AMERICAN BANKRUPTCY INSTITUTE

# 2017 New York City Bankruptcy Conference

CONCURRENT SESSION

# Health Care and Education


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2017

# Background: The Higher Education Act

- The Higher Education Act was enacted in 1965 (*16. Pub. L. No. 89-329).*
- Title IV of the HEA established a Federal program of loan insurance for students who did not have reasonable access to a State or private nonprofit program
- Program administered by the Department of Education provided postsecondary students with financial aid via federal grants and federally backed loans including Pell Grants, Stafford Loans, PLUS Loans and others
- Program participation agreement (PPA) must be entered into with the Secretary of Education for an institution to be eligible. PPA imposes certain requirements including:
  - 90/10 rule
  - Limitations on cohort default rate
  - Publication of accurate employment and graduation statistics
  - Operation of a drug abuse prevention program
- National Vocational Student Loan Insurance Act of 1965 extended the loan program to vocational and technical schools

# Background: Growth in the For-Profit Sector

- Report by New York Federal Reserve Bank described trends (although recently enrollment has slowed)
  - 3x as many students attended for-profit schools in 2015 as compared to 2000
  - 36% more for-profit schools during the same period
- As much as 81% of the market is comprised of less-than-two-year programs
- Growth attributable to several factors
  - Bush Administration relaxed regulations that allowed more for-profit programs to be viable
  - Recession resulted in a larger pool of students seeking retraining
  - Rise in technology based education made programs more viable
- Demographics show that attendees skew toward the following:
  - Single parents
  - Lower family incomes
  - More GED

# Title IV

- Concerns about business practices of for-profit or private institutions came to the forefront first in the late 1980s
  - Lack of Funding
  - Aggressive Recruiting
  - Front-loading tuition
  - High salaries and use of tuition monies on other non-education related costs
- Fear was that institutions could (or had) collected the Title IV funding and then filed for bankruptcy leaving the students without an education or recourse
- HEA was amended in 1992 to provide that if an institution filed for bankruptcy protection then it would no longer be eligible for Title IV funding
- Effectively, this regulation made it impossible for higher education institutions dependent on Title IV protection to avail themselves of bankruptcy protection

# Title IV: In re Betty Owen Schools, Inc.

- Bankruptcy Decision by the Southern District of New York in 1996
- Facts
  - A not-for-profit vocational school located in New York City
  - Debtor sold substantially all of its assets to a new owner in a 363 sale in a chapter 11 proceeding.
  - New owner had to reapply for Title IV eligibility because of the purchase
    - Purchasers can typically apply immediately
    - Avoid two-year waiting period for a new school
- Department of Education refused to allow new owner to take advantage of expedited process
  - School lost Title IV eligibility upon the bankruptcy
  - New owner was therefore subject to the standard waiting period
  - Debtors and new owner argued that § 525(a) of the Bankruptcy Code prohibited the action by the DOE
- Court found for the DOE
  - Congressional judgment on Title IV was specific and therefore trumped general bankruptcy policy
  - New owner took a business risk when it elected to proceed through a chapter 11 proceeding

# Title IV: In re: Lon Morris College

- Bankruptcy Decision by the Eastern District of Texas in 2012
- Facts
  - Private junior college located in Texas
  - College ran out of cash in 2012
  - Filed Chapter 11 to recapitalize or effect a going concern sale
- DOE notified Lon Morris was no longer eligible for Title IV programs
- College response
  - Sought 525(a) injunction
  - Monetary damages
- Court found for the DOE
  - Adopted Betty Owen reasoning
  - Congress made a specific public policy choice in this situation
  - Judge recognized Lon Morris was not attempting to use the Bankruptcy Code inappropriately to take advantage of students but determined that didn't matter
- Order affirmed by appellate court and college liquidated

# Student Claims: Right to Sue

- Enrollment agreements generally include provisions limiting student rights to bring claims
  - Binding arbitration clauses
  - College selects arbitrator
  - Acts as an effective bar to class class-action lawsuits
  - Limited discovery
  - Limited to no right to appeal
  - Private tribunals
- Consumer protection laws in many states limited the effectiveness of many of those provisions until 2011
- Supreme Court ruling In AT&T Mobility LLC v. Concepcion et ux.
  - States cannot reject arbitration clauses as "unconscionable" solely because they bar class-action lawsuits and jury trials
  - Applied to most for-profit college students as well as for consumers of many financial products
- Limited the ability of Courts to fashion a judicial remedy for students where these clauses existed

## Student Claims: Corinthian Colleges

- Corinthian Colleges filed for bankruptcy protection in 2015
- Company Closed
  - Closing of locations happened over time
  - 120 colleges and 110,000 students at its peak
  - Valued at more than $1.4 billion at its height
- Cause of Closing
  - DOE slowed its access to federal financial aid and ultimately accused certain of Corinthian's schools of misleading students
  - Consumer Financial Protection Bureau sued the company for allegedly duping students with fake job placement promises
  - Federal and state authorities investigated and in some cases sued Corinthian
  - DOE levied a $30 million fine

## Student Claims: Corinthian Colleges

- Student committee
  - Committee created on behalf of the school's 500,000 former students
  - Total student claims of $2.5 billion for voting purposes (tort liability alleged to be greater)
  - Separate from the unsecured creditors committee
- Negotiation for a student trust seeded with over $4 million specifically for student claims
  - Money was unlikely to be distributed to students
  - Pursuit of litigation to obtain forgiveness or discharge of loans
- DOE fashioned a program for Corinthian students to obtain forgiveness of loans
  - Application process through DOE
  - Working with state attorney generals to determine bases on which debt could be forgiven

# Student Claims: ITT Tech

- ITT filed for bankruptcy protection to liquidate its business in September 2016
  - Shut down 137 campuses
  - 35,000 students and 8,000 employees
- Reasons for Closing
  - DOE decision to curtail ITT's access to federal student aid
  - Accrediting body threatened to pull its accreditation
  - Lawsuits and investigations.
  - ITT was being investigated by more than a dozen state attorneys general and two federal agencies for fraud, deceptive marketing or steering students into predatory loans

# Student Claims: ITT

- Students brought a law suit in the bankruptcy proceeding estimated at $7.3 billion of damages
  - Group of former ITT Tech students moved to intervene in proceedings
  - Act as representatives students
  - Filed over a thousand pages of first-hand accounts from students who attended ITT
  - Trustee objected
  - Judge determined it was unquestionably appropriate to permit former students to file their claims as a group, rather than individually
- Judge denied trustee's motion to hire a company to begin collecting on loan accounts
  - Students objected arguing that trustee would confuse former students and expose ITT's estate to liability for collecting bad debts
  - Request denied preliminarily while trustee meet with lawyers for former students to discuss their positions on continuing debt collection against former ITT students
  - Accounts are perceived as one of the assets available to the estate
  - Students seeking loan forgiveness

# Student Loans: Dischargeability

- Difficult to obtain a discharge for student loans
- Test is "undue hardship"
- Most courts use Brunner test *(Brunner v. New York State Higher Educ. Servs. Corp., 831 F. 2d 395 (2d Cir. 1987)*
  - Debtor cannot maintain a minimal standard of living
  - Likely to persist for a significant portion of the repayment period of the student loans
  - Debtor has made good faith efforts to repay the loans
- Borrower defense against repayment rule provides a defense based on any act or omission of the school attended by the student that would give rise to a cause of action against the school under applicable State law

AMERICAN BANKRUPTCY INSTITUTE
NEW YORK CITY BANKRUPTCY CONFERENCE
Healthcare and Education Panel

# HEALTHCARE INSOLVENCIES: TRENDS AND CONSIDERATIONS IN ASSET SALES

MAY 18, 2017
10:00 to 11:15 a.m.

## Topics for Discussion

- Healthcare Industry Market Trends
- Bankruptcy Code Section 363 Sale of Assets and Other Statutory Predicates
- Not-For-Profit Laws and Regulations
- Notable Trends:
  - Bankruptcy Court Section 363 Approval is Not Subject to State Court Approval
  - Bankruptcy Protection Can Provide Breathing Room for, and Expedite, a Healthcare Provider's Sale
- Government Deals and Prepackaged Reorganization Plans
- Other Key Considerations

# Healthcare Industry:
## Current Market Trends

- **Hospitals (including rural hospitals) are failing at a rapid rate**
  - Lack finances (attributable to, among other things, federal spending and reimbursement cuts).
  - Migration of populations to urban environments.
- **Healthcare consolidation frenzy**
  - Mergers, acquisitions, joint ventures, and joint operating agreements have increased from 66 in 2010 to 112 in 2015, and a slight dip in 2016 with 102 transactions.
    - Benefits of market power of larger organizations.
    - Affordable Care Act implications.
  - In 27 of the 102 transactions in 2016, the acquiring entity was for-profit; in 74 transactions, the acquiring entity was not-for-profit; and in one transaction, a not-for-profit and for-profit organization jointly acquired an organization.
    - New York bans for-profit companies from owning hospitals, does not allow a publically traded company to own hospitals, and limits private equity investments in hospitals.
  - Creation of regional systems.
    - Growth of urgent care, walk-in facilities, and minute clinics.
- **Acquisitions of Distressed Health Care Assets**
  - Bankruptcy is a cost-effective way to market and sell assets free and clear of liens, claims, encumbrances, and interests.
  - For example, Prime Healthcare Services has seized this opportunity, acquiring Southern Regional Medical Center, Coshocton (Ohio) County Memorial Hospital, and Saint Michael's Medical Center in Chapter 11 cases.



# Unique Elements of Healthcare Transaction

- **Disposal of Patient Records – Section 351 of the Bankruptcy Code**
  - If insufficient funds exist to pay for storage of patient records pursuant to state and federal law, the trustee must (i) publish a notice of least 365 days in advance of its intent to destroy patient records, (ii) send notice during the first 180 days to each patient or insurance carrier regarding the claiming or disposal of the records, (iii) make a written request to each appropriate federal agency to accept any unclaimed records that remain.
- **Cost of Implementing Electronic Health Record (EHR) Systems**
  - To comply with the Patient Protection and Affordable Care Act, hospitals are transitioning patient records to electronic form.
  - Partners HealthCare spent over $1 billion implementing its EHR system, taking approximately three years to complete.
  - The MD Anderson Cancer Center reported a 57% drop in adjusted income in the seven-month period ending March 31, 2016 – a $160.5 million decrease that it attributed to its EHR implementation.

## Unique Elements of Healthcare Transaction (continued)

- **Corporate**
  - Any necessary approvals based on seller's and purchaser's corporate governance must be obtained.
- **Regulatory Review**
  - Consider ability of proposed purchaser to be approved by state and local regulatory agencies to hold required licenses.
  - Timing for purchaser to acquire license is fact-specific and needs to be considered in structuring transaction.
  - NY not-for-profit corporation law section 510: Attorney General (Charities Bureau) or NYS Supreme Court approval are required for the transfer of all or substantially all of a not-for-profit seller's assets and other fundamental changes in not-for-profit corporations, such as a change of purposes.
  - Transfer / assignment of Provider Agreement and Provider Number enable purchasers to continue to bill Medicare and Medicaid without interruption. However, this comes with successor liability concerns.
- **Third Party Consents**
  - Consider notices or consents required in seller's contracts.
  - Other applicable laws may require additional consents or approvals.

5

## Bankruptcy Code Section 363: Acquisition Tool

- Under section 363 of the Bankruptcy Code, a debtor may only sell assets "outside of the ordinary course of business" with approval of the Bankruptcy Court.
  - Section 363(f) of the Bankruptcy Code allows a debtor to sell assets "**free and clear of any interests in such property**" which allows a purchaser to buy assets from a debtor that are not subject to successor liability subject to certain exceptions.
  - In a healthcare transaction, the acquirer assumes a hospital's Medicare provider number and related agreements, which are subject to the government's right to seek recoupment of overpayments made by the debtor prepetition.
- Section 363 sales can be done expeditiously and require only 21 days notice under Rule 2002 of the Federal Rules of Bankruptcy Procedure.
  - The notice period can be shortened for cause and extended to run a marketing process if there is not an urgent need for Bankruptcy Court approval.
- The "free and clear" characteristic of a 363 sale provides an incentive for companies to buy the assets of an insolvent hospital after it has filed for bankruptcy.

6

## Section 363 Sales:
### Healthcare Specific Bankruptcy Code Provisions

- **Section 363(d)(1)**: A trustee may only use, sell, or lease property "only in accordance with **non-bankruptcy law**" that governs the transfer of property by a "corporation or trust that is not a moneyed business, commercial corporation, or trust."
  - For example, Section 510 of New York Not-For-Profit Corporation Law requires the Attorney General (Charities Bureau) or the New York Supreme Court approve the transfer of all or substantially all of a not-for-profit seller's assets and other fundamental changes in not-for-profit corporations, such as a change of purpose.
- **Section 541(f)**: Addresses transfer of assets of a not-for-profit entity to a for-profit purchaser: "property that is held by a [501(c)(3) corporation] debtor . . . may be transferred to an entity that is not such a corporation, but only under the same conditions as would apply if the debtor had not filed a case under this title."
- **Section 1129(a)(16)**: Applies the requirements of 363(d)(1) and 541(f) to confirmation of a plan.
- **Section 333**: Provides for a patient ombudsman to be appointed 30 days after the commencement of a bankruptcy case. Accordingly, courts consider how a potential sale will affect patients and want assurance that any sale will not adversely impact the quality of patient care.

7

## Section 363 Sales:
### Not-For-Profit Laws and Regulations Apply

- **Bankruptcy Courts consider factors other than price when evaluating 363 asset sales of healthcare providers, such as hospitals, nursing homes, and continuing care residential cooperatives.**
  - Outside of bankruptcy, directors have a duty of, among other things, obedience to the charitable mission.
  - When balancing these interests, the **highest economic offer may not be the best offer**, and courts may defer to state authorities:
    - *In re United Healthcare Sys., Inc.*, Civ. A. 97-1159 (NHP), 1997 WL 176574, at *5, *10 (D.N.J. Mar. 26, 1997): The "highest and best" offer should not always prevail, "[r]ather, the [c]ourt must not only weigh the financial aspects of the transaction but also look to the countervailing consideration of a public health emergency." Further, "the bankruptcy court may not impede the State in its obligation to protect the health and safety of its citizenry."
  - A lower bidder may win if a sale to that bidder would help **maintain the charitable mission** of the organization:
    - *In re HHH Choices Health Plan, LLC, et al.*, 554 B.R. 697 (Bankr. S.D.N.Y. 2016) ("It is clear under state law that price alone is not determinative, and that fulfilling the corporate mission can be decisive if creditors are all being paid in full.").

8

## Section 363 Sales:
### Notable Trends

- **Bankruptcy Court section 363 approval is not subject to state court approval**
  - ***In re HHH Choices Health Plan, LLC, et al.*, 554 B.R. 697 (Bankr. S.D.N.Y. 2016)**
    - In May 2015, an involuntary petition was filed under Chapter 11 of the Bankruptcy Code against nursing home HHH Choices Health Plan, LLC ("Hebrew Health"), and on June 1, 2015 Hebrew Health consented to the petition.
    - Hebrew Health sought to sell substantially all of its assets pursuant to various provisions of section 363 of the Bankruptcy Code. Under New York Not-For-Profit Corporation Law, section 511 requires that the New York Supreme Court approve any transfer of the assets of an insolvent not-for-profit corporation.
    - The Bankruptcy Court (Judge Wiles) held, pursuant to section 1221(e) of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), no court other than the Bankruptcy Court can approve the transfer of property of the estate, and furthermore, that while state law requirements apply, the analysis under section 511 must be performed by the Bankruptcy Court because the Bankruptcy Court has "exclusive jurisdiction over the estate and the disposition of its assets."
    - When evaluating the competing bids under section 511, the court took a holistic approach finding that "the mission can be an appropriate consideration, but it does not answer the question of how much weight to give to that factor."
    - The court examined (i) how a potential sale to each bidder would effect the continuation of Hebrew Health's original mission, (ii) the likelihood that the bidder could close the transaction, (iii) the ability of the bidder to receive the necessary regulatory approvals, (iv) the effect of the sale on creditor continuances, (v) the interests of Hebrew Health's employees, (vi) the interests of former and current Hebrew Health residents, (vii) the ability of the bidder to make certain contractual payments, and (viii) the ability of the bidder to make refund payments to certain residents.
    - The court approved the sale to a bidder that was backed by the Hebrew Health's board, rather than the highest bidder, which was backed by the UCC, reasoning that the effects of the different proposals on the general unsecured creditors would be negligible, but the initial bidder would uphold the mission of Hebrew Health and better serve the interests of its current residents.

9

## Section 363 Sales:
### Notable Trends

- **Bankruptcy protection can provide breathing room for, and expedite, a healthcare provider's sale**
  - ***In re Saint Michael's Medical Center, Inc.*, Case No. 15-24999 (D.N.J.)**
    - On August 10, 2015, the Newark hospital Saint Michael's Medical Center, Inc. ("SMMC") filed voluntary Chapter 11 petitions.
    - Prior to filing, SMMC engaged in sale discussions with Prime Healthcare Services, a for-profit company, but due to the state's long review process (which, by the time of filing, had spanned over two years), SMMC filed Chapter 11 to provide it with enough breathing room to stay solvent while waiting for state approval of the sale. Prior to filing, SMMC also faced a report by a state-commissioned report recommending that the hospital cease operating as a full-service hospital and be converted to outpatient ambulatory/emergency care facility because five hospitals in the Newark area had excess capacity, and three of them, including SMMC should cease operating as full-service hospitals.
    - After a competitive auction, the Bankruptcy Court approved SMMC's sale to Prime Healthcare Services for $62 million- nearly $13 million above the stalking horse offer. Prime Healthcare Services also committed to spend at least $50 million in capital improvements.
    - After the Bankruptcy Court approved the sale, and nearly six months later, a New Jersey Superior Court and the Christie Administration approved Prime Healthcare Services' purchase of SMMC.
    - In February 2017, it was reported that SMMC turned a profit, something it had not accomplished in many years prior to the bankruptcy.

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# Other Considerations:
## Trends in Healthcare Prepackaged Reorganization Plans

- **Government Deals and Prepackaged Reorganization Plans**
  - A prepackaged bankruptcy begins with the filing of a Chapter 11 plan of reorganization that has already been accepted by creditors, or where solicitation of plan approval by such creditors has already commenced.
- ***In re Millennium Lab Holdings II, LLC* (D. Del. Mar. 17, 2017)**
  - After a failed out-of-court restructuring, on November 10, 2015, Millennium Lab Holdings II and its affiliated debtors filed its Chapter 11 bankruptcy petition and, concurrently therewith, a prepackaged reorganization plan (the "Plan").
  - Prior to filing, debtor Millennium Health, LLC ("Millennium") entered into a $256 million agreement with the government, settling allegations that it violated the False Claims Act, Stark law, and the Anti-Kickback Statute for billing Medicare and Medicaid for medically unnecessary testing, including billings submitted for 59 deceased patients.
  - The Delaware Bankruptcy Court entered an order confirming the Plan (the "Confirmation Order"), which included nonconsensual third-party releases in favor of non-debtor equity holders, with no option for lenders to opt-out of the releases.
  - Several lenders wanted to opt-out and, prior to confirmation, filed a complaint against the Debtors' former owners asserting various state law fraud and federal RICO claims. Aware that approval of the Plan would enjoin them from prosecuting these claims, the lenders argued the Bankruptcy Court lacked subject matter jurisdiction and statutory authority to approve the releases. The Bankruptcy Court overruled these objections, and found that it had, at the very least, "related to" subject matter based on the indemnification provisions in Millennium's operating agreements and individual prepetition indemnification agreements.
  - The lenders appealed the Confirmation Order, and on March 17, 2017, the Delaware District Court remanded the case back to the Bankruptcy Court, questioning whether post *Stern v. Marshall* the Bankruptcy Court had the constitutional adjudicatory authority to "enter into a final order discharging Appellants' non-bankruptcy state law claims against non-debtors without Appellants' consent."

11

# The Healthcare Industry & Section 363 Sales:
## Other Key Considerations

- **Always think of patients:**
  - The courts will consider how a potential sale of a health care provider will affect patients and will want assurance that any sale will not result in a decrease in the quality of patient care.
- **Have a purchaser lined up at filing:**
  - Having a "stalking horse" bidder prior to an auction will not only result in a higher offer, but potentially mitigate the regulatory, state law, antitrust, and practical issues that affect a hospital 363 sale.
- **Health Insurance Portability and Accountability Act of 1996 (HIPAA) laws apply:**
  - HIPAA establishes national standards to protect individuals' medical records and other personal health information.
  - To avoid a HIPAA violation, HIPAA laws should be strictly complied with to make sure that all patient records are properly retained or disposed of.
- **Successor liability:**
  - Although assets are purchased free and clear of any prepetition "interests" in those assets in a 363 sale, some claims survive the sale process.
  - According to CMS, the provider agreement is an executory contract and a purchaser taking an assignment of the provider agreement accepts any pre-sale liability arising thereunder, whether known or unknown, should the debtor / seller not satisfy such liabilities.
- **Non-bankrupt rules apply:**
  - Sales of healthcare providers are subject to a myriad of different regulatory considerations, and proper diligence is needed to confirm compliance with these regulations will be maintained throughout the process.

12

# Contact Information

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# Recent Bankruptcy/Healthcare Case Law:

## U.S. Bankruptcy Court Jurisdiction

*In re: Bayou Shores SNF, LLC*, 828 F.3d 1297 (2016) (11th Circuit)

## Enforcement of the Automatic Stay

*Parkview Adventist Medical Center v. United States on behalf of Department of Health and Human Services*, 842 F.3d 757 (2016) (1st Circuit)

1

# Recent Bankruptcy/Healthcare Case Law:

- Takeaways:
  - Medicare/Medicaid provider agreements ("Provider Agreements") are surrounded by "bet the case" land mines.
  - *Bayou Shores* joins a circuit split in answering if the Bankruptcy Court has jurisdiction over Provider Agreements with the debtor.
  - *Parkview* sidesteps the jurisdictional question, but limits the protections of the automatic stay and thereby the enforceability of Provider Agreements.

2

# Medicare & U.S. Bankruptcy Court Jurisdiction

*In re: Bayou Shores SNF, LLC*, 828 F.3d 1297 (2016) (11th Circuit)



# Medicare & U.S. Bankruptcy Court Jurisdiction

*In re: Bayou Shores* (2016)

- Background:
  - From 1939 through 1984, undisputed that U.S. Bankruptcy Courts lacked jurisdiction over Medicare claims.
  - In 1984, Congress recodified portions of the Judicial Code and opened the jurisdictional door for U.S. Bankruptcy Courts.
- Key question:
  - Did statutory revision to 42 U.S.C. Section 405(h) ("Section 405(h)") demonstrate Congress's clear intention to vest U.S. Bankruptcy Courts with jurisdiction over Medicare claims?

## Medicare & U.S. Bankruptcy Court Jurisdiction

*In re: Bayou Shores*

- St. Petersburg, FL operator of skilled nursing home facility; 90% of revenues from Medicare/Medicaid patients.
- U.S. Department of Health and Human Services ("HHS"):
  - Notifies Bayou Shores that it is –

    (i) not in compliance with Medicare Participation Requirements; and

    (ii) that HHS will terminate Medicare & Medicaid Provider Agreements.

5

## Medicare & U.S. Bankruptcy Court Jurisdiction

*In re: Bayou Shores* (2016)

U.S. District Court for Middle District of Florida ("District Court")

- *August 1, 2014:*
  - Bayou Shores seeks injunction to prevent termination of Provider Agreements.
  - District Court grants Temporary Restraining Order ("TRO") until August 15, 2014.
  - HHS moves to dissolve TRO on jurisdictional grounds.
- *August 15, 2014:*
  - District Court denies extension of TRO, holding that it lacks subject matter jurisdiction over Provider Agreements.
    - Bayou Shores has not exhausted administrative remedies pursuant to Section 405(h).

6

## Medicare & U.S. Bankruptcy Court Jurisdiction

*In re: Bayou Shores* (2016)

- One hour after District Court's denial of TRO extension:
  - Bayou Shores files for Chapter 11 in the Middle District of Florida ("Bankruptcy Court").
  - Seeks ruling that automatic stay prevents HHS from terminating Provider Agreements.
- HHS argues Bankruptcy Court lacks subject matter jurisdiction over Provider Agreements under Section 405(h).
- Bankruptcy Court disagrees and rules in favor of Bayou Shores.
  - HHS is enjoined from terminating Provider Agreements.
  - Bankruptcy Court ultimately confirms Chapter 11 plan which authorizes Bayou Shores to assume disputed Provider Agreements.

7

## Medicare & U.S. Bankruptcy Court Jurisdiction

*In re: Bayou Shores* (2016)

- HHS appeals Bankruptcy Court ruling to District Court, arguing Bankruptcy Court lacks subject matter jurisdiction over Provider Agreements.
- District Court rules in favor of HHS and reverses plan confirmation order.
- Bayou Shores appeals decision to U.S. Court of Appeals for the 11th Circuit ("11th Circuit").
- Issue on Appeal:
  - Does Section 405(h) bar Bankruptcy Court exercise of Section 1334 ("Section 1334") jurisdiction over claims that arise under the Medicare Act?

8

## Medicare & U.S. Bankruptcy Court Jurisdiction

*In re: Bayou Shores* (2016)

- Section 1334:
  - Provides jurisdictional grounding for U.S. Bankruptcy Courts.
- Section 405(h):
  - Addresses judicial review of Social Security Commissioner's Administrative Decisions.
  - "No action against the United States, the Commissioner of Social Security, or any officer or employee thereof shall be brought under section 1331 or 1346 of Title 28 to recover on any claim arising under this subchapter."

9

## Medicare & U.S. Bankruptcy Court Jurisdiction

*In re: Bayou Shores* (2016)

- 11th Circuit Ruling:
  - Lack of reference to Section 1334 in Section 405(h) is the result of a codification error. Bankruptcy Court therefore lacks jurisdiction over termination of Provider Agreements.
  - "Because we are persuaded that the 1984 amendments to Section 405(h) were a codification and not a substantive change, we align ourselves with the Seventh, Eighth, and Third circuits and hold that Section 405(h) bars Section 1334 jurisdiction over claims that "arise under [the Medicare Act]." " (at 1314)
  - Outcome:
    - District Court ruling which overturned Bankruptcy Court's confirmation of plan was upheld.
    - Bankruptcy Court was without subject matter jurisdiction to issue orders enjoining the termination of the Provider Agreements.

10

# Medicare & U.S. Bankruptcy Court Jurisdiction

*In re: Bayou Shores* (2016)

- Circuit Split:
  - 11th Circuit follows majority view that Bankruptcy Court does not have independent basis for jurisdiction to enjoin and order the assumption of Medicare/Medicaid Provider Agreements.
  - Circuits following majority view: **3rd**, **7th**, **8th**, and **11th Circuits**.
  - Circuits following minority view: **9th Circuit**.
    - The 9th Circuit has placed "great weight on section 1334's broad jurisdictional grant over all matters conceivably having an effect on the bankruptcy estate." (at 1311)
  - Note: Petition for a Writ of Certiorari filed February 2, 2017. U.S. Supreme Court Docket indicates May 5, 2017 deadline for response to Petition.

11

# Medicare & Enforcement of the Automatic Stay

*Parkview Adventist Medical Center v. United States on behalf of Department of Health and Human Services*, 842 F.3d 757 (2016) (1st Circuit)

12

## Medicare & Enforcement of the Automatic Stay

*Parkview Adventist Medical Center (2016)*

- Parkview Adventist Medical Center ("Parkview") operated a 55 bed hospital in Brunswick, ME.
- Provided emergency services, along with a variety of other inpatient and outpatient services.
- Maintained a Provider Agreement with the Centers for Medicare and Medicaid Services ("CMS") which specified the conditions to which Parkview was to adhere for reimbursement of Medicare Part A (inpatient) and Medicare Part B (outpatient) services.

13

## Medicare & Enforcement of the Automatic Stay

*Parkview Adventist Medical Center (2016)*

- Facing financial difficulties, Parkview notified CMS that it would file for Chapter 11 in the District of Maine ("Bankruptcy Court") on June 16, 2015. Parkview would also end inpatient services and transition to acute care services on June 18, 2015.
- CMS responded to Parkview noting that it would terminate Parkview's Medicare Part A Provider Agreement as of June 18, 2015.
    - Parkview no longer would meet the definition of a "hospital" per administrative regulations.

14

## Medicare & Enforcement of the Automatic Stay

*Parkview Adventist Medical Center (2016)*

- Parkview filed motion in Bankruptcy Court to compel "Post-Petition Performance of Executory Contracts" arguing:
  - (i) CMS's termination of the Part A Provider Agreement was in violation of automatic stay; and
  - (ii) the termination constituted impermissible discrimination against a debtor in bankruptcy (violating Section 525 of the Bankruptcy Code).

15

## Medicare & Enforcement of the Automatic Stay

*Parkview Adventist Medical Center (2016)*

- Bankruptcy Court denied Parkview's motion.
  - Bankruptcy Court held it "lacked jurisdiction over the motion until Parkview's claims were administratively exhausted and that CMS had not violated either the automatic stay or the non-discrimination provision." (at 760)
  - On appeal, U.S. District Court for District of Maine ("District Court") affirmed Bankruptcy Court's ruling.

16

## Medicare & Enforcement of the Automatic Stay

*Parkview Adventist Medical Center (2016)*

- Parkview appealed District Court's ruling to U.S. Court of Appeals, 1st Circuit (the "1st Circuit").
- 1st Circuit noted jurisdictional split amongst U.S. Courts of Appeals and instead ruled solely on narrower question of whether CMS's actions violated the automatic stay. 1st Circuit held:
  - Although Provider Agreement was an executory contract, it could be terminated based upon the "police and regulatory power" exception to the automatic stay under Bankruptcy Code Section 362(b)(4).
  - CMS's termination of Parkview's Provider Agreement did not constitute "impermissible discrimination".

17

## Medicare & Enforcement of the Automatic Stay

*Parkview Adventist Medical Center (2016)*

- 1st Circuit Decision:
  - Automatic stay of actions against the debtor does not apply to "an action or proceeding by a governmental unit…to enforce such governmental unit's police and regulatory power." (at 763)
  - "The question is whether CMS's termination enforces a generally applicable regulatory law." (at 764)
    - "CMS has a strong public policy interest in seeing that Medicare-program dollars are not spent on institutions that fail to meet qualification standards." (at 764)

18

## Medicare & Enforcement of the Automatic Stay

*Parkview Adventist Medical Center (2016)*

- 1st Circuit Decision (cont'd):
  - CMS's termination of Parkview's Provider Agreement did not constitute "impermissible discrimination":
    - CMS terminated Provider Agreement because Parkview had "decided to close its inpatient facilities and thereby had ceased to qualify as a hospital under the Medicare Statute." (at 765)
    - "Because CMS's termination of the Provider Agreement enforced the generally applicable framework of the Medicare statute and advanced a significant public policy interest, the police and regulatory power exception applies, and the automatic stay does not bar the termination." (at 764)

19

## Medicare & Enforcement of the Automatic Stay

*Parkview Adventist Medical Center (2016)*

- Debtor hospital may not rely on protections of the automatic stay to retain Medicare Provider Agreements to the extent debtor hospital no longer meets Medicare participation standards.
- Government agencies can exercise broad "police and regulatory power" without constraints of automatic stay.

20

ANKURA CONSULTING

# For-Profit Postsecondary Education

NOTES TO THE READERS:
(1) NOT SURE OF THE FORMAT WE ARE UTILIZING FOR THE DISCUSSION. I WILL BE HAPPY TO ADJUST ACCORDINGLY WITH FURTHER DIRECTION

April 2017

## Overview

- Education, similar to healthcare, is a highly regulated industry, with the for-profit sector having been a major target of the Obama Administration in its final years
- While under Obama a number of changes impacted the for-profit sector, but two main issues had the most significant impact on the sector: (i) limits on providing incentive compensation to recruiters (i.e., removable all the "safe harbor" provisions) and (ii) legislative approval of new gainful employment regulations
- The widely publicized reports of “bad actors” in the for-profit sector aggressively recruiting students by skewing student outcomes gave cause for the Administrations to hold the sector to stricter regulatory standards
  - e.g., deceptive and fraudulent marketing practices of failed institutions, Corinthian Colleges and ITT Educational Services
- With such aggreges behavior in the public eye, on Dec. 12, 2016, the U.S. Department of Education took actions towards a major for-profit accrediting body and announced that it no longer recognized the Accrediting Council for Independent Colleges and Schools (ACICS) as an accrediting agency
  - ACICS was the accrediting body of Corinthian Colleges and ITT Educational Services
- The combined impact of stricter regulatory standards and the opinion that growth is counter-cyclical to economic trend, has resulted in a under-performing sector

## Background

- The for-profit postsecondary education market is a subset of the larger postsecondary education industry and accounted for 7.7% of industry enrollments in the 2014-2015* school year
- The industry (and related subsets) are driven by several key long-term drivers:
  - **Increasing demand for skilled professionals**
    - With technological advances and the continued globalization of the economy, the Bureau of Labor Statistics predicts that by 2024 approximately 34.9% of the workforce will be required to have at least some form of postsecondary associate degree or non-degree award or higher
  - **Potential earnings premium**
    - Professionals partially completing college or attaining an associate's degree earned $92 more on average per week than a high school graduate
    - Professionals attaining a bachelor's degree earned $463 more on average per week than a high school graduate
  - **Demographics**
    - General population growth as well as enrollment growth within specific age groups
  - **Acceptance of online degrees**
    - With a greater acceptance of online degrees, online programs has allowed schools to target a wider group of potential students who may not be have been able to travel or attend classes during normal hours



## Advantages of Postsecondary For-Profit Schools

- Most for-profit schools focus on the undergraduate level and offer programs in which their students earn diplomas, certificates, and/or associate's and bachelor's degrees
- The undergraduate segment of the for-profit sector -- both degree-granting (e.g., associate's, bachelor's) and non-degree granting (e.g., diploma, certificate) -- is highly attractive to students owing to its pragmatic, student-centered, and job-oriented focus
- For-profit postsecondary providers capture an underserved market by offering job opportunities and career development for those who may not be interested in the more traditional higher education, white-collar path but have the ability to earn a solid income
- For-profit programs are more attractive to the lower-income and working adult population versus their closest competition, community colleges, for a variety of reasons:
  - Greater **focus on providing students with practical skills** that are crucial to employers
  - Ability to quickly create and roll out **new programs to better serve current market demand**
  - Better **customer service and support systems** (i.e., quality customer service is a key differentiating factor in attracting students)
  - **Larger budgets** to support more expensive programs (e.g., equipment needed for instruction in auto repair courses)
  - Greater ability to **create alliances with corporations** through advisory boards and other programs (fewer conflicts of interest), thus potentially improving job placement rates and establishing positive endorsements for their products
  - Ability to **finish programs at an accelerated pace**

## Key Issues Impacting the For-Profit Sector

| | |
|---|---|
| **Continued Declining Enrollments** | • The near to medium term will continue to show signs of a declining market<br>• Industry analysts forecast sector enrollment and market share to continue to decline into 2014-2015 with sector market share down from a peak of 9.9% in 2010 to 7.7% in 2015<br>• Industry analysts expect that economic expansion will likely have a detrimental effect on the for-profit sector due to slower growth rates and margin expansions, though these typically lag changes in economic cycles<br>• According to BMO Capital Markets estimates market share is not expected to stabilize until 2021 with an approximate 6% share |
| **Compliance & Reporting** | • High degree of scrutiny by regulators and accreditors<br>• Placement – minimum student placement rates must be maintained for each of the programs offered at each school<br>• Retention – schools and programs must not fall below a certain retention threshold determined by the accrediting body |
| **Unrecognized Accrediting Body** | • DOE has ceased recognition of a major accrediting body, ACICS<br>• As a specialized accrediting body to for-profit colleges and universities, the lack of recognition by the DOE puts federal student aid programs at risk for these institutions<br>• Currently, ACICS accredited institutions have less than 15-months to find another accreditor in order to continue participating in federal student aid programs |



## Key Issues Impacting the For-Profit Sector

| | |
|---|---|
| **Counter-Cyclical Trends** | • Strong support of the theory of a counter-cyclical educational sector<br>• Studies by Mark Kantrowitz (August 2010) and Sarah Turner (2003 paper) found a strong correlation between annual fall enrollments to the US unemployment rate, citing evidence that shows for-profit schools can be more flexible than their not for-profit peers in responding to economic shocks<br>• The for-profit postsecondary sector typically exhibits some counter-cyclicality though can linger longer than the economic recovery due to a "jobless recovery" |
| **Marketing Restrictions / Negative Publicity** | • Aggressive recruiting practices resulting in students being encouraged to take out loans they could not afford or enroll in programs where they were either unqualified or could not succeed<br>• Current laws prohibit schools from compensating admissions recruiters based solely on success in securing student enrollment, provisions known as "safe harbors" allowed this practice<br>• Regulations remove all the "safe harbor" provisions<br>• To protect consumers, the regulations strengthen the Education Department's authority to take action against institutions engaging in deceptive advertising, marketing, and sales practices<br>• High profile closures of Corinthian Colleges and ITT Educational Services have put the for-profit postsecondary schools under fire by media organizations and politicians for alleged aggressive marketing techniques, high tuition costs and lack of job opportunities upon graduation |

# Bankruptcy Perspectives on Healthcare and Education

AMERICAN BANKRUPTCY INSTITUTE
NEW YORK BANKRUPTCY CONFERENCE
MAY 18, 2017

1

## Bankruptcy Perspectives on Healthcare and Education

**Healthcare**

Trends and Considerations in Asset Sales

Recent Healthcare Cases

- Jurisdiction (*In re Bayou Shores SNF, LLC*)
- Automatic Stay (*Parkview Adventist Medical Center v. United States*)

Expectations and trends in healthcare bankruptcies

**Education**

Legal issues confronting distressed for-profit institutions

- Title IV of the Higher Education Act
- Student Claims
- Loan Dischargeability

Current market challenges and regulatory issues

Expectations and trends in for-profit education

2

# Trends and Considerations in Asset Sales

BANKRUPTCY PERSPECTIVES ON HEALTHCARE

3

## Topics for Discussion

- Healthcare Industry Market Trends
- Bankruptcy Code Section 363 Sale of Assets and Other Statutory Predicates
- Not-For-Profit Laws and Regulations
- Notable Trends:
  - Bankruptcy Court Section 363 Approval is Not Subject to State Court Approval
  - Bankruptcy Protection Can Provide Breathing Room for, and Expedite, a Healthcare Provider's Sale
- Government Deals and Prepackaged Reorganization Plans
- Other Key Considerations

4

# Healthcare Industry:
## Current Market Trends

**Hospitals (including rural hospitals) are failing at a rapid rate**

- Lack finances (attributable to, among other things, federal spending and reimbursement cuts).
- Migration of populations to urban environments.

**Healthcare consolidation frenzy**

- Mergers, acquisitions, joint ventures, and joint operating agreements have increased from 66 in 2010 to 112 in 2015, and a slight dip in 2016 with 102 transactions.
  - Benefits of market power of larger organizations.
  - Affordable Care Act implications.
- In 27 of the 102 transactions in 2016, the acquiring entity was for-profit; in 74 transactions, the acquiring entity was not-for-profit; and in one transaction, a not-for-profit and for-profit organization jointly acquired an organization.
  - New York bans for-profit companies from owning hospitals, does not allow a publically traded company to own hospitals, and limits private equity investments in hospitals.
- Creation of regional systems.
  - Growth of urgent care, walk-in facilities, and minute clinics.

**Acquisitions of Distressed Health Care Assets**

- Bankruptcy is a cost-effective way to market and sell assets free and clear of liens, claims, encumbrances, and interests.
- For example, Prime Healthcare Services has seized this opportunity, acquiring Southern Regional Medical Center, Coshocton (Ohio) County Memorial Hospital, and Saint Michael's Medical Center in Chapter 11 cases.

5

# Unique Elements of Healthcare Transactions

**Disposal of Patient Records – Section 351 of the Bankruptcy Code**

- If insufficient funds exist to pay for storage of patient records pursuant to state and federal law, the trustee must (i) publish a notice of least 365 days in advance of its intent to destroy patient records, (ii) send notice during the first 180 days to each patient or insurance carrier regarding the claiming or disposal of the records, (iii) make a written request to each appropriate federal agency to accept any unclaimed records that remain.

**Cost of Implementing Electronic Health Record (EHR) Systems**

- To comply with the Patient Protection and Affordable Care Act, hospitals are transitioning patient records to electronic form.
- Partners HealthCare spent over $1 billion implementing its EHR system, taking approximately three years to complete.
- The MD Anderson Cancer Center reported a 57% drop in adjusted income in the seven-month period ending March 31, 2016 – a $160.5 million decrease that it attributed to its EHR implementation.

6

# Unique Elements of Healthcare Transactions (continued)

**Corporate**

- Any necessary approvals based on seller's and purchaser's corporate governance must be obtained.

**Regulatory Review**

- Consider ability of proposed purchaser to be approved by state and local regulatory agencies to hold required licenses.
- Timing for purchaser to acquire license is fact-specific and needs to be considered in structuring transaction.
- NY not-for-profit corporation law section 510: Attorney General (Charities Bureau) or NYS Supreme Court approval are required for the transfer of all or substantially all of a not-for-profit seller's assets and other fundamental changes in not-for-profit corporations, such as a change of purposes.
- Transfer / assignment of Provider Agreement and Provider Number enable purchasers to continue to bill Medicare and Medicaid without interruption. However, this comes with successor liability concerns.

**Third Party Consents**

- Consider notices or consents required in seller's contracts.
- Other applicable laws may require additional consents or approvals.



# Bankruptcy Code Section 363: Acquisition Tool

- Under section 363 of the Bankruptcy Code, a debtor may only sell assets "outside of the ordinary course of business" with approval of the Bankruptcy Court.
  - Section 363(f) of the Bankruptcy Code allows a debtor to sell assets "**free and clear of any interests in such property**" which allows a purchaser to buy assets from a debtor that are not subject to successor liability subject to certain exceptions.
  - In a healthcare transaction, the acquirer assumes a hospital's Medicare provider number and related agreements, which are subject to the government's right to seek recoupment of overpayments made by the debtor prepetition.
- Section 363 sales can be done expeditiously and require only 21 days notice under Rule 2002 of the Federal Rules of Bankruptcy Procedure.
  - The notice period can be shortened for cause and extended to run a marketing process if there is not an urgent need for Bankruptcy Court approval.
- The "free and clear" characteristic of a 363 sale provides an incentive for companies to buy the assets of an insolvent hospital after it has filed for bankruptcy.

# Section 363 Sales:
## Healthcare Specific Bankruptcy Code Provisions

- **Section 363(d)(1)**: A trustee may only use, sell, or lease property "only in accordance with **non-bankruptcy law**" that governs the transfer of property by a "corporation or trust that is not a moneyed business, commercial corporation, or trust."
  - For example, Section 510 of New York Not-For-Profit Corporation Law requires the Attorney General (Charities Bureau) or the New York Supreme Court approve the transfer of all or substantially all of a not-for-profit seller's assets and other fundamental changes in not-for-profit corporations, such as a change of purpose.
- **Section 541(f)**: Addresses transfer of assets of a not-for-profit entity to a for-profit purchaser: "property that is held by a [501(c)(3) corporation] debtor . . . may be transferred to an entity that is not such a corporation, but only under the same conditions as would apply if the debtor had not filed a case under this title."
- **Section 1129(a)(16)**: Applies the requirements of 363(d)(1) and 541(f) to confirmation of a plan.
- **Section 333**: Provides for a patient ombudsman to be appointed 30 days after the commencement of a bankruptcy case. Accordingly, courts consider how a potential sale will affect patients and want assurance that any sale will not adversely impact the quality of patient care.

9

# Section 363 Sales:
## Not-For Profit Laws and Regulations Apply

**Bankruptcy Courts consider factors other than price when evaluating 363 asset sales of healthcare providers, such as hospitals, nursing homes, and continuing care residential cooperatives.**

- Outside of bankruptcy, directors have a duty of, among other things, obedience to the charitable mission.
- When balancing these interests, the **highest economic offer may not be the best offer**, and courts may defer to state authorities:
  - *In re United Healthcare Sys., Inc.*, Civ. A. 97-1159 (NHP), 1997 WL 176574, at *5, *10 (D.N.J. Mar. 26, 1997): The "highest and best" offer should not always prevail, "[r]ather, the [c]ourt must not only weigh the financial aspects of the transaction but also look to the countervailing consideration of a public health emergency." Further, "the bankruptcy court may not impede the State in its obligation to protect the health and safety of its citizenry."
- A lower bidder may win if a sale to that bidder would help **maintain the charitable mission** of the organization:
  - *In re HHH Choices Health Plan, LLC, et al.*, 554 B.R. 697 (Bankr. S.D.N.Y. 2016) ("It is clear under state law that price alone is not determinative, and that fulfilling the corporate mission can be decisive if creditors are all being paid in full.").

10

# Section 363 Sales: Notable Trends

**Bankruptcy Court section 363 approval is not subject to state court approval**

- ***In re HHH Choices Health Plan, LLC, et al.*, 554 B.R. 697 (Bankr. S.D.N.Y. 2016)**
  - In May 2015, an involuntary petition was filed under Chapter 11 of the Bankruptcy Code against nursing home HHH Choices Health Plan, LLC ("Hebrew Health"), and on June 1, 2015 Hebrew Health consented to the petition.
  - Hebrew Health sought to sell substantially all of its assets pursuant to various provisions of section 363 of the Bankruptcy Code. Under New York Not-For-Profit Corporation Law, section 511 requires that the New York Supreme Court approve any transfer of the assets of an insolvent not-for-profit corporation.
  - The Bankruptcy Court (Judge Wiles) held, pursuant to section 1221(e) of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), no court other than the Bankruptcy Court can approve the transfer of property of the estate, and furthermore, that while state law requirements apply, the analysis under section 511 must be performed by the Bankruptcy Court because the Bankruptcy Court has "exclusive jurisdiction over the estate and the disposition of its assets."
  - When evaluating the competing bids under section 511, the court took a holistic approach finding that "the mission can be an appropriate consideration, but it does not answer the question of how much weight to give to that factor."
  - The court examined (i) how a potential sale to each bidder would effect the continuation of Hebrew Health's original mission, (ii) the likelihood that the bidder could close the transaction, (iii) the ability of the bidder to receive the necessary regulatory approvals, (iv) the effect of the sale on creditor continuances, (v) the interests of Hebrew Health's employees, (vi) the interests of former and current Hebrew Health residents, (vii) the ability of the bidder to make certain contractual payments, and (viii) the ability of the bidder to make refund payments to certain residents.
  - The court approved the sale to a bidder that was backed by the Hebrew Health's board, rather than the highest bidder, which was backed by the UCC, reasoning that the effects of the different proposals on the general unsecured creditors would be negligible, but the initial bidder would uphold the mission of Hebrew Health and better serve the interests of its current residents.



# Section 363 Sales: Notable Trends (continued)

**Bankruptcy protection can provide breathing room for, and expedite, a healthcare provider's sale**

- ***In re Saint Michael's Medical Center, Inc.*, Case No. 15-24999 (D.N.J.)**
  - On August 10, 2015, the Newark hospital Saint Michael's Medical Center, Inc. ("SMMC") filed voluntary Chapter 11 petitions.
  - Prior to filing, SMMC engaged in sale discussions with Prime Healthcare Services, a for-profit company, but due to the state's long review process (which, by the time of filing, had spanned over two years), SMMC filed Chapter 11 to provide it with enough breathing room to stay solvent while waiting for state approval of the sale. Prior to filing, SMMC also faced a report by a state-commissioned report recommending that the hospital cease operating as a full-service hospital and be converted to outpatient ambulatory/emergency care facility because five hospitals in the Newark area had excess capacity, and three of them, including SMMC should cease operating as full-service hospitals.
  - After a competitive auction, the Bankruptcy Court approved SMMC's sale to Prime Healthcare Services for $62 million- nearly $13 million above the stalking horse offer. Prime Healthcare Services also committed to spend at least $50 million in capital improvements.
  - After the Bankruptcy Court approved the sale, and nearly six months later, a New Jersey Superior Court and the Christie Administration approved Prime Healthcare Services' purchase of SMMC.
  - In February 2017, it was reported that SMMC turned a profit, something it had not accomplished in many years prior to the bankruptcy.

# Other Considerations:
## Trends in Healthcare Prepackaged Reorganization Plans

**Government Deals and Prepackaged Reorganization Plans**

- A prepackaged bankruptcy begins with the filing of a Chapter 11 plan of reorganization that has already been accepted by creditors, or where solicitation of plan approval by such creditors has already commenced.

***In re Millennium Lab Holdings II, LLC* (D. Del. Mar. 17, 2017)**

- After a failed out-of-court restructuring, on November 10, 2015, Millennium Lab Holdings II and its affiliated debtors filed its Chapter 11 bankruptcy petition and, concurrently therewith, a prepackaged reorganization plan (the "Plan").
- Prior to filing, debtor Millennium Health, LLC ("Millennium") entered into a $256 million agreement with the government, settling allegations that it violated the False Claims Act, Stark law, and the Anti-Kickback Statute for billing Medicare and Medicaid for medically unnecessary testing, including billings submitted for 59 deceased patients.
- The Delaware Bankruptcy Court entered an order confirming the Plan (the "Confirmation Order"), which included nonconsensual third-party releases in favor of non-debtor equity holders, with no option for lenders to opt-out of the releases.
- Several lenders wanted to opt-out and, prior to confirmation, filed a complaint against the Debtors' former owners asserting various state law fraud and federal RICO claims. Aware that approval of the Plan would enjoin them from prosecuting these claims, the lenders argued the Bankruptcy Court lacked subject matter jurisdiction and statutory authority to approve the releases. The Bankruptcy Court overruled these objections, and found that it had, at the very least, "related to" subject matter based on the indemnification provisions in Millennium's operating agreements and individual prepetition indemnification agreements.
- The lenders appealed the Confirmation Order, and on March 17, 2017, the Delaware District Court remanded the case back to the Bankruptcy Court, questioning whether post *Stern v. Marshall* the Bankruptcy Court had the constitutional adjudicatory authority to "enter into a final order discharging Appellants' non-bankruptcy state law claims against non-debtors without Appellants' consent."



# The Healthcare Industry & Section 363 Sales:
## Other Key Considerations

**Always think of patients:**

- The courts will consider how a potential sale of a health care provider will affect patients and will want assurance that any sale will not result in a decrease in the quality of patient care.

**Have a purchaser lined up at filing:**

- Having a "stalking horse" bidder prior to an auction will not only result in a higher offer, but potentially mitigate the regulatory, state law, antitrust, and practical issues that affect a hospital 363 sale.

**Health Insurance Portability and Accountability Act of 1996 (HIPAA) laws apply:**

- HIPAA establishes national standards to protect individuals' medical records and other personal health information.
- To avoid a HIPAA violation, HIPAA laws should be strictly complied with to make sure that all patient records are properly retained or disposed of.

- **Successor liability:**
  - Although assets are purchased free and clear of any prepetition "interests" in those assets in a 363 sale, some claims survive the sale process.
  - According to CMS, the provider agreement is an executory contract and a purchaser taking an assignment of the provider agreement accepts any pre-sale liability arising thereunder, whether known or unknown, should the debtor / seller not satisfy such liabilities.
- **Non-bankruptcy rules apply:**
  - Sales of healthcare providers are subject to a myriad of different regulatory considerations, and proper diligence is needed to confirm compliance with these regulations will be maintained throughout the process.

# Recent Bankruptcy Cases

BANKRUPTCY PERSPECTIVES ON HEALTHCARE

15

# Recent Bankruptcy & Healthcare Case Law

U.S. Bankruptcy Court Jurisdiction

*In re Bayou Shores SNF, LLC*, 828 F.3d 1297 (2016) (11th Circuit)

Enforcement of the Automatic Stay

*Parkview Adventist Medical Center v. United States on behalf of Department of Health and Human Services*, 842 F.3d 757 (2016) (1st Circuit)

16

## Key Takeaways

- Medicare/Medicaid provider agreements ("Provider Agreements") are surrounded by "bet the case" land mines.
- *Bayou Shores* joins a circuit split in answering if the Bankruptcy Court has jurisdiction over Provider Agreements with the debtor.
- *Parkview* sidesteps the jurisdictional question, but limits the protections of the automatic stay and thereby the enforceability of Provider Agreements.

17

## Medicare & U.S. Bankruptcy Court Jurisdiction

*In re Bayou Shores SNF, LLC*, 828 F.3d 1297 (11th Cir. 2016)

18

## Medicare and U.S. Bankruptcy Court Jurisdiction
### *In re Bayou Shores* (2016)

- St. Petersburg, FL operator of skilled nursing home facility; 90% of revenues from Medicare/Medicaid patients.
- U.S. Department of Health and Human Services ("HHS"):
  - Notifies Bayou Shores that it is –
    - not in compliance with Medicare Participation Requirements; and
    - that HHS will terminate Medicare & Medicaid Provider Agreements.

19

## Medicare and U.S. Bankruptcy Court Jurisdiction
### *In re Bayou Shores* (2016)

**U.S. District Court for the Middle District of Florida ("District Court")**

- August 1, 2014:
  - Bayou Shores seeks injunction to prevent termination of Provider Agreements.
  - District Court grants Temporary Restraining Order ("TRO") until August 15, 2014.
  - HHS moves to dissolve TRO on jurisdictional grounds.
- August 15, 2014:
  - District Court denies extension of TRO, holding that it lacks subject matter jurisdiction over Provider Agreements.
  - Bayou Shores has not exhausted administrative remedies pursuant to Section 405(h).

20

## Medicare and U.S. Bankruptcy Court Jurisdiction
## *In re Bayou Shores* (2016)

- One hour after District Court's denial of TRO extension:
  - Bayou Shores files for Chapter 11 in the Middle District of Florida ("Bankruptcy Court").
  - Seeks ruling that automatic stay prevents HHS from terminating Provider Agreements.
- HHS argues Bankruptcy Court lacks subject matter jurisdiction over Provider Agreements under Section 405(h).
- Bankruptcy Court disagrees and rules in favor of Bayou Shores.
  - HHS is enjoined from terminating Provider Agreements.
  - Bankruptcy Court ultimately confirms Chapter 11 plan which authorizes Bayou Shores to assume disputed Provider Agreements.

21

## Medicare and U.S. Bankruptcy Court Jurisdiction
## *In re Bayou Shores* (2016)

- HHS appeals Bankruptcy Court ruling to District Court, arguing Bankruptcy Court lacks subject matter jurisdiction over Provider Agreements.
- District Court rules in favor of HHS and reverses plan confirmation order.
- Bayou Shores appeals decision to U.S. Court of Appeals for the 11th Circuit ("11th Circuit").
- Issue on Appeal:
  - Does Section 405(h) bar Bankruptcy Court exercise of Section 1334 ("Section 1334") jurisdiction over claims that arise under the Medicare Act?

22

## Medicare and U.S. Bankruptcy Court Jurisdiction
### *In re Bayou Shores* (2016)

- Section 1334:
  - Provides jurisdictional grounding for U.S. Bankruptcy Courts.
- Section 405(h):
  - Addresses judicial review of Social Security Commissioner's Administrative Decisions.
  - "No action against the United States, the Commissioner of Social Security, or any officer or employee thereof shall be brought under section 1331 or 1346 of Title 28 to recover on any claim arising under this subchapter."

23

## Medicare and U.S. Bankruptcy Court Jurisdiction
### *In re Bayou Shores* (2016)

- 11th Circuit Ruling:
  - Lack of reference to Section 1334 in Section 405(h) is the result of a codification error. Bankruptcy Court therefore lacks jurisdiction over termination of Provider Agreements.
  - "Because we are persuaded that the 1984 amendments to Section 405(h) were a codification and not a substantive change, we align ourselves with the Seventh, Eighth, and Third circuits and hold that Section 405(h) bars Section 1334 jurisdiction over claims that 'arise under [the Medicare Act].'" (at 1314)
- Outcome:
  - District Court ruling which overturned Bankruptcy Court's confirmation of plan was upheld.
  - Bankruptcy Court was without subject matter jurisdiction to issue orders enjoining the termination of the Provider Agreements.

24

## Medicare and U.S. Bankruptcy Court Jurisdiction
### *In re Bayou Shores* (2016)

- Circuit Split:
  - 11th Circuit follows majority view that Bankruptcy Court does not have independent basis for jurisdiction to enjoin and order the assumption of Medicare/Medicaid Provider Agreements.
  - Circuits following majority view: **3rd, 7th, 8th, and 11th Circuits**.
  - Circuits following minority view: **9th Circuit**.
    - The 9th Circuit has placed "great weight on section 1334's broad jurisdictional grant over all matters conceivably having an effect on the bankruptcy estate." (at 1311)
- Note: Petition for a Writ of Certiorari filed February 2, 2017. U.S. Supreme Court Docket indicates May 5, 2017 deadline for response to Petition.

25

## Medicare & Enforcement of the Automatic Stay

*Parkview Adventist Medical Center v. United States on behalf of the Dept. of Health and Human Services*, 842 F.3d 757 (1st Cir. 2016)

26

## Medicare and Enforcement of the Automatic Stay *Parkview Adventist Medical Center* (2016)

- Facing financial difficulties, Parkview notified CMS that it would file for Chapter 11 in the District of Maine ("Bankruptcy Court") on June 16, 2015. Parkview would also end inpatient services and transition to acute care services on June 18, 2015.
- CMS responded to Parkview noting that it would terminate Parkview's Medicare Part A Provider Agreement as of June 18, 2015.
  - Parkview no longer would meet the definition of a "hospital" per administrative regulations.

27

## Medicare and Enforcement of the Automatic Stay *Parkview Adventist Medical Center* (2016)

- Parkview filed motion in Bankruptcy Court to compel "Post-Petition Performance of Executory Contracts" arguing:
  - CMS's termination of the Part A Provider Agreement was in violation of automatic stay; and
  - the termination constituted impermissible discrimination against a debtor in bankruptcy (violating Section 525 of the Bankruptcy Code).

28

## Medicare and Enforcement of the Automatic Stay *Parkview Adventist Medical Center* (2016)

- Bankruptcy Court denied Parkview's motion.
  - Bankruptcy Court held it "lacked jurisdiction over the motion until Parkview's claims were administratively exhausted and that CMS had not violated either the automatic stay or the non-discrimination provision." (at 760)
  - On appeal, U.S. District Court for District of Maine ("District Court") affirmed Bankruptcy Court's ruling.

29

## Medicare and Enforcement of the Automatic Stay *Parkview Adventist Medical Center* (2016)

- Parkview appealed District Court's ruling to U.S. Court of Appeals, 1st Circuit (the "1st Circuit").
- 1st Circuit noted jurisdictional split amongst U.S. Courts of Appeals and instead ruled solely on narrower question of whether CMS's actions violated the automatic stay. 1st Circuit held:
  - Although Provider Agreement was an executory contract, it could be terminated based upon the "police and regulatory power" exception to the automatic stay under Bankruptcy Code Section 362(b)(4).
  - CMS's termination of Parkview's Provider Agreement did not constitute "impermissible discrimination."

30

## Medicare and Enforcement of the Automatic Stay *Parkview Adventist Medical Center* (2016)

- 1st Circuit Decision:
  - Automatic stay of actions against the debtor does not apply to "an action or proceeding by a governmental unit…to enforce such governmental unit's police and regulatory power." (at 763)
  - "The question is whether CMS's termination enforces a generally applicable regulatory law." (at 764)
    - "CMS has a strong public policy interest in seeing that Medicare-program dollars are not spent on institutions that fail to meet qualification standards." (at 764)

31

## Medicare and Enforcement of the Automatic Stay *Parkview Adventist Medical Center* (2016)

- 1st Circuit Decision (cont'd):
  - CMS's termination of Parkview's Provider Agreement did not constitute "impermissible discrimination":
    - CMS terminated Provider Agreement because Parkview had "decided to close its inpatient facilities and thereby had ceased to qualify as a hospital under the Medicare Statute." (at 765)
    - "Because CMS's termination of the Provider Agreement enforced the generally applicable framework of the Medicare statute and advanced a significant public policy interest, the police and regulatory power exception applies, and the automatic stay does not bar the termination." (at 764)

32

## Medicare and Enforcement of the Automatic Stay
*Parkview Adventist Medical Center* (2016)

- Debtor hospital may not rely on protections of the automatic stay to retain Medicare Provider Agreements to the extent debtor hospital no longer meets Medicare participation standards.
- Government agencies can exercise broad "police and regulatory power" without constraints of automatic stay.

33

# Expectations and Trends

BANKRUPTCY PERSPECTIVES ON HEALTHCARE

34

# Basics: How Do Americans Pay for Health Care

**Health Insurance**

- Broadly, health insurance is designed to pool the health care spending risk of individuals and to smooth spending over time.
- **There are two basic health insurance variants: (1) Indemnity and (2) Managed Care**
  - Indemnity, increasingly uncommon, is a system in which individuals obtain care from a provider, pay their provider and are then reimbursed by their health insurance company.
  - Managed Care, is a system in which a health insurance organization contracts with providers to form a network. Those providers agree to be paid at a certain rate for the care they provide. When individuals obtain coverage, the provider is paid by the health insurance company (often the patient must make a co-payment). Medicare and Medicaid are forms of managed care with the government in the role of insurer.
- **We can think of the U.S. health insurance system as consisting of four parts:**
  - Large Group Insured (49% of the population) – Employer-sponsored coverage for large employers (50+) employees. The health insurance company bears the risk of insuring the population. Low-Negative growth due to demographic headwinds – population aging out the system.
    - Commercial ASO / Fee – Health insurers administer (ASO = administrative services organization) health insurance plans where the risk of loss is borne by the employer.
  - Small Group & Individual (7%) – Sub 50-employer businesses and individuals, increasingly exchange-business.
  - Government –
    - Medicaid (20%) – For lower-income Americans. Significant growth through the Medicaid expansion.
    - Medicare (14%) – For seniors. Demographic growth-driven.
      - Medicare Part A – Traditional fee-for-service (FFS) hospital care.
      - Medicare Part B – Traditional fee-for-service outpatient and other care.
      - Medicare Part C (Medicare Advantage) – Private health insurers contract with CMS to provide benefits that are at least equal to those provided to Medicare beneficiaries (under Part A and B) in exchange for a fixed monthly payment per member per month. This payment varies by county, member demographics and the member's health condition. Growth through demographics and switchers from Medicare FFS.
      - Medicare Part D – Enrollment in Part D is voluntary. Private insurers contract with CMS to provide prescription drug benefits to Medicare-eligible seniors. Private insurers include both prescription drug only plans (typically for Medicare enrollees in Part A and B) and the prescription drug component of the Medicare Advantage (Part C) plan. For the purposes of part D, CMS divides the country into 34 regions (33 for the states plus 1 for D.C.). In June of each year, all Part D plans submit bids to CMS. The CMS then establishes a benchmark based on the second-lowest cost bid.
  - Remainder is Other Public (2%) or Uninsured (9%)

35

# Basics: What is the Affordable Care Act (Obamacare)?

**Overview of the ACA:** It's easiest to think of the ACA in five parts: (1) The Individual and Employer Mandate; (2) the Medicaid Expansion; (3) Reimbursement and Spending Cuts; (4) Delivery Reform; and (5) Insurance Reform. The first two parts of the legislation relate to the expansion of insurance coverage to those previously uninsured. And they are funded by the third: the Reimbursement and Spending Cuts are in place to pay for the cost of coverage expansion (and indirectly push providers towards delivery reform). The fourth part, Insurance Reform, requires changes in the practices of the health insurance industry (e.g., insurance companies can no longer deny coverage based on pre-existing conditions). Finally, Delivery Reform attempts to alter the provision of health care services and improve patient outcomes – broadly, the ACA aims to shift health care away from the fee-for-service (FFS) model toward paying providers for quality or value-based care.

**(1) Individual and Employer Mandate** – The ACA requires all citizens to obtain insurance and it demands certain employers purchase insurance for their employees.

- (A) The Individual Mandate – Individuals must purchase health insurance or pay a "shared responsibility payment" – beginning at $95 in 2014 and reaching $695 in 2016 and increasing at the rate of inflation thereafter.
- (B) The Employer Mandate – Employers of 100 or more employees (changing to 50 in 2016) that do not provide "affordable" health care of at least "minimum value" to their employees will pay a per-employee penalty. Affordable is defined as no more than 9.56% of the employee's family income for coverage. Minimum value is defined as covering 60% of the health care expenses of a typical population.
- To make it easier to purchase the mandated coverage, the ACA requires the creation of state Health Exchanges. Today, these exchanges come in four flavors:
  - (i) State-based exchanges – The state sets up the marketplace and performs all vital substantive functions (e.g., qualifying plans, determining Medicaid eligibility, etc.). New York operates a state-based exchange.
  - (ii) Federally-supported State exchanges – The state manages the vital substantive function but relies on the HealthCare.gov IT platform.
  - (iii) State-partnership exchanges – States provide some assistance functions, but everything else goes through HealthCare.gov and is managed by HHS.
  - (iv) Federally-facilitated exchanges – Everything through HealthCare.gov and is managed by HHS.
- Further, in an attempt to simplify the choices to consumers, the ACA categorizes health plans into:
  - Bronze – Covers 60% of benefits cost; Silver – Covers 70%; Gold – Covers 80%; Platinum – Covers 90%.
- Relevant to Tenet, many of the lower cost plans (Bronze and Silver) operate what the industry calls "narrow networks." These narrow networks limit provider choice (patients have less ability to pick their doctor or choose their hospital) in an attempt to lower costs. Tenet's strategy is to include their hospitals in these narrow networks and to work with "Silver" plans – the company has contracted with 83% of Silver plans as of YE2014.
- To ensure individuals can afford coverage, the ACA provides premium credits (and cost sharing subsidies) so that Americans earning less than 400% of the Federal Poverty Level (FPL) do not have to spend more than 9.5% of their income on health insurance (% ratcheting down for poorer individuals).

36

# Basics: What is the Affordable Care Act (Obamacare)?

**2) The Medicaid Expansion** – Medicaid is a Federal program, but it is operated and administered by the states. There is no federal requirement to participate in Medicaid, but states that do participate receive substantial subsidies from the Federal Government – in some cases pre-ACA up to 75% of the cost of the program.

Even before the ACA, all 50 states participated in Medicaid. And they still do. Some states, however, have chosen not to expand Medicaid as the ACA incents.

In the pre-ACA world, states were required to cover pregnant women and children under 6 with family incomes under 133% of the FPL, parents who had previously met the requirements for the AFDC program (commonly known as welfare), and the elderly and the disabled that qualified for Supplemental Security Income (SSI).

- The ACA attempted to induce (coerce) states to expand Medicaid eligibility to all adults under 133% of the FPL.
- States that expanded their Medicaid rolls would receive subsidies for 100% of the cost of coverage until 2016 ratcheting down to 90% by 2020 and staying at 90% in the years after.
- States that failed to expand Medicaid were threatened with the loss of *all* their Federal subsidies for Medicaid not just those related to the new expansion.
    - This last provision was struck down in *NFIB v. Sebelius* (see below). As a result, the Federal Government can currently only induce states with new subsidies rather than compel them with the threat of the loss of old subsidies.
    - Perhaps consequently, only 31 states and the District of Columbia have expanded (or are expanding) Medicaid as of today.
    - Most of the states that have expanded Medicaid are in the Northeast or West Coast (Blue States).
    - Of the publicly-traded hospital operators, Tenet has the highest exposure to states that have already expanded Medicaid.
- The Medicaid Expansion is a positive for hospital operators. By law, hospitals are often required to treat to indignant patients that cannot pay. Once these patients are on Medicaid, hospitals will begin to recover some of the cost of treating these patients. At Tenet, in the most recent three-month period (Oct. 2014-Dec. 2014), charity care and uninsured admissions fell 20% and charity and uninsured outpatient visits fell by 10% year-over-year - largely as a result of the ACA.

**(3) Reimbursement and Spending Cuts** – While the Medicaid expansion is a significant positive for hospital operators, some (maybe all) of its benefits are offset by cuts in Medicaid and Medicare reimbursement as well as in certain programs that had compensated hospitals for their care of the indignant. These cuts:

- Reduce Medicare fee-for-service rates.
- Reduce Medicaid Disproportionate Share Hospital (DSH) payments (allowances) by $1.7 billion between 2014 and 2016 and $1.8 billion in 2017, $5 billion in 2018, $5.6 billion in 2019, and $4 billion in 2020. DSH payments are made to hospitals to compensate them for the costs of providing uncompensated care.
- Reduce Medicare DSH payments by 75% initially and then increase as needed for uncompensated care.

While these reimbursement cuts do hurt hospitals (offsetting some of the benefits of the Medicaid expansion) they also indirectly help hospitals consolidate independent providers. Many of these cuts (not the DSH) also affect outpatient providers. And unlike hospitals, the outpatient providers (physicians) typically see less of a compensating benefit. In combination with the regulatory burdens imposed by the ACA, the cuts serve as a powerful inducement for outpatient providers to leave independent practice and join a hospital. As a result, hospitals are consolidating providers (at low-cost) in regional areas giving them significant leverage with payers. In 2000, 57% of doctors were considered independent. Today, that number is estimated to be 36% (as of 2013).

37

# Basics: What is the Affordable Care Act (Obamacare)?

**(4) and (5) Insurance Reform and Delivery Reform** – Rather than dwell on these areas, what's important to note is the following:

The ACA aims to shift compensation from fee-for-service (FFS) to value, quality, or performance-based care. To do so, among other things:

- The ACA allows for the creation of Accountable Care Organizations (ACOs) – groups of physicians and/or hospitals that agree to be responsible for a population of Medicare beneficiaries in exchange for fixed payments with bonuses for improved health outcomes and cost savings.
- The ACA provides funds for Medicare and Medicaid to experiment with "bundled" payments for a collection of services,
- The ACA creates an innovation center for experimenting with different payment models.
- Beyond the ACA, HHS has recently announced (1/26/15) that it aims to have 30% of all Medicare payments tied to quality, value, or through alternative payment systems by 2016 and 50% by 2018.
- Insurance Reform requires that insurers (among other things):
- Spend no less than 80% of their premium income on medical care (85% in large group plans) – this is called the "medical loss ratio."
- Offer premiums according to "guarantee issue" and "community rating."
- The former prohibits insurers from refusing to provide coverage on the basis of a pre-existing condition.
- Similarly, the latter prohibits insurers from charging differential premiums – sick people cannot be forced to pay more than healthy people for the same coverage.
- Cover "dependent children" until age 26

**Legal issues:**

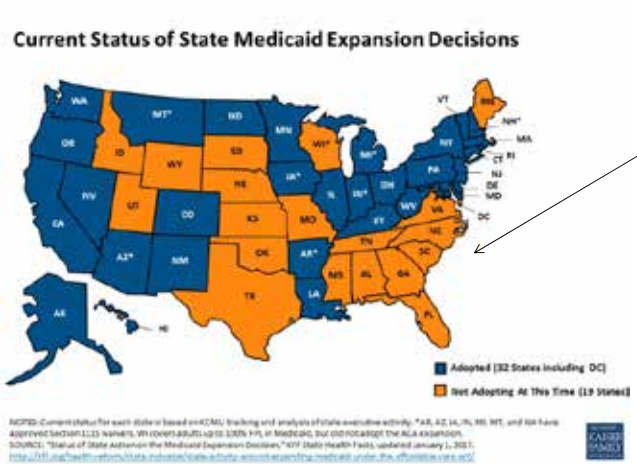
At issue in *NFIB v. Sebelius* (2012) (and related) was, (1) whether Congress had the power to compel individuals to purchase insurance (the individual mandate) and (2) whether the funding mechanism of the Medicaid expansion (whereby states would lose all of their previous Medicaid funding in addition to any incremental funding if they failed to expand Medicaid) was unconstitutionally coercive to the states. Five members of the court held that the individual mandate was constitutional. However, seven members of the court held that the Medicaid funding mechanism was unconstitutional. But rather than deem the entire Medicaid expansion beyond Congress's powers, five members of the court held that Medicaid expansion could survive with the parts found coercive severed from the rest of the legislation.

In *King v. Burwell* at issue was whether the IRS may extend tax credits to individuals obtaining care through Federal exchanges rather than state-based exchanges. The case turned on whether the IRS has properly interpreted the relevant subsidy provisions in the ACA. Specifically, the law provides that individuals should receive tax benefits for the purchase of insurance on an exchange "established by the State." Before the Court was whether this provision limits subsidies to individuals obtaining coverage through exchanges established by their state or whether individuals can obtain subsidies when purchasing coverage through HealthCare.gov (or possibly other variants of the Federal/State health care exchange partnerships). The current regulatory practice of the IRS is to grant individuals subsidies regardless of the type of exchange through which they obtain their insurance.

The court found the IRS's interpretation correct (importantly, it found that the statute was not ambiguous but instead that the IRS had correctly interpreted the statute). Because the statute is not ambiguous (which would typically still entitle the IRS to deference), it makes it much harder for the Trump administration to undo the IRS's current position.

38

# Medicaid Expansion




Worth noting that the for-profit hospital industry is concentrated in the South with particularly large presence in Texas and Florida



# Status of Republican Health Care Reform Efforts

**Overview**

For the better part of a decade, Republicans have campaigned on repealing the Affordable Care Act (ACA). With control of the House, Senate, and White House, repealing the ACA is a campaign promise that Republicans appear to be unable to back away from. Since early March 2017, the House has worked on a bill to repeal and replace the ACA – the American Health Care Act (AHCA). After initially struggling to get the necessary votes to pass the AHCA, the House was able to pass the AHCA on May 4, 2017. The AHCA will move to the Senate, but is far from in the clear. The Senate bill will likely be less conservative than the AHCA. Once the Senate passes its bill, the House and Senate will conference on the two bills to reconcile them. The dilemma for House Republicans (particularly the more-conservative Freedom Caucus members) is whether they will allow a more moderate version of their bill to become law or if they will renege on the campaign promise of repealing the ACA.

The AHCA impacts the private market, but also makes sweeping changes to the Medicaid program, including scaling back the Medicaid expansion under the ACA and converting the program to a per capita cap or block grant model. Currently, there are 20 Senate Republicans whose states have expanded Medicaid and could see their funding cut as a result of Medicaid reform. Further, the AHCA turns significant control over to the states, indicating that governors will have a significant role to play in either implementing or blocking ACA repeal and replace. Ultimately, the AHCA will likely undergo significant revisions and a combined House and Senate bill is not expected to be ready for President Trump to sign until the end of 2017.

**Key Details**

a) American Health Care Act (AHCA, H.R. 1628): the GOP-led House bill that repeals many of the Affordable Care Act (ACA) provisions and makes significant changes to the Medicaid program and individual market.
   a) Per CBO estimates of an earlier version of the AHCA (dated March 23, 2017), an estimated 58 million people will be uninsured in 2026 (24 million more people than the estimated 28 million under the ACA).
      i. *Note: the CBO has not released a score of the AHCA as passed on 5/4/17.*
   b) Per CBO estimates, the Medicaid-related coverage provisions of the AHCA would result in a budget savings of $839 billion. Specifically, the AHCA:
      i. Sunsets the ACA-created enhanced Federal Medical Assistance Percentages (FMAP) for states that adopted expansion as of 3/1/17 (except for grandfathered enrollees enrolled through Medicaid expansion as of 12/31/19 and who do not have a break in eligibility of more than one month)
      ii. Provides 100% FMAP for eligibility systems for FY 18-19 and increases other administrative matching to 60% for expenses related to implementing the new data requirements in the AHCA (e.g., to implement, monitor, and track a work requirement as a condition of eligibility for Medicaid)
      iii. Repeals Medicaid Disproportionate Share Hospital (DSH) cuts for FY 20-25; exempts non-expansion states from DSH cuts for FY 18-19
      iv. Repeals enhanced FMAP for the Community First Choice Option beginning 1/1/20

# Status of Republican Health Care Reform Efforts

a) State options:
   i. Participate in Medicaid per capita cap model beginning in FY 2019 or select 10-year block grant option beginning in FY 2020
   ii. Require work as a condition of eligibility for nondisabled, nonelderly, non-pregnant Medicaid adults
   iii. Apply for a portion of the $15 billion Federal Invisible Risk Sharing Program (FIRSP) (i.e., reinsurance) grant, available for 2018-2026
   iv. Apply for portions of $100 billion Patient and State Stability Fund to obtain financial assistance for high-risk individuals, stabilize private insurance premiums, promote access to preventive services, provide cost-sharing subsidies, for maternity coverage and newborn care, for mental health and substance use disorder services; for states that do not successfully apply for funding, funds will be used for a default reinsurance program administered by CMS
   v. Continue to operate a state-based exchange, but premium subsidies will also be available for plans sold outside of exchanges beginning 1/1/18
   vi. Continue to have the option to establish a Basic Health Program or obtain a five-year waiver of certain health insurance requirements (Section 1332 waiver)
   vii. Waive certain ACA requirements including: (1) beginning in 2018, specify an age rating ratio higher than the 5:1 ratio in the AHCA; (2) beginning in 2020, specify essential health benefits other than those required under the ACA; and (3) replace the AHCA's penalty for failure to maintain continuous coverage with a health status rating (only available for a state that has established a FIRSP or operates a risk-mitigation program).

**Prospects for the AHCA in the Senate**

a) 52 Republican Senators; 52 ideas – several working groups and coalitions, will take a long time. At a minimum, 3 months of negotiations and discussions, but more realistically won't have a new bill for President to sign until the end of 2017. Much like the House, GOP won't move unless they are sure something will get through.

b) Senators have criticized the House (Sens. Cassidy, R-LA and Cotton, R-AR have been very vocal) and we will likely see changes made to the AHCA.
   i. Medicaid cuts – opposed by: Rob Portman (R-OH), Lisa Murkowski (R-AK), Shelley Moore Capito (R-WV), John McCain (R-AZ)
   ii. Changes to pre-existing conditions protections – opposed by: Bill Cassidy (R-LA), Susan Collins (R-ME)
   iii. Defunding Planned Parenthood – opposed by Collins (R-ME), Murkowski (R-AK)
   iv. "Age Tax" – opposed by: Collins (R-ME), John Thune (R-SD)

c) Key Figures: Majority Leader McConnell, R-KY (can he pull 50 Republican Senators together to pass the Senate version?); Ted Cruz (R-TX)

**Prospects for regulatory changes under the administration**

a) HHS/CMS has already been active through rulemaking with changes expected to the bundled payment models, listening sessions on prescription drugs, and meeting with key players in the insurance market; will continue to play a role when the AHCA goes through in terms of implementing the changes to the ACA

b) States may consider expanding Medicaid, but the baseline for the per capita cap or block grant is set based on 2016 data, so it would not necessarily help them there or offer much of an incentive. Some states are already exploring the waiver options (age-rating, essential health benefits, and continuous coverage penalty), but they won't be in effect until after a state has established a FIRSP or some risk-mitigation program.
   i. The CBO score of the final AHCA bill will likely include a state-by-state analysis. Several members have quietly (and publicly) stated that their state governors likely will not apply for a waiver. Likely candidates to apply for the waiver include Texas Governor Greg Abbott and Florida Governor Rick Scott.

41

# Opportunities

**Insurers**

- Few, if any, distressed situations of note.
- Insurers are generally seen to benefit from the AHCA; well-positioned to weather any regulatory or policy changes.
- Potential opportunities for equity activism, merger arbitrage.
- Will be interesting to see how next wave of consolidation develops.
- Different strategies – i.e. Grow in Managed Medicaid; Build-out provider business (United/Optum), etc.

**Hospitals**

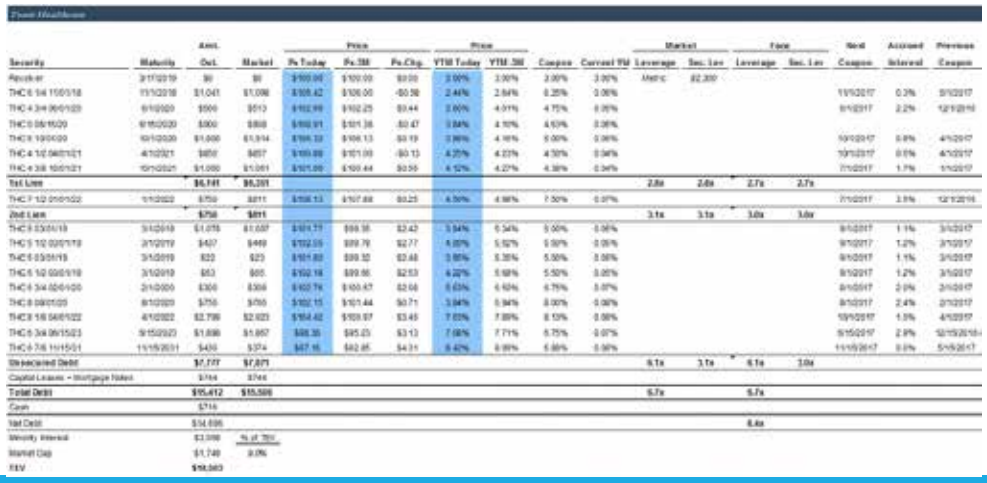
- Multiple stressed capital structures in large public operators.
- High fixed cost base, need for substantial ongoing maintenance capital expenditures, and high working capital needs may result in significant distress in the event of adverse policy outcomes (e.g. fewer insured leading to greater amounts of bad debt expense).
- Asset sales can be a meaningful source of both liquidity and de-leveraging as proceeds may be substantially higher than leverage and/or trading multiples due to factors such as CON, significant acquirer synergies, and non-economic or less-economic actors such non-profits.

**Staffing / Services / ASCs**

- Recent wave of consolidation following poor performance.
- Limited leverage in publicly traded equities, some public debt opportunities.
- Possibility that significant overbuilding occurred in freestanding EDs, ASCs.

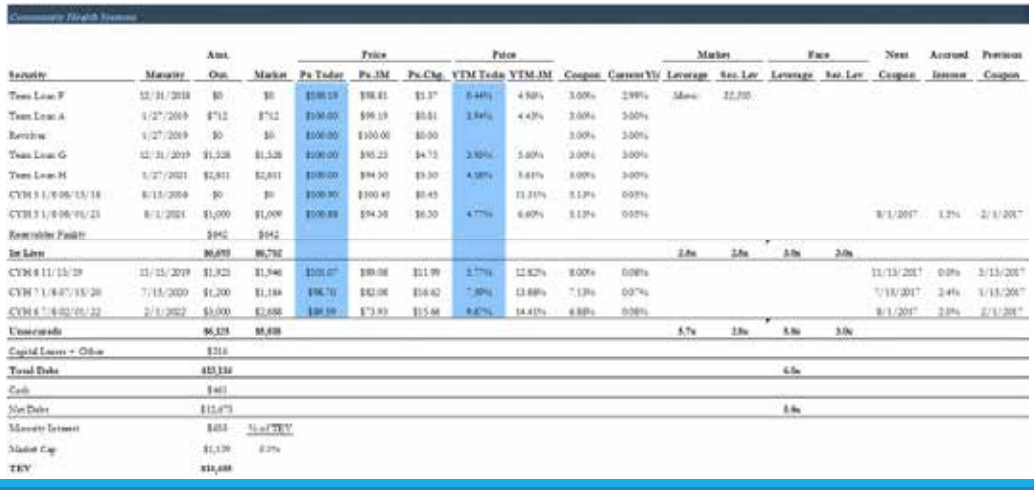
42

# Stressed Hospital Capital Structures (Tenet)

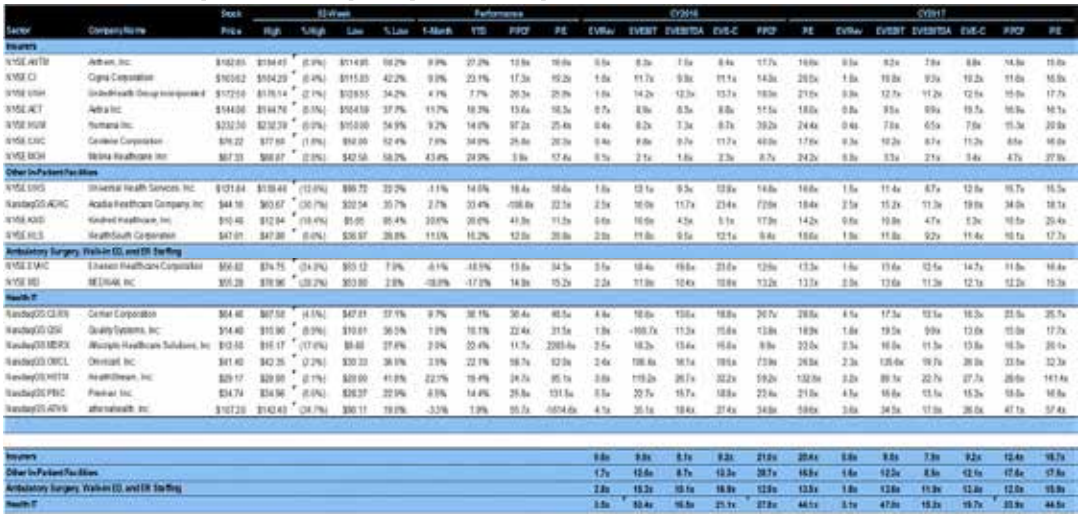




# Stressed Hospital Capital Structures (Community)



## Non-Hospital Equity Comps



45

# Legal Issues Confronting Distressed For-Profit Education

BANKRUPTCY PERSPECTIVES ON EDUCATION

46

# Background: The Higher Education Act

- The Higher Education Act was enacted in 1965 (*16. Pub. L. No. 89-329*).
- Title IV of the HEA established a Federal program of loan insurance for students who did not have reasonable access to a State or private nonprofit program
- Program administered by the Department of Education provided postsecondary students with financial aid via federal grants and federally backed loans including Pell Grants, Stafford Loans, PLUS Loans and others
- Program participation agreement (PPA) must be entered into with the Secretary of Education for an institution to be eligible. PPA imposes certain requirements including:
  - 90/10 rule
  - Limitations on cohort default rate
  - Publication of accurate employment and graduation statistics
  - Operation of a drug abuse prevention program
- National Vocational Student Loan Insurance Act of 1965 extended the loan program to vocational and technical schools

47

# Background: Growth in the For-Profit Sector

- Report by New York Federal Reserve Bank described trends (although recently enrollment has slowed)
  - 3x as many students attended for-profit schools in 2015 as compared to 2000
  - 36% more for-profit schools during the same period
- As much as 81% of the market is comprised of less-than-two-year programs
- Growth attributable to several factors
  - Bush Administration relaxed regulations that allowed more for-profit programs to be viable
  - Recession resulted in a larger pool of students seeking retraining
  - Rise in technology based education made programs more viable
- Demographics show that attendees skew toward the following:
  - Single parents
  - Lower family incomes
  - More GED

48

# Title IV: The Higher Education Act

- Concerns about business practices of for-profit or private institutions came to the forefront first in the late 1980s
  - Lack of Funding
  - Aggressive Recruiting
  - Front-loading tuition
  - High salaries and use of tuition monies on other non-education related costs
- Fear was that institutions could (or had) collected the Title IV funding and then filed for bankruptcy leaving the students without an education or recourse
- HEA was amended in 1992 to provide that if an institution filed for bankruptcy protection then it would no longer be eligible for Title IV funding
- Effectively, this regulation made it impossible for higher education institutions dependent on Title IV protection to avail themselves of bankruptcy protection

49

# Title IV: *In re Betty Owen Schools, Inc.*

- Bankruptcy Decision by the Southern District of New York in 1996
- Facts
  - A not-for-profit vocational school located in New York City
  - Debtor sold substantially all of its assets to a new owner in a 363 sale in a chapter 11 proceeding.
  - New owner had to reapply for Title IV eligibility because of the purchase
    - Purchasers can typically apply immediately
    - Avoid two-year waiting period for a new school
- Department of Education refused to allow new owner to take advantage of expedited process
  - School lost Title IV eligibility upon the bankruptcy
  - New owner was therefore subject to the standard waiting period
  - Debtors and new owner argued that § 525(a) of the Bankruptcy Code prohibited the action by the DOE
- Court found for the DOE
  - Congressional judgment on Title IV was specific and therefore trumped general bankruptcy policy
  - New owner took a business risk when it elected to proceed through a chapter 11 proceeding

50

## Title IV: *In re Lon Morris College*

- Bankruptcy Decision by the Eastern District of Texas in 2012
- Facts
  - Private junior college located in Texas
  - College ran out of cash in 2012
  - Filed Chapter 11 to recapitalize or effect a going concern sale
- DOE notified Lon Morris was no longer eligible for Title IV programs
- College response
  - Sought 525(a) injunction
  - Monetary damages
- Court found for the DOE
  - Adopted Betty Owen reasoning
  - Congress made a specific public policy choice in this situation
  - Judge recognized Lon Morris was not attempting to use the Bankruptcy Code inappropriately to take advantage of students but determined that didn't matter
- Order affirmed by appellate court and college liquidated

51

## Student Claims: Right to Sue

- Enrollment agreements generally include provisions limiting student rights to bring claims
  - Binding arbitration clauses
  - College selects arbitrator
  - Acts as an effective bar to class class-action lawsuits
  - Limited discovery
  - Limited to no right to appeal
  - Private tribunals
- Consumer protection laws in many states limited the effectiveness of many of those provisions until 2011
- Supreme Court ruling In AT&T Mobility LLC v. Concepcion et ux.
  - States cannot reject arbitration clauses as "unconscionable" solely because they bar class-action lawsuits and jury trials
  - Applied to most for-profit college students as well as for consumers of many financial products
- Limited the ability of Courts to fashion a judicial remedy for students where these clauses existed

52

# Student Claims: Corinthian Colleges

- Corinthian Colleges filed for bankruptcy protection in 2015
- Company Closed
  - Closing of locations happened over time
  - 120 colleges and 110,000 students at its peak
  - Valued at more than $1.4 billion at its height
- Cause of Closing
  - DOE slowed its access to federal financial aid and ultimately accused certain of Corinthian's schools of misleading students
  - Consumer Financial Protection Bureau sued the company for allegedly duping students with fake job placement promises
  - Federal and state authorities investigated and in some cases sued Corinthian
  - DOE levied a $30 million fine

53

# Student Claims: Corinthian Colleges

- Student committee
  - Committee created on behalf of the school's 500,000 former students
  - Total student claims of $2.5 billion for voting purposes (tort liability alleged to be greater)
  - Separate from the unsecured creditors committee
- Negotiation for a student trust seeded with over $4 million specifically for student claims
  - Money was unlikely to be distributed to students
  - Pursuit of litigation to obtain forgiveness or discharge of loans
- DOE fashioned a program for Corinthian students to obtain forgiveness of loans
  - Application process through DOE
  - Working with state attorney generals to determine bases on which debt could be forgiven

54

# Student Claims: ITT Tech

- ITT filed for bankruptcy protection to liquidate its business in September 2016
  - Shut down 137 campuses
  - 35,000 students and 8,000 employees
- Reasons for Closing
  - DOE decision to curtail ITT's access to federal student aid
  - Accrediting body threatened to pull its accreditation
  - Lawsuits and investigations.
  - ITT was being investigated by more than a dozen state attorneys general and two federal agencies for fraud, deceptive marketing or steering students into predatory loans

55

# Student Claims: ITT Tech

- Students brought a law suit in the bankruptcy proceeding estimated at $7.3 billion of damages
  - Group of former ITT Tech students moved to intervene in proceedings
  - Act as representatives students
  - Filed over a thousand pages of first-hand accounts from students who attended ITT
  - Trustee objected
  - Judge determined it was unquestionably appropriate to permit former students to file their claims as a group, rather than individually
- Judge denied trustee's motion to hire a company to begin collecting on loan accounts
  - Students objected arguing that trustee would confuse former students and expose ITT's estate to liability for collecting bad debts
  - Request denied preliminarily while trustee meet with lawyers for former students to discuss their positions on continuing debt collection against former ITT students
  - Accounts are perceived as one of the assets available to the estate
  - Students seeking loan forgiveness

56

## Student Loans: Dischargeability

- Difficult to obtain a discharge for student loans
- Test is "undue hardship"
- Most courts use *Brunner* test (*Brunner v. New York State Higher Educ. Servs. Corp.*, 831 F. 2d 395 (2d Cir. 1987)
  - Debtor cannot maintain a minimal standard of living
  - Likely to persist for a significant portion of the repayment period of the student loans
  - Debtor has made good faith efforts to repay the loans
- Borrower defense against repayment rule provides a defense based on any act or omission of the school attended by the student that would give rise to a cause of action against the school under applicable State law

57

# Current Market Trends and Regulatory Issues

BANKRUPTCY PERSPECTIVES ON EDUCATION

58

# Overview

- Education, similar to healthcare, is a highly regulated industry, with the for-profit sector having been a major target of the Obama Administration in its final years
- While under Obama a number of changes impacted the for-profit sector, but two main issues had the most significant impact on the sector: (i) limits on providing incentive compensation to recruiters (i.e., removable all the "safe harbor" provisions) and (ii) legislative approval of new gainful employment regulations
- The widely publicized reports of “bad actors” in the for-profit sector aggressively recruiting students by skewing student outcomes gave cause for the Administrations to hold the sector to stricter regulatory standards
  - e.g., deceptive and fraudulent marketing practices of failed institutions, Corinthian Colleges and ITT Educational Services
- With such aggreges behavior in the public eye, on Dec. 12, 2016, the U.S. Department of Education took actions towards a major for-profit accrediting body and announced that it no longer recognized the Accrediting Council for Independent Colleges and Schools (ACICS) as an accrediting agency
  - ACICS was the accrediting body of Corinthian Colleges and ITT Educational Services
- The combined impact of stricter regulatory standards and the opinion that growth is counter-cyclical to economic trend, has resulted in a under-performing sector

59

# Key Issues Impacting the For-Profit Sector

| | |
|---|---|
| **Continued Declining Enrollments** | • The near to medium term will continue to show signs of a declining market<br>• Industry analysts forecast sector enrollment and market share to continue to decline into 2014-2015 with sector market share down from a peak of 9.9% in 2010 to 7.7% in 2015<br>• Industry analysts expect that economic expansion will likely have a detrimental effect on the for-profit sector due to slower growth rates and margin expansions, though these typically lag changes in economic cycles<br>• According to BMO Capital Markets estimates market share is not expected to stabilize until 2021 with an approximate 6% share |
| **Compliance & Reporting** | • High degree of scrutiny by regulators and accreditors<br>• Placement – minimum student placement rates must be maintained for each of the programs offered at each school<br>• Retention – schools and programs must not fall below a certain retention threshold determined by the accrediting body |
| **Unrecognized Accrediting Body** | • DOE has ceased recognition of a major accrediting body, ACICS<br>• As a specialized accrediting body to for-profit colleges and universities, the lack of recognition by the DOE puts federal student aid programs at risk for these institutions<br>• Currently, ACICS accredited institutions have less than 15-months to find another accreditor in order to continue participating in federal student aid programs |

60

# Key Issues Impacting the For-Profit Sector

| | |
|---|---|
| **Counter-Cyclical Trends** | • Strong support of the theory of a counter-cyclical educational sector<br>• Studies by Mark Kantrowitz (August 2010) and Sarah Turner (2003 paper) found a strong correlation between annual fall enrollments to the US unemployment rate, citing evidence that shows for-profit schools can be more flexible than their not for-profit peers in responding to economic shocks<br>• The for-profit postsecondary sector typically exhibits some counter-cyclicality though can linger longer than the economic recovery due to a "jobless recovery" |
| **Marketing Restrictions / Negative Publicity** | • Aggressive recruiting practices resulting in students being encouraged to take out loans they could not afford or enroll in programs where they were either unqualified or could not succeed<br>• Current laws prohibit schools from compensating admissions recruiters based solely on success in securing student enrollment, provisions known as "safe harbors" allowed this practice<br>• Regulations remove all the "safe harbor" provisions<br>• To protect consumers, the regulations strengthen the Education Department's authority to take action against institutions engaging in deceptive advertising, marketing, and sales practices<br>• High profile closures of Corinthian Colleges and ITT Educational Services have put the for-profit postsecondary schools under fire by media organizations and politicians for alleged aggressive marketing techniques, high tuition costs and lack of job opportunities upon graduation |

61

# Key Regulatory Compliance Requirements

| Federal | *Department of Education* |
|---|---|
| **90/10** | ▪ Under the 90/10 rule, for-profit colleges must receive at least 10% of their revenue from sources other than the Education Department to remain eligible to receive federal student aid. An institution that does not comply with the 90/10 requirements for two consecutive fiscal years will lose eligibility to participate in Title IV programs for at least two years. |
| **Cohort Default Rate** | ▪ The school's cohort default rate is the percentage of a school's borrowers who enter repayment on certain Federal Family Education Loans during that fiscal year and default within the cohort default period (3-year measurement). *Sanctions, including loss of Title IV eligibility, apply when a school's official cohort default rate is at or above certain percentages* |
| **Financial Responsibility** | ▪ The composite score reflects the overall relative financial health of institutions along a scale from negative 1.0 to positive 3.0. *A school with a score less than 1.0 is considered not financially responsible but may continue to participate in the Title IV programs under provisional certification (cash monitoring and letter of credit requirements)* |
| **Gainful Employment ("GE")** | ▪ **Recent legislative approval of new regulations effective July 2015 include two separate metrics to determine compliance: (i) Cohort Default Rates and (ii) Debt-to-earnings where programs fail if graduates spend more than 12 percent of their annual earnings on student debt, or more than 30 percent of their discretionary earnings**<br>▪ **Additional regulations includes Reporting, Disclosure and Certification requirements** |

62

# Key Regulatory Compliance Requirements

| **Accreditation** | ***National or Regional Accreditors*** |
|---|---|
| **Student Achievement Standards** | ▪ National Accreditors: Measured outcomes include Retention, Graduation, Placement and Licensure Pass Rates. Generally measured on an annual basis by campus and program via required annual filings. Specific measurement cohorts and dates vary by accreditor. *Failure to meet the required standards results in additional monitoring and can eventually result in loss of program or campus accreditation and effect future growth* |
| **Corporate Governance** | ▪ Regional Accreditors: More stringent guidelines regarding Board composition, corporate governance and faculty qualifications and involvement |
| **State/Territory** | |
| **Varies** | ▪ Varies by state with some states imposing their own outcome (retention/graduation/placement) requirements in addition to accreditor requirements. In addition, many state attorney generals may been monitoring for-profit sales practices |

63

# Gainful Employment Framework

**Standards**

| **GE Program Performance Ratings** | **Annual Debt-to-Earnings (aD/E) Rate** | | **Discretionary Debt-to-Earnings (dD/E) Rate** |
|---|---|---|---|
| Passing | aD/E ≤ 8% | or | dD/E ≤ 20% |
| Not Passing (Zone) | 8% < aD/E ≤ 12 % | or | 20% < dD/E ≤ 30% |
| Failing | aD/E > 12 % | and | dD/E > 30% |

**Compliance**

- Program becomes ineligible if:
  - Failing BOTH the dD/E & aD/E rates in 2 out of any 3 consecutive Award Year ("AY") or
  - Combination of failing the D/E rates or in the zone for 4 consecutive AY
- Warnings began in 2016, loss of eligibility begins in 2017
  - Must provide warning to enrolled students within 30 days and to prospective students during 1st contact
- Failing program remains ineligible for 3 calendar years
- Must issue warnings to students if ED notifies institution that a program could become ineligible in next year

**Ineligibility**

- Spring 2017 - first year that failing programs may become ineligible
- Ineligible for 3 years, cannot reestablish eligibility for program or establish the eligibility of a program that is substantially similar if ED determined program to be ineligible or institution voluntarily discontinued program after receiving draft D/E rates that are failing or in the zone, until—
  - Final D/E rates that are passing are issued for the program for that award year or
  - If the final D/E rates for the program for that award year are failing or in the zone, three years following the date the institution discontinued the program
  - Substantially similar : Programs that share the same first four digits of a CIP Code (regardless of credential)

64

## Preemptive Measures to Gainful Employment Impact

Recognizing the GE regulations will have a meaningful impact across a wide range of school activities, institutions have had to take preemptive steps in order to be well positioned for the pending requirement milestones

| | |
|---|---|
| **Programs** | ▪ Shorter duration programs: effort to reduce the size of loan necessary to attend programs, therefore reducing debt burden<br>▪ Bachelor and higher degree programs: attract a student demographic with a higher earning potential, therefore increased ability to repay student loans<br>▪ Online offerings: programs offered at lower tuition costs, emphasizing a reduced debt level<br>▪ Program-specific changes: deemphasize programs which do not meet the gainful employment requirements and increase emphasis on programs with positive outcome |
| **Recruitment** | ▪ Candidate screening: less aggressive recruiting strategies and selectively accepting "higher quality" students to ensure ability to perform academically and repay loans post-graduation<br>▪ Greater disclosure: increase communication with prospective students on programs' debt measures |
| **Tuition/Financial Aid** | ▪ Tuition Rates: utilize tuition rates as a lever to comply with gainful employment. Although, to date, no school has announced tuition decreases, tuition increases may be lower than in the past<br>▪ Scholarships: use of scholarships to students in order to decrease debt levels |

65

## Distressed For-Profit Institutions

- Given the many regulatory requirements on for-profit institutions, it is not surprising that these colleges or universities can become distressed rather quickly and fail to meet any one of the federal regulatory compliance requirements
- In the event of non-compliance, the DOE can subject an institution to heightened cash monitoring (HCM), which, in essence, delays the receipt of future Title IV funds
  - HCM 1: Colleges must disburse student aid funds prior to requesting reimbursement from the ED. Ordinarily, colleges are allowed "advance payment," by which they can submit requests for student aid before disbursing funds
  - HCM 2: In addition to prior disbursement of funds, schools must also submit additional documentation specified by the ED on a case-by-case basis. Once placed on this list, schools remain there for five years
- Under the more severe HCM 2 status when there are serious ED concerns over the financial integrity of the institution the road can be unrecoverable as the institution's primary source of cash is significantly disrupted and potentially turned off
- With for-profit institutions essentially unable to reorganize under Chapter 11 (federal statute forever revokes an operator's eligibility for federal student aid after a bankruptcy petition), operators are forced to liquidate or wind down outside of court

66

# Footnotes and Sources

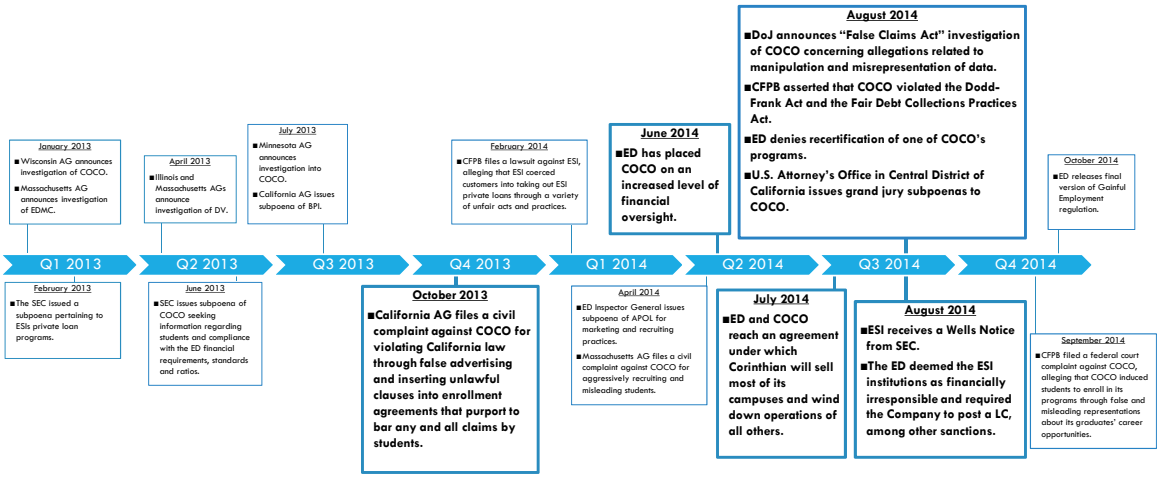
1. BMO Capital Markets – Education and Training Industry Primer
2. U.S. Department of Education National Center for Education Statistics
3. Federal Student Aid, An Office of the U.S. Department of Education
4. United States Bureau of Labor Statistics
5. Parthenon Group Research
6. Accrediting Council for Independent Colleges and Schools (ACICS)
7. Bloomberg Markets



# Expectations and Trends

## BANKRUPTCY PERSPECTIVES ON EDUCATION

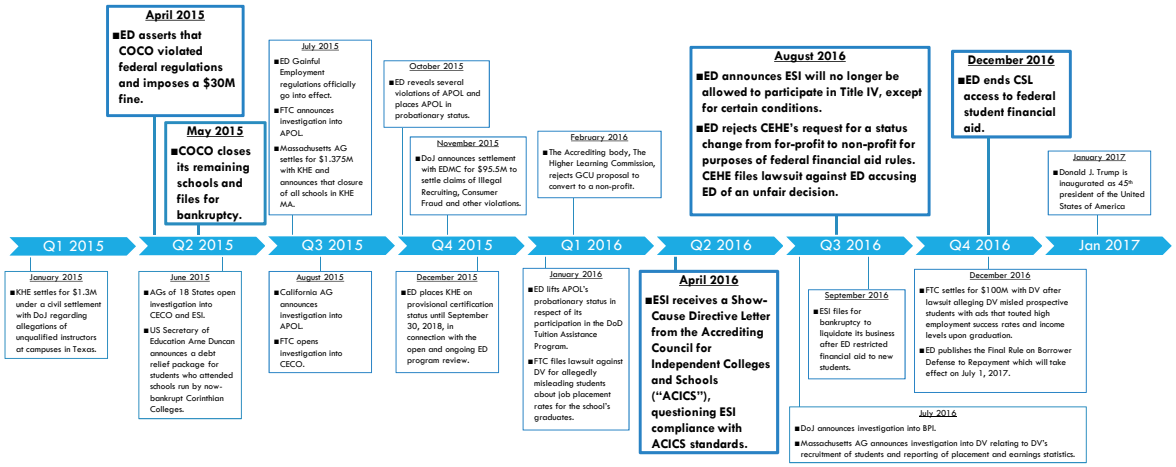
# Difficult Legal & Regulatory Environment




*Source: Company filings; Republic Report.*
Note: APOL: Apollo Education Group; BPI: Bridgepoint Education; CECO: Career Education; COCO: Corinthian Colleges; CPLA: Capella Education; ED: Department of Education; DoJ: Department of Justice; DV: DeVry Education Group; EDMC: Education Management Corporation; LOPE: Grand Canyon Education; ESI: ITT Educational Services; LINC: Lincoln Educational Services; STRA: Strayer Education; UTI: Universal Technical Institute.

69

# Difficult Legal & Regulatory Environment



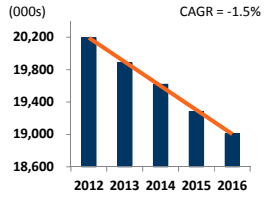

*Source: Company filings; Republic Report.*
Note: APOL: Apollo Education Group; BPI: Bridgepoint Education; CECO: Career Education; CEHE: Center for Excellence in Higher Education; COCO: Corinthian Colleges; CSL: Charlotte School of Law; ED: Department of Education; DoJ: Department of Justice; DV: DeVry Education Group; EDMC: Education Management Corporation; ESI: ITT Educational Services; GCU: Grand Canyon University; KHE: Kaplan Higher Education, LLC; UTI: Universal Technical Institute

70

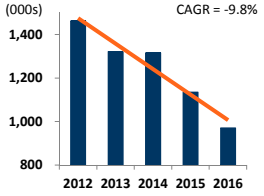
# Troubling Enrollment Trends

- Post-secondary education Fall enrollment has fallen at a rate of 1.2%, while for-profit school enrollment has fallen at a rate of 7.9% since 2012.
- Various issues can explain the decline, including an increasingly competitive online market.
  - For-profit schools have the highest portion of their students online; however, traditional schools have expanded into online education over the last several years. Pursuant to Babson Survey Research Group, 11.3% of all post-secondary institutions offered Massive Open Online Courses ("MOOCs") in 2015, up from 2.6% in 2012.
  - In 2015, students learning online at a distance grew by 11.3% at private not-for-profit institutions while private for-profit institutions saw their distance enrollments drop by 2.8%.
- Negative press coverage and a stronger economy are driving down for-profit enrollment at a faster rate than general enrollment trends

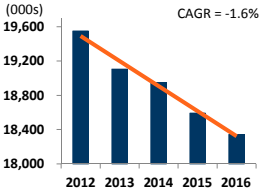
**Total Enrollment Fall 2012 – Fall 2016**



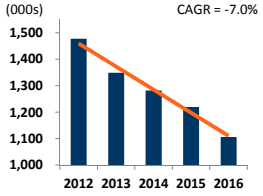

**For-Profit Enrollment Fall 2012 – Fall 2016**




**Total Enrollment Spring 2012 – Spring 2016**




**For-Profit Enrollment Spring 2012 – Spring 2016**




*Source: Babson Survey Research Group; National Student Clearinghouse*

71

# Sector-wide Enrollment Declines

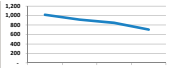
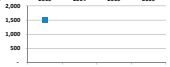
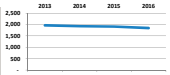
| Company | Calendar Year Enrollment 2013 | 2014 | 2015 | 2016 | Trend |
|---|---|---|---|---|---|
| Apollo Education | 263,000 | 233,500 | 190,700 | 142,500 | |
| % Change | (17.7)% | (11.2)% | (18.3)% | (25.3)% | |
| Bridgepoint Education | 63,624 | 55,283 | 49,159 | 45,087 | |
| % Change | (22.2)% | (13.1)% | (11.1)% | (8.3)% | |
| Capella Education | 35,432 | 36,309 | 36,976 | 37,882 | |
| % Change | (2.5)% | 2.5% | 1.8% | 2.5% | |
| Career Education | 52,900 | 50,200 | 43,200 | 36,600 | |
| % Change | (6.2)% | (5.1)% | (13.9)% | (15.3)% | |
| Corinthian Colleges | 77,584 | 74,000 | N/A | N/A | |
| % Change | (11.1)% | (4.6)% | N/A | N/A | |
| DeVry Education | 44,795 | 45,097 | 37,922 | 29,313 | |
| % Change | (13.3)% | 0.7% | (15.9)% | (22.7)% | |

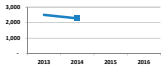
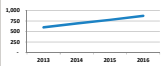
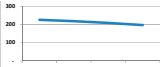
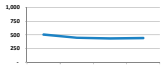
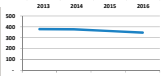
| Company | Calendar Year Enrollment 2013 | 2014 | 2015 | 2016 | Trend |
|---|---|---|---|---|---|
| Education Management | 127,360 | 118,090 | 91,000 | 65,000 | |
| % Change | (11.3)% | (7.3)% | (22.9)% | (28.6)% | |
| Grand Canyon Education | 59,658 | 67,806 | 74,506 | 81,900 | |
| % Change | 14.1% | 13.7% | 9.9% | 9.9% | |
| ITT Technical Institute | 57,542 | 53,646 | 44,922 | N/A | |
| % Change | (5.8)% | (6.8)% | (16.3)% | N/A | |
| Lincoln Tech | 15,013 | 13,278 | 11,881 | 11,864 | |
| % Change | (11.6)% | (11.6)% | (10.5)% | (0.1)% | |
| Strayer Education | 43,969 | 40,254 | 40,450 | 41,556 | |
| % Change | (10.9)% | (8.4)% | 0.5% | 2.7% | |
| Universal Technical | 15,000 | 14,400 | 13,200 | 12,000 | |
| % Change | (9.1)% | (4.0)% | (8.3)% | (9.1)% | |

*Source: Company filings*

72

# Sector-wide Revenue Declines

| Company | Fiscal Year Revenue ($ in millions) 2013 | 2014 | 2015 | 2016 | Trend |
|---|---|---|---|---|---|
| Apollo Education | 3,614 | 2,997 | 2,566 | 2,102 |  |
| % Change | (13.0)% | (17.1)% | (14.4)% | (18.1)% | |
| Bridgepoint Education | 751 | 639 | 562 | 527 |  |
| % Change | (22.4)% | (15.0)% | (12.1)% | (6.2)% | |
| Capella Education | 416 | 422 | 430 | 429 |  |
| % Change | (1.5)% | 1.5% | 2.0% | (0.2)% | |
| Career Education | 1,017 | 914 | 847 | 704 |  |
| % Change | (31.8)% | (10.1)% | (7.3)% | (16.9)% | |
| Corinthian Colleges | 1,508 | N/A | N/A | N/A |  |
| % Change | (6.1)% | N/A | N/A | N/A | |
| DeVry Education | 1,964 | 1,923 | 1,910 | 1,844 |  |
| % Change | (5.0)% | (2.1)% | (0.7)% | (3.5)% | |

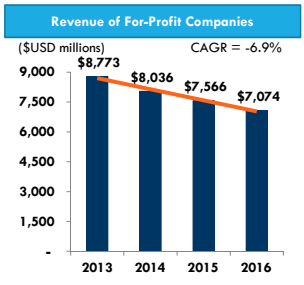
| Company | Fiscal Year Revenue ($ in millions) 2013 | 2014 | 2015 | 2016 | Trend |
|---|---|---|---|---|---|
| Education Management | 2,499 | 2,273 | N/A | N/A |  |
| % Change | (9.5)% | (9.0)% | N/A | N/A | |
| Grand Canyon Education | 598 | 691 | 778 | 873 |  |
| % Change | 14.1% | 15.5% | 12.6% | 12.2% | |
| ITT Technical Institute | 1,072 | 962 | 850 | N/A |  |
| % Change | -5.8 | (10.3)% | (11.6)% | N/A | |
| Lincoln Tech | 226 | 218 | 208 | 197 |  |
| % Change | (11.6)% | (3.4)% | (4.5)% | (5.4)% | |
| Strayer Education | 504 | 446 | 434 | 441 |  |
| % Change | (10.9)% | (11.4)% | (2.6)% | 1.5% | |
| Universal Technical | 380 | 378 | 363 | 347 |  |
| % Change | (9.1)% | (0.5)% | (4.2)% | (4.3)% | |

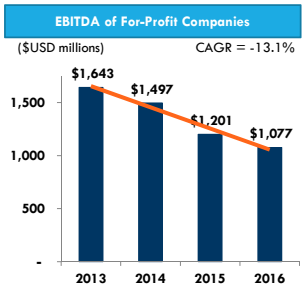
*Source: Company filings*

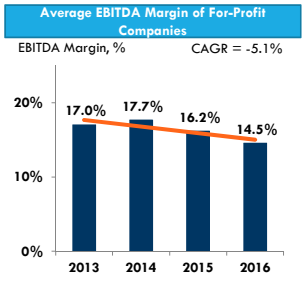


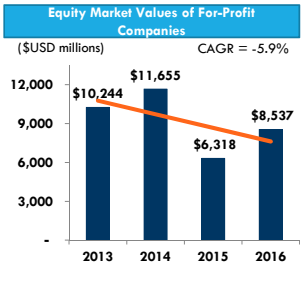
# Deteriorating Industry Performance

- Deteriorating operating performance resulting from declining enrollment trends across the for-profit education sector has negatively impacted valuations.



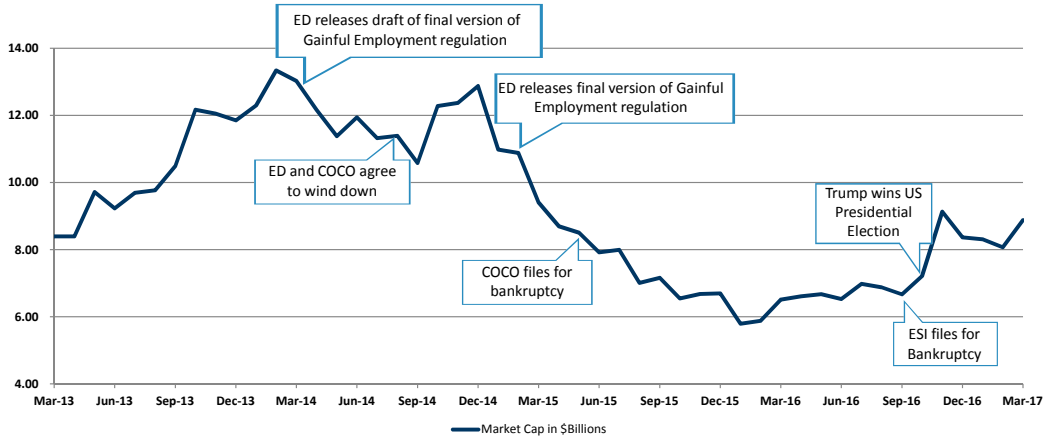




*Source: Company filings; Seeking Alpha; Google Finance*
*Comparable set includes: Apollo Education, Bridgepoint Education, Capella Education, DeVry Education, American Public Education, Grand Canyon, Lincoln, Strayer University, and Universal Technical.*

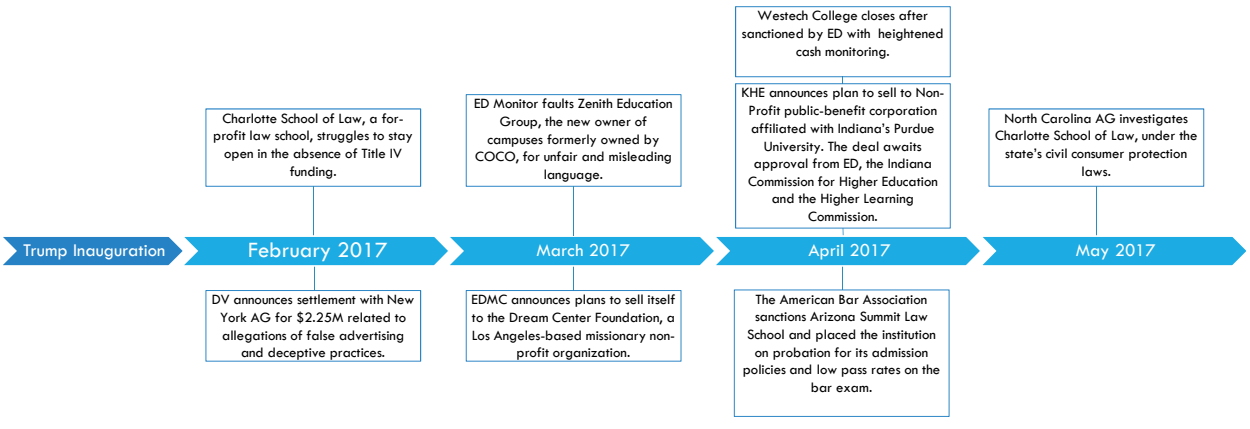
# Election Brings New Hope for the Sector




*Stocks included: APEI, APOL, BPI, CECO, COCO, CPLA, DV, ESI, LINC, LOPE, NAUH, STRA, UTI*
Note: COCO: Corinthian Colleges; ED: Department of Education; ESI: ITT Educational Services.

75

# But so far the industry seems to continue to contract…




*Source: Company filings, Republic Report.*
Note: COCO: Corinthian Colleges; ED: Department of Education; DV: DeVry Education Group; EDMC: Education Management Corporation; KHE: Kaplan Higher Education, LLC

76

# So what has the Department of Education been doing?

- The Department of Education is in transition
- Key Leadership Roles have been slow to be filed
  - Vetting candidates has slowed the process
  - No political appointees have been confirmed
  - Some candidates have been controversial
  - Acting and interim employees have limited ability to act
- Major issues were left to be dealt with by the Trump Administration
  - Gainful Employment regulation
  - Borrower Defense to Repayment ("BDTR") rule
  - FAFSA – DRT Data Breach
  - Re-authorization of Higher Education Act

77

# So what has the Department of Education been doing?

- Some key appointees have been named
  - James Manning – Acting Under Secretary
    - A long time education expert
    - Has served in Republican and Democratic Administrations
  - Robert S. Eitel – Special Assistant to the Secretary of Education
    - Rumored to be a candidate for General Counsel of the Education Department
    - Education Department lawyer in the George W. Bush Administration
    - Currently on leave from role as VP for Regulatory and Legal Services at Bridgepoint, an operator of for profit colleges, Ashford University and University of the Rockies
- "Things are not getting worse"
  - Observers have indicated that there does not seem to be a targeting of the industry
  - Inside Higher Education, quotes higher education advocates as saying that the Interagency Task Force "is basically done or has suspended activities"
  - "I think the current administration, to their credit, says, "we're not going to target one sector. We're going to look at the good, the bad and the ugly in all of higher education." - Steve Gunderson, President and CEO, Career Education Colleges and Universities, Inside Higher Education

78

# What can we tell from actions so far?

- **Delay in Gainful Employment Deadlines**
  - Have until July 2017 to submit appeals to academic programs' debt-to-earnings ratios
  - Colleges will have until July to meet a previously set April mark for updating their public disclosures for 2017
  - The Trump Administration's Department of Education decided to make the new delays to "allow the department to further review the Gainful Employment regulations and their implementation."
- **Withdrew Student Loan Servicing Reforms**
  - Secretary DeVos rescinded Obama Administration directives designed to do more to help borrowers manage, or even discharge their debt
  - In a letter dated April 11, 2017 from Secretary DeVos to James W. Runcie, Federal Student Aid Chief Operating Officer, Secretary DeVos withdrew three Obama Administration directives stating that….
    - "the process has been subjected to a myriad of moving deadlines, changing requirements and a lack of consistent objectives"
    - The directives were being withdrawn "to negate any impediment, ambiguity or inconsistency in the approach needed to accomplish this critical mission."
- **Jerry Falwell Jr. to Lead Education Task Force in Trump Administration**
  - "I've seen firsthand what the Department of Education is doing to college and universities, using the leverage of financial aid to micromanage college and schools with regulations that are overly burdensome"



# What to look for next…

- **Will the Department approve pending Higher Education transactions?**
  - Navient's pending acquisition of $3.7 billion of federal student loans from JPMorgan Chase
  - EDMC plans to sell Argosy University, South University, and the Art Institutes to Dream Center Education, a Christian missionary organization that says it will convert the for-profit colleges into not-for-profit enterprises
  - Purdue University's plans to acquire Kaplan University, a for-profit college with approximately 33,000 students. This would transform Kaplan into one of Purdue's public, not-for-profit branch campuses, with its classes offered almost entirely online.
- **Will the Department delay or modify the Borrower Defense to Repayment ("BDTR") rule?**
  - The final BDTR rule, published in October 2016, will be effective on July 1, 2017, absent some action by the Department of Education or Congress
  - The BDTR rule has wide ranging implications, including, but not limited to:
    - Student loan forgiveness and chargeback to schools
    - New Title IV Program Financial Responsibility "Triggers" and new Letter of Credit requirements
    - Elimination of pre-dispute arbitration agreements and class action waivers
    - Loan Repayment Warnings at For Profit Schools

# What to look for next…

- **Will the Department delay, modify or fail to aggressively enforce Gainful Employment regulation?**
  - Most observers believe that the Gainful Employment regulation will eventually be enacted, the question is when and are there any modifications to the regulations
  - Even critics of the Gainful Employment regulations recognize that some better system of accountability is needed
  - Trump Administration lawyers argued on behalf of Secretary DeVos by defending the Gainful Employment regulation in federal court in a case where the American Association of Cosmetology Schools ("AACS") filed a lawsuit to block the regulation. The AACS is arguing that Gainful Employment data undercounted income of cosmetology program graduates.
- **Will the State Attorney Generals and the CFPB fill the void if the Department of Education is less aggressive?**
  - State Attorney Generals and the CFPB played a major role in the shut down of Corinthian and ITT Tech
  - Several State Attorney Generals intervened in the lawsuit of the for-profit accreditor ACICS against the Department of Education
  - California State Assembly introduced bills that would codify the federal Gainful Employment regulation in state law or create an entirely new data collection and disclosure system under the California Bureau for Private Postsecondary Education

81

# Footnotes and Sources

1. Babson Survey Research Group
2. National Student Clearinghouse
3. Seeking Alpha
4. Google Finance
5. Company Reports
6. Republic Report
7. Inside Higher Education
8. Pro Publica
9. New York Times

82

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