductible per claim and a coverage limit of $500,000 per claim. The insurer was obliged by the policy to defend and indemnify the debtor, even if the claim was false or fraudulent. The policy had no maximum aggregate limit, and it was non-eroding, meaning that defense costs were not counted against the policy limit for each claim.

The plan divided asbestos claims into two classes: (1) those covered by the policy; and (2) those not covered by the policy. Uninsured claims were to be paid entirely by the trust. According to the insurance company, there were no uninsured claims.

Claims covered by insurance were to be litigated in the tort system, nominally against the debtor but subject to the coverage limit for each claim. The trust would pay the $5,000 deductible for each claim.

The claims covered by insurance remained subject to the insurer's prepetition coverage defenses.

The uninsured claims were subject to antifraud provisions under the plan to protect the trust by requiring the claimants to provide disclosures designed to avoid fraudulent and duplicate claims. The plan had no antifraud provisions for insured claims.

Unsecured creditors were to be paid in full.

The asbestos claimants, the only class impaired by the plan, voted unanimously in favor of the plan. The only confirmation objection came from the insurer.

The insurer contended that the plan was not proposed in good faith because the anti-fraud provisions didn't apply to insured claims. The insurer also objected, contending that the plan was not insurance-neutral. The bankruptcy court wrote an opinion recommending that the district court approve the plan, finding that it was insurance-neutral and filed in good faith. Because the plan was insurance-neutral, the bankruptcy court concluded that the insurer was not a party in interest under Section 1109(b) and thus lacked standing to challenge the plan.

The district court confirmed the plan and adopted the bankruptcy court's findings *in toto* after *de novo* review.

The insurer appealed to the circuit.

The Fourth Circuit Affirmance

In February, the Fourth Circuit affirmed, in an opinion by Circuit Judge G. Steven Agee. *Truck Insurance Exchange v. Kaiser Gypsum Co. (In re Kaiser Gypsum Co.)*, 60 F.4th 73 (4th Cir. Feb. 14, 2023). To read ABI's report, **click here**.

Confusingly, the Fourth Circuit held that a creditor found by the bankruptcy court to have no standing *does* have standing to appeal the denial of standing to object to confirmation of the chapter 11 plan.

On the other hand, the Fourth Circuit found the plan to have been "insurance-neutral," thereby giving the insurance company no standing in the bankruptcy court or on appeal to object to the merits of the plan pertaining to any other aspects of the plan. In a footnote, the appeals court also said that the insurer had Article III, or constitutional, standing to challenge the finding of insurance neutrality.

The insurer argued that it also had standing on appeal to challenge other provisions of the plan, such as good faith, because it also was a creditor on account of unpaid deductibles. The Fourth Circuit held that the insurer, as a creditor, was subject to the strictures of Article III standing, also known as constitutional standing.

As a creditor, the insurer was unimpaired and had no objections to its treatment as a creditor. Thus, Judge Agee said, the insurer alleged no injury in fact as a creditor. Consequently, the insurer had no Article III standing "to object to aspects of a reorganization plan that in no way relate to its status *as a creditor* but instead implicate only the rights of third parties (who actually *support* the Plan)." [Emphasis in original.] *Id.*, 60 F.4th at 88.

The Fourth Circuit affirmed the district court's judgment because (1) insurance neutrality left the insurer bereft of bankruptcy standing under Section 1109(b), and (2) the insurer had no Article III standing as a creditor to object to other aspects of the plan.

The 'Grant' of '*Cert*'

The insurer filed a petition for *certiorari* in early May. In July, the justices requested a response from the debtor. The Court granted *certiorari* on October 13, with Justice Alito taking no part in considering the petition and thus suggesting that he will not participate in the ruling on the merits.

The insurer urged the Court to grant *certiorari* to resolve a split of circuits. According to the insurer, "the Third Circuit has held that Section 1109(b), by its plain text, simply codifies the right of any party with Article III standing to appear and be heard in Chapter 11 proceedings."

On the other hand, the insurer says that the "Fourth and Seventh Circuits have taken the opposite view . . . . [T]he Seventh Circuit held that Section 1109(b) silently preserved certain 'other' pre-Code "imitations on standing, such as that the claimant be within the class of intended beneficiaries of the statute that he is relying on for his claim.'"

The Ninth Circuit, according to the insurer, "has a foot in each camp."

The insurer summed up the grounds for having Article III standing and status as a party in interest by alluding to its "responsibility to pay claims against the debtor [that] makes confirmation of the plan a concrete, traceable, and redressable injury."

The Other Bankruptcy Cases this Term

There are already two bankruptcy cases on the Supreme Court's calendar for the term that began this month. In August, the Supreme Court granted *certiorari* in *Harrington v. Purdue Pharma LP*, 23-124 (Sup. Ct.), to decide whether chapter 11 plans can confer so-called nonconsensual, nondebtor, third-party releases. *Purdue* will be argued on December 4.

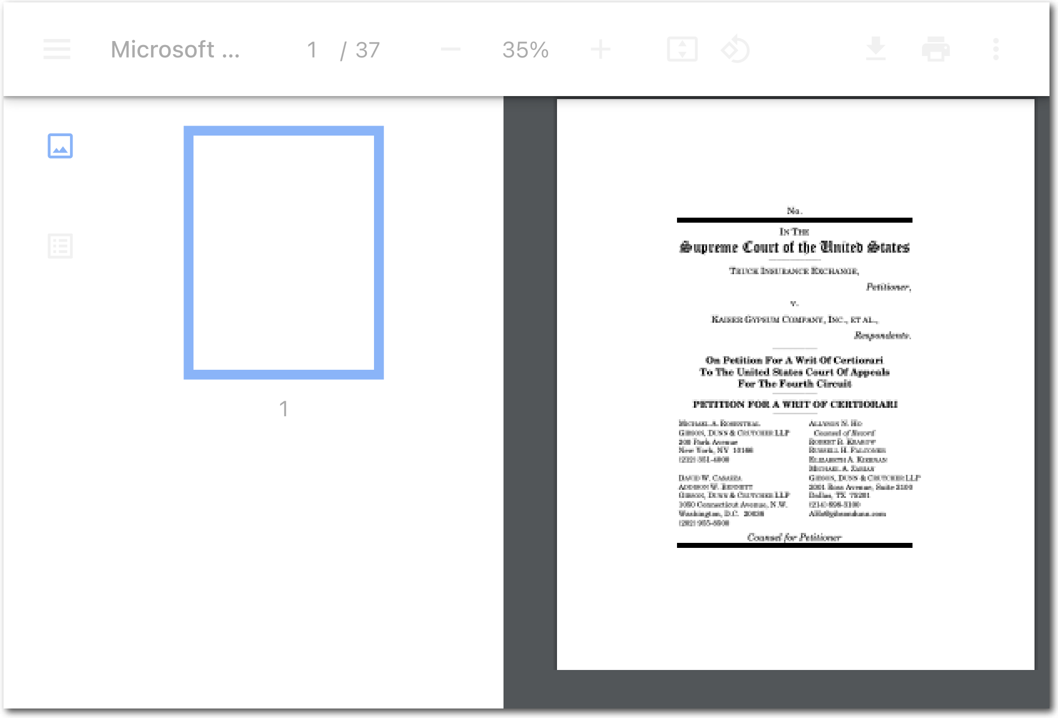
On September 29, the U.S. Supreme Court granted the U.S. Solicitor General's petition for a writ of *certiorari* in *Office of the U.S. Trustee v. John Q. Hammons Fall 2006 LLC*, 22-

1238 (Sup. Ct.), to decide whether chapter 11 debtors are entitled to refunds for overpayment of fees for the U.S. Trustee System.

In *Siegel v. Fitzgerald*, 142 S. Ct. 1770 (Sup. Ct. June 6, 2022), the Court unanimously held that the 2018 increase in fees paid by chapter 11 debtors to the U.S. Trustee System was unconstitutional because it was not immediately applicable in the two states with Bankruptcy Administrators rather than U.S. Trustees. The Court in *Siegel* explicitly left open the question of remedy. No date has been set yet for argument in *Hammons Fall*.

Opinion Link

PREVIEW



No.

IN THE
Supreme Court of the United States

TRUCK INSURANCE EXCHANGE,
Petitioner,
v.
KAISER GYPSUM COMPANY, INC., ET AL.,
Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

PETITION FOR A WRIT OF CERTIORARI

Counsel of Record

GIBSON, DUNN & CRUTCHER LLP

Counsel for Petitioner

https://abi-opinions.s3.amazonaws.com/Truck+Insurance.pdf

Case Details

Case Citation	Truck Insurance Exchange v. Kaiser

Gypsum Co. Inc., 22-1079 (Sup. Ct.).

Case Name	Truck Insurance Exchange v. Kaiser Gypsum Co. Inc.
Case Type	Business
Court	Supreme Court
Bankruptcy Tags	Plan Confirmation Venue/Jurisdiction Business Reorganization Mass Torts