



AMERICAN  
BANKRUPTCY  
INSTITUTE

# 2019 Central States Bankruptcy Workshop

*Business Track*

## Preparing for the Next Recession

**Hon. Catherine J. Furay, Moderator**

*U.S. Bankruptcy Court (W.D. Wis.); Madison*

**Mark T. Iammartino**

*Development Specialists, Inc.; Chicago*

**James A. Lodoen**

*Ballard Spahr LLP; Minneapolis*

**Nancy A. Peterman**

*Greenberg Traurig, LLP; Chicago*

## Preparing for the Next Recession



26<sup>th</sup> Annual Central States Bankruptcy Workshop  
June 13 - 15, 2019  
Traverse City, MI

**Hon. Catherine J. Furay** (Moderator), *U.S. Bankruptcy Court (W.D. Wis.)*  
Madison, WI

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## State of the Economy

- Economy is generally strong with continued expectations for growth throughout 2019
  - Confidence was generally weaker towards the end of the prior year
  - Many fundamentals have strengthened in the first quarter
- U.S. CFOs now generally don't believe a recession will occur in 2019
  - Duke University has been conducting a quarterly survey of 1,500 global CFOs for over 20 years
  - 38% of U.S. CFOs predict a recession by 1Q20
  - 67% of U.S. CFOs predict a recession by 3Q20
  - 84% of U.S. CFOs predict a recession by 1Q21
- Significant indicators of recession
  - GDP growth
  - Consumer spending
  - Commodity prices
  - Interest rates
- Long-term structural problems but related issues may not materialize in near term
  - Federal debt obligations and deficit spending
  - State/local pension and post-retirement benefit obligations
  - Generational shifts with Gen X smaller than Baby Boomers (but Millennials larger than either)
  - Geographic shifts from Midwest/Northeast to South/West; continued increased urbanization

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## Gross Domestic Product

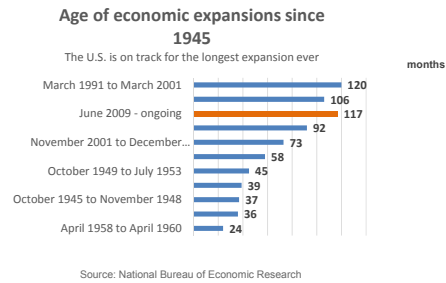
- GDP growth was decelerating from 2<sup>nd</sup> quarter 2018 through the end of the year
  - Even at 2.2% growth in 4Q18, the economy was still relatively healthy
  - Economy similarly slowed in 2015 only to recover
- 1Q19 GDP was 3.2% - a strong performance!
- Most estimates for 2019 GDP growth range from 2.0-2.5%



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## Continued Economic Expansion

- Current growth period is the second-longest in US history
  - Longest expansion in history was from March 1991 to March 2001 (120 months)
  - Current expansion dating from June 2009 is approximately 117 months long
  - Will set record for longest expansion in July 2019
- If no recession in 2019, it will be the first time in US history that we have had an entire decade free of recession



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## Consumer Spending

- U.S. has a very consumer-driven economy, so public perception of economic conditions has a material impact on actual economic conditions
  - Unemployment is at historical lows and wage growth strengthened in 2018
  - Labor force participation rate has stabilized over prior 3 years after peaking in early 2000 at 67.3% and steadily declining since; currently at 63.0%
  - Consumer confidence rebounded strongly in early 2019 and currently higher than any point during the period from 2009-2016
- Occasionally plummets, but often snaps back; in recessions we see significant declines



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## Consumer Spending

- Potential headwinds to consumer spending
  - Impact of tax changes; perceptions that refunds are less
  - Student debt overhang on younger adults
    - Total student loan debt has increased from \$260 billion in 2004 to \$1.6 trillion in 2019; average debt doubled with Class of 2017 having an average debt of nearly \$29k
    - Delinquent or defaulted loans are 11.4% with a comparable amount in forbearance
    - Mortgage market more than 10x the size of the student debt market
  - Mortgage delinquencies continue declining; mortgage abuses not repeating
  - Auto loan delinquencies have been surging, especially among lower credit score individuals (<620); numerous subprime auto lender bankruptcies
    - Often attributed to credit being too easy; competition from banks and average auto vehicle prices increased over time due to technological improvements
- Overall levels of household debt service as a percentage of income is still below pre-financial crisis levels, and are generally lower than any time in the 1980s, 1990s, or 2000s
- More susceptible to external shocks and headlines to drive behavior (e.g., 9/11, Lehman)

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## Commodity Prices – Farming

- Corn prices have fallen dramatically from recent peaks and remain low
  - Decline has largely moderated but is persisting at low prices
  - Peaked in 2011-2013 and crashed shortly thereafter; corn is now down 10%+ during 2019 alone
- Similar patterns in soybeans, wheat, milk, and other farming commodities
- Commodity pricing boom in early 2010s generated significant economic activity in the farming sector
  - Numerous operators sought scale by acquisition and modernization
  - Low interest rates and possible general asset bubble has kept farm acreage prices high
  - Many farms have held on due to farm equity, but how long can they persevere?
- Expect increased farm distress in 2019, but not to the extent of the mid-1980s



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## Commodity Prices – Oil

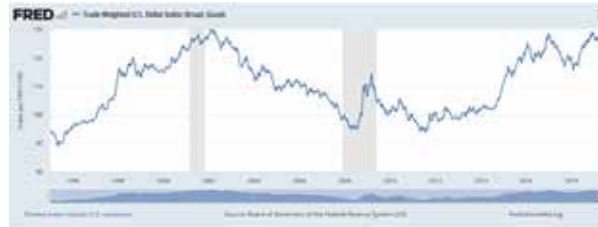
- Commodity prices have complex effects on broader economy
  - Impact of fluctuations may mean much more to specific segments of economy
  - Degree of globalization makes a difference in impact
- Oil prices have been steadily increasing, but are still below levels seen in 2011-2015
  - Prices are up roughly 50% in 2019; \$45/bbl at end of 2018 and now currently approximately \$65/bbl (WTI)
  - High oil prices have a widespread adverse impact on transportation, manufacturing, and general economic activity
  - Oil industry one of the primary drivers of overall GDP growth during peak years; higher prices sparked booms in Texas and North Dakota
  - Drop in oil prices in 2014-2015 generated a lot of oil-related bankruptcy work
- Net effect of rising oil prices may very well be positive to the overall U.S. economy
  - More of the increased cost is kept within the U.S.
  - Increases export market opportunities
  - Still hurts specific market sectors that can't absorb increased costs



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## Commodity Prices – U.S. Dollar

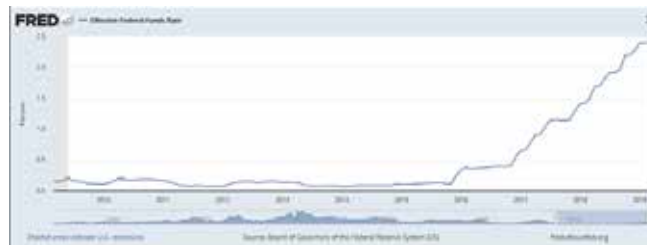
- U.S. Dollar appears to be in a period of prolonged strength
  - Tends to appreciate during periods of global instability
  - Hurts companies with large reliance on exports (including the farm industry)
  - Worldwide recession would likely further strengthen the U.S. Dollar
- Interplay between U.S. Dollar prices and interest rates
  - Strong demand for U.S. Dollars often expressed with strong demand for U.S. Treasuries, which keeps interest rates down
  - U.S. Dollar still viewed as a safe haven currency



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## Interest Rates

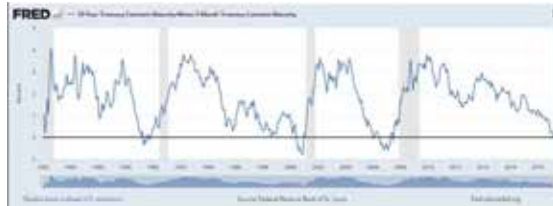
- Interest rates remain at historic lows despite Federal Reserve Bank steadily increasing rates for past two years
- Rate increases largely on hold after witnessing negative impact on economy; announcement that further increases may not occur likely contributed to recent strengthening of economy
- Many attribute low rates to causing a widespread asset bubble as evidenced by the stock market, P/E multiples, ease of credit, and other assets



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## Interest Rates

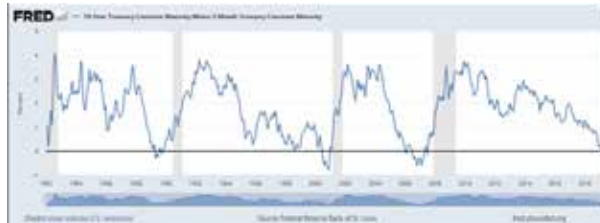
- Rates have been so low for so long that economy is almost addicted to them; may be very difficult for the Federal Reserve to normalize rates without causing severe recession
  - Ability of companies to absorb higher debt service costs
  - Ability of federal and state governments to absorb higher debt service costs without cutting services or raising taxes
  - Impact on pension funds if asset prices decline; increased contributions required partially offset by increased interest income
  - Further increases in U.S. Dollar strength
- Challenges to maintaining the current interest rate environment
  - Continued foreign appetite for US Treasuries may wane, though demand may increase during a recession or volatility; likely low risk of foreign holders (primarily China and Japan) rapidly selling holdings to negatively shock interest rates
  - Federal Reserve Bank started reversing quantitative easing in late 2017; many years to normalize at current pace
  - Social Security has been one of the largest buyers of U.S. Treasuries but is likely to become a net seller by 2020



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## Interest Rates – Inverted Yield Curve

- A key interest rate measure recently inverted in March 2019
  - Represents the difference between the yield on 10-Year US Treasury Notes and 3-Month US Treasury Bills
  - Normally longer-term debt has higher interest rates than shorter-term debt; when this is not the case, it has inverted
  - The inversion of the 10y-3mo spread has predicted every recession since 1960; recession occurred within 12 months of the occurrence
  - Indicates market participants don't believe current economic conditions can continue
- But is this time different?
  - Inversion quickly reversed and yield curve is now considerably steeper (positive)
  - Price signaling from yield on 10-Year Treasuries is distorted by heavy government intervention in recent years
  - All other factors seem to indicate continued economic strength



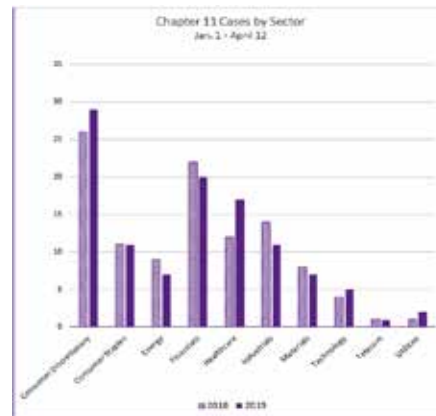
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## What to Expect in 2019

- If no broad-based recession is expected in 2019, what do we do?
- Individual segments of the economy will still likely experience distress due to secular trends
  - Farming industry showing increasing fractures due to prolonged low commodity prices
  - Auto industry likely at cyclical peaks due to recent year strengths and shifting consumer sentiments
  - Health care continues to shift towards greater concentration and increased pressure on reimbursement rates
  - Casual dining and many retail options are falling out of favor with current consumers
- What if the recession actually does arrive in 2020?
  - Hopefully you will have trained up your bench during 2019
  - Ensured you stayed front of mind with referral sources
  - Taken your vacations

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## Cases with \$10 million or more of Liabilities



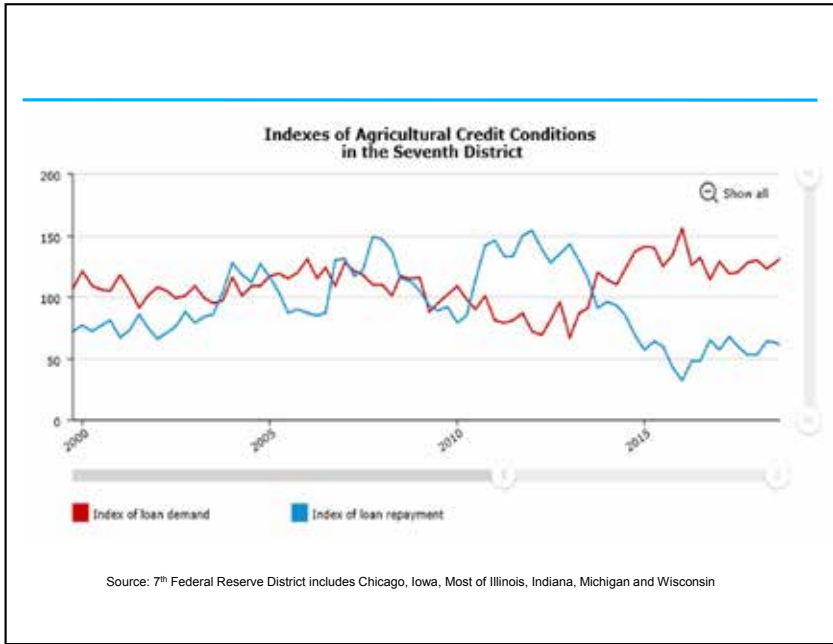
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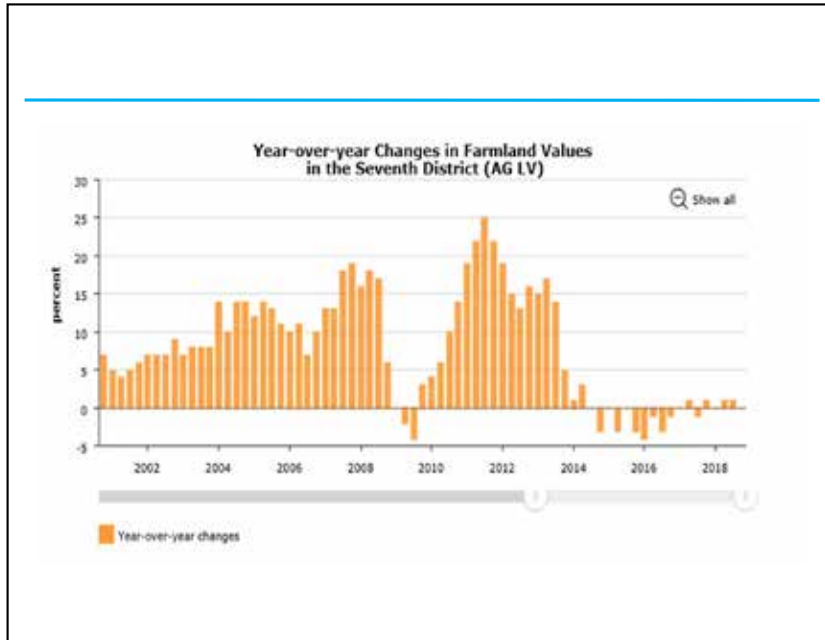
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**Agriculture Financial Stress  
No Need to Predict—It's Here!**

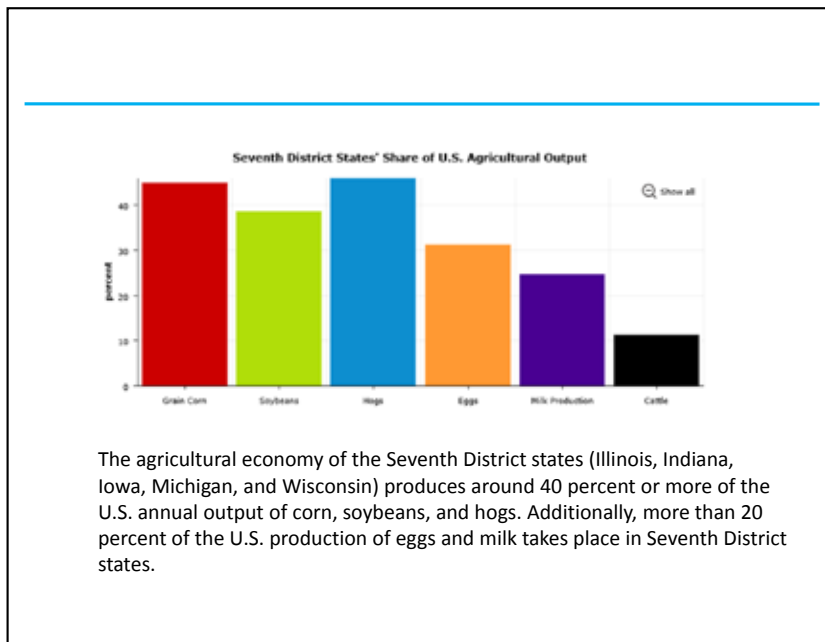
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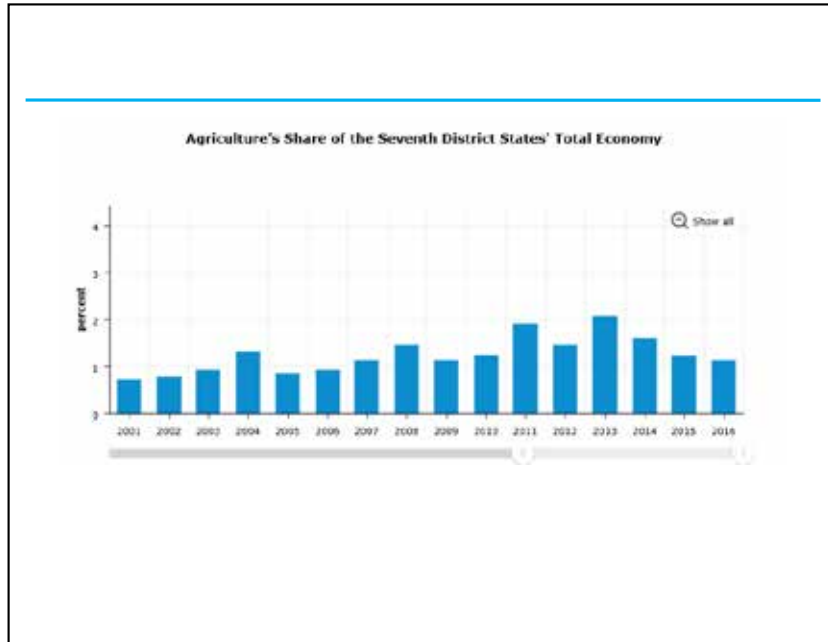
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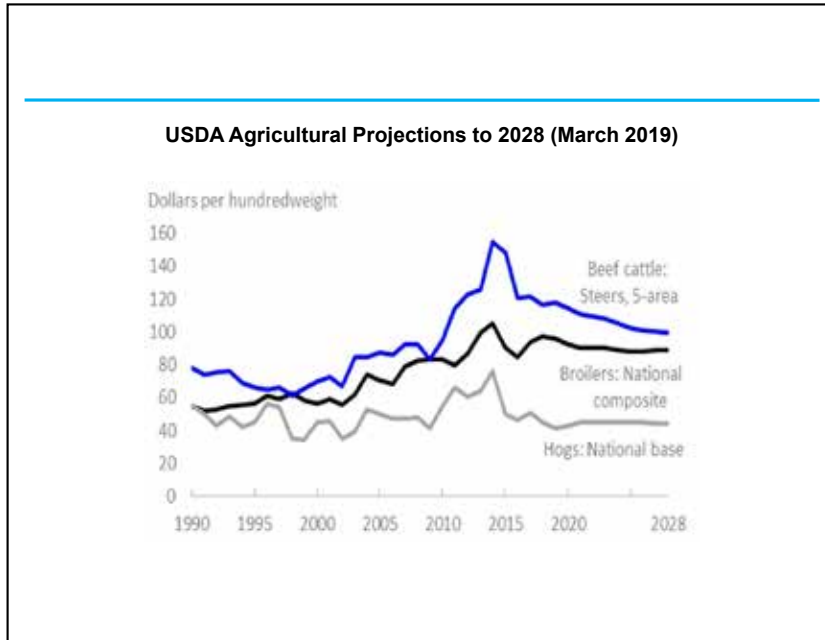
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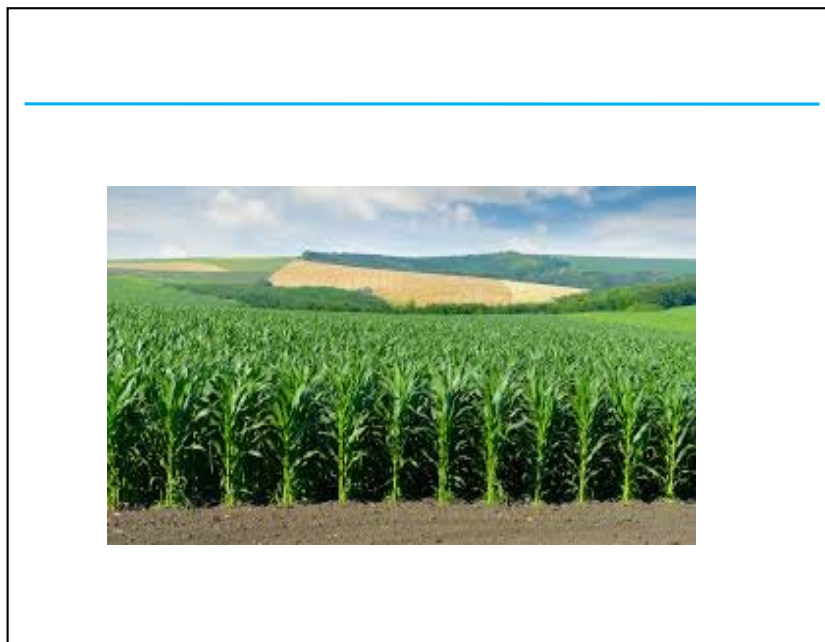
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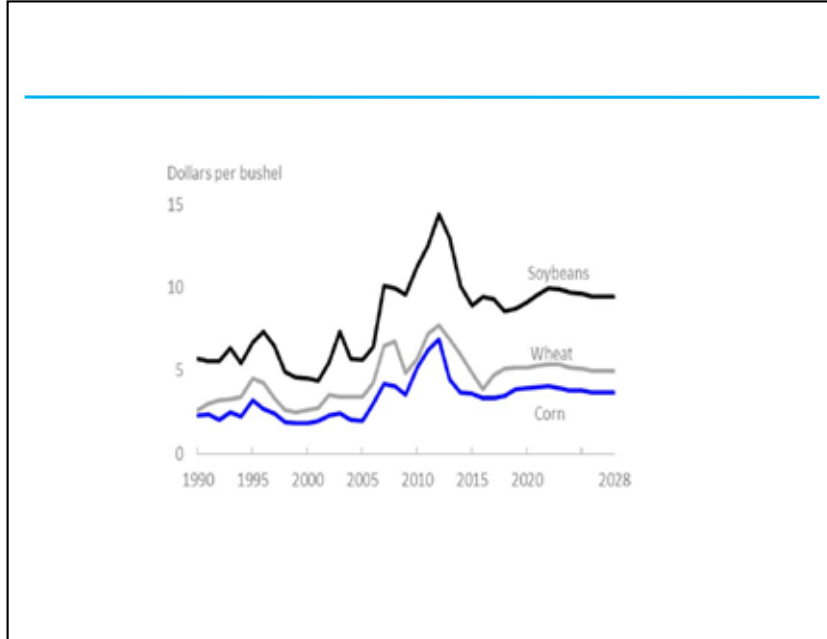
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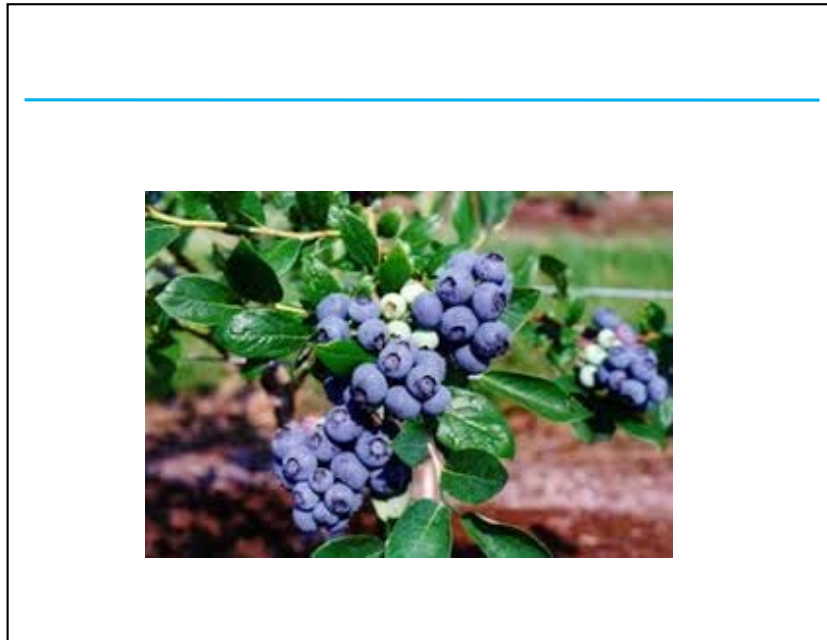
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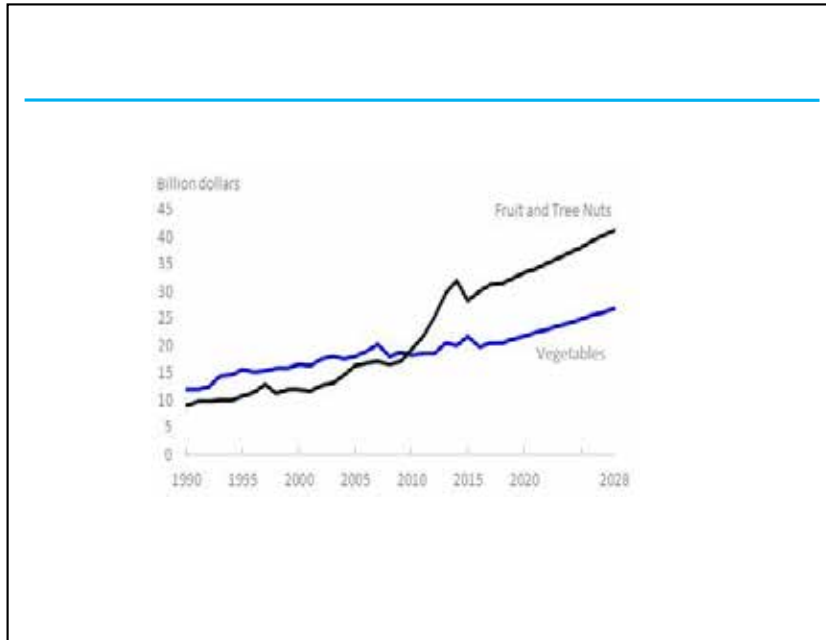
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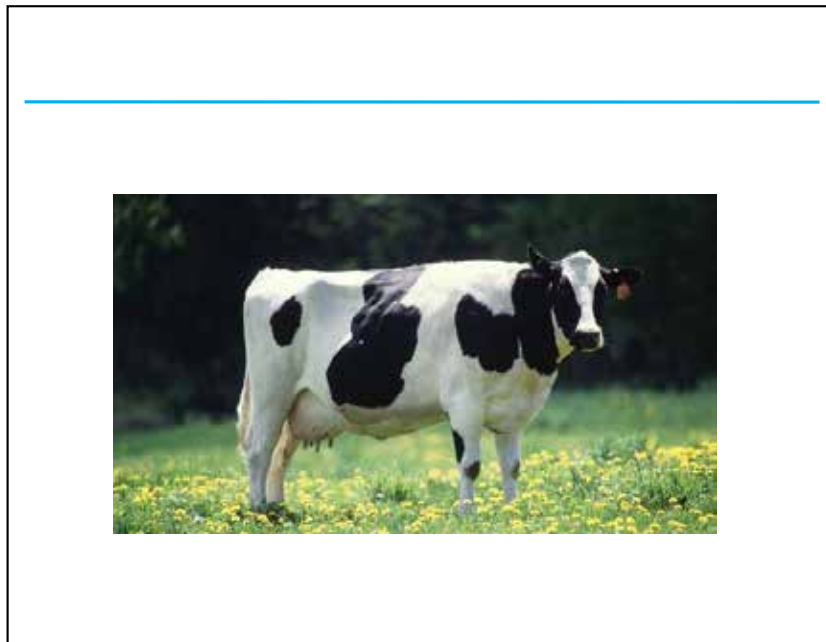
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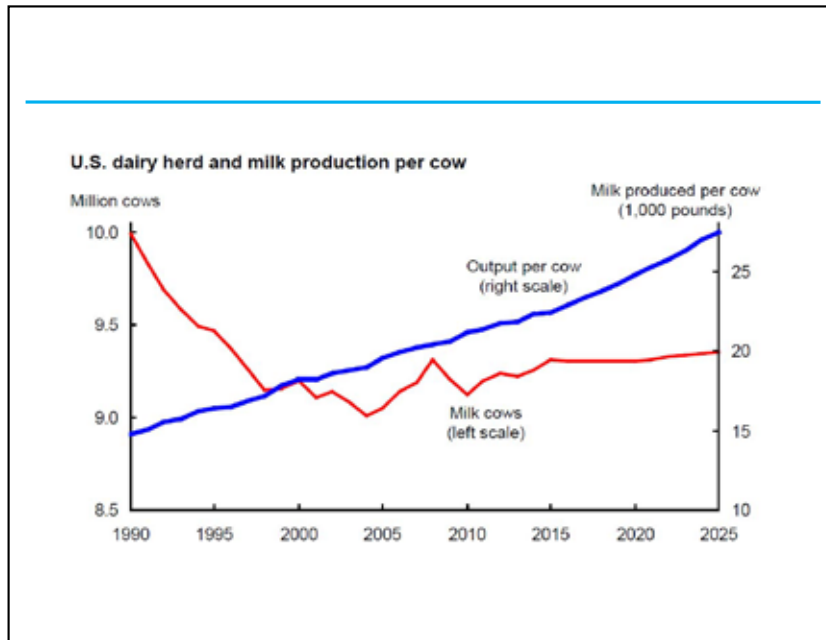
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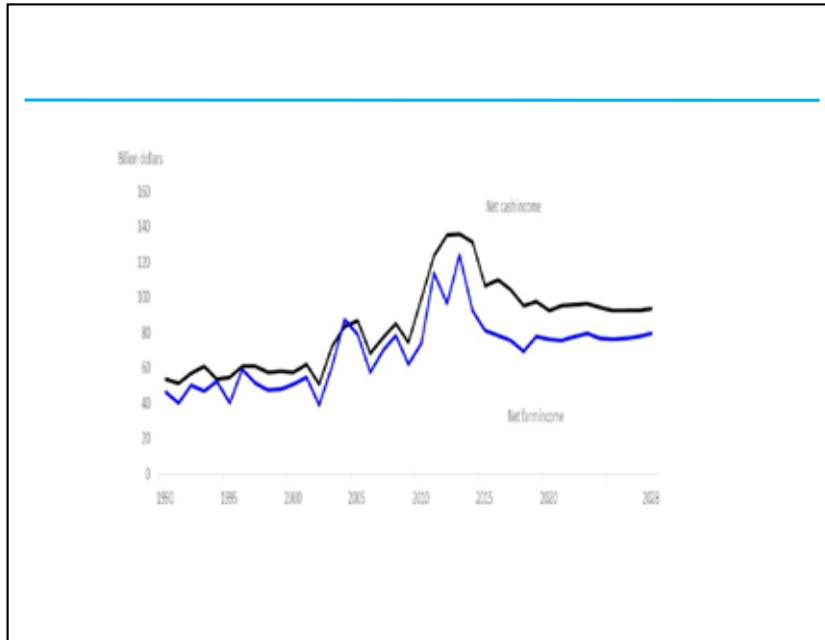


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### Dairy Facts (USDA)

- Cost of production estimate
  - \$16.28/cwt dairies less than 200 cows
  - \$14.61/cwt dairies with more than 1000 cows
- Price estimate
  - \$17/cwt from 2019-2022
  - \$18/cwt from 2023-2025
  - \$19/cwt in 2026
- Betsy Efficiency/Demand
  - 14.5% more milk/cow from 2018-2028
  - 12.6% increase in commercial use from 2018-2028
  - 9% increase in exports

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### Farm Crisis 80's vs. 2019

- Chapter 12 Filings
  - 1987 - 5,788
  - 2018 - 498
- Differences
  - 5-7% vs. 18-20% interest
  - Several years of build up of cash
  - Land values stable vs. 1% per month or more drop in 80s
  - Robust crop insurance program
  - Liquidity/working capital vs. balance sheet problem

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### Chapter 12 Filings

	2018	2017	2016
Illinois, Central	1	2	5
Illinois, Northern	4	2	2
Illinois, Southern	8	4	5
Indiana, Northern	1	3	2
Indiana, Southern	14	4	6
Iowa, Northern	10	15	7
Iowa, Southern	3	3	5
Michigan, Eastern	8	11	17
Michigan, Western,	2	5	4
Minnesota	26	19	11
Wisconsin, Eastern	16	17	19
Wisconsin, Western	33	28	21

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### Farm Bankruptcy Issues

- Accounting/Records
  - Costs
  - Cash Flow
  - Profitability
- Valuation
- Joint Ownerships
- Priority Disputes
- Legs and Wheels
- One more year—or liquidate—or sell off machinery and lease out land?

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Expenses Drive Farm Profitability

"The Michael Swanson effect"

Cash-on-Cash Rent Ranked by Percentage Profit	Low 20% 2015/2014	30-40% 2015/2014	40-60% 2015/2014	60-80% 2015/2014	High 20% 2015/2014
Direct Expenses					
Land Rent	288,238	215,217	288,787	296,783	288,029
Fertilizer	285,847	151,742	196,525	230,118	408,982
Seed	226,324	222,519	228,511	222,708	228,381
Interest	12,050	44,041	39,488	36,022	48,082
Fuel and Oil	42,028	29,721	23,000	24,000	18,000
Crop Chemicals	85,762	81,787	91,785	91,789	81,000
Crop Insurance	26,022	24,719	22,518	22,717	26,218
Other					
Total Direct Expenses	230,798	474,955	846,814	786,540	1,021,312
Total w/ln Rent	511,036	461,838	486,607	567,278	710,327
Total Overhead Expense per Acre	243,022	118,739	132,294	106,788	151,288

Source: USDA

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Unique Priority Issues

- Blanket Lien Lender
  - After acquired clause in crops not effective if stop providing financing (i.e., NDCC 35-05-01)
- Contract for Deed
- Machinery Lender--PMSI
- Secured Input Financier
- Buyer of Farm Products from Farmer
- Statutory Liens
- PACA Claims
- Fixture Lender (storage bins, irrigation systems)

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### Farm Product Exception

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- **UCC § 9-320 (Former 9-307)**
  - Buyer in the ordinary course of business takes free of a security interest created by the buyer's seller, even if perfected, and the buyer knows of its existence
  - "Other than a person buying farm products from a person engaged in a farming operation"

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### Farm Product Exception (cont.)

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- Huge issue during the 80s farm crisis
- Problem created by exception
  - Grain elevator pays the farmer for the grain
    - But does not include name of secured bank on check
  - Farmer does not give proceeds to bank
  - Elevator is sued by the bank for conversion
  - Grain elevator buyer pays twice
- Congress to the rescue!

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**Food Security Act of 1985**  
**7 U.S.C. § 1631**

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- Protects buyers and trumps 9-320
- Eliminates the farm products exception so the buyer takes free and clear unless:
  - Secured party provided notice to buyer of its security interest within year before sale or,
  - In states with a Central Filing System, the secured party filed an Effective Financing Statement (EFS)
  - And buyer fails to perform payment obligation (lender name on the check)

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**19 States with Central Filing System**

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- Regional states with Central Filing System
  - Minnesota
  - North Dakota
  - South Dakota
- Direct notice states
  - Wisconsin
  - Michigan
  - Illinois
  - Indiana
  - Iowa

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### **Agricultural Statutory Liens**

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- Perfection/Priority Governed by State Law-UCC § 9-302
- Types of liens
  - Landlord lien for unpaid rent
  - Custom planting, tilling, harvesting
  - Input liens for seed, chemical, fertilizer to raise crops
  - Input liens for livestock production inputs
  - Lien for storing or caring for livestock
  - Breeder (semen costs and stud fees)/veterinarian liens
  - Timber
  - Transportation of commodities
  - Animal finders lien (only Wisconsin?)

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### **Agricultural Lien Issues**

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- Scope of lien, priority and filing requirements vary by state
  - Some liens can prime existing security interests
  - Some states require notice to lender before delivery of inputs to prime
  - Recording time varies among states and liens
  - Filings may be required but not always
  - Some states require filing in county recorder
  - Some require filing with the secretary of state
  - Liens only encumber commodities the inputs helped produce
- Practical problems litigating lien issues
  - Tracking inputs to particular locations/fields
  - Tracking inputs into specific livestock or proceeds
  - Tracing lien rights into harvested crops or sold commodities

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### Particular State Agricultural Liens

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- Compilation of state Agricultural Liens
  - [www.NationalAgLawCenter.org](http://www.NationalAgLawCenter.org)
- Illinois-510; 735; 770; 810 ILCS
- Indiana-I.C.A 26-1; 32-28; 32-31; 32-33
- Michigan-M.C.L.A. 287; 426; 440; 485; 570
- Minnesota-M.S.A. 236, 336A; 343, 514
- Wisconsin-Wis. Stat 170; 171, 172, 407; 779;

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RETIREE FINANCIAL PROBLEMS ARE HERE  
AND WILL ONLY GET WORSE

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## The Retirement Savings Crisis



Age Bracket	Mean Household Retirement Savings	Median Household Retirement Savings
32-37	\$32,602	\$1,000
38-43	\$61,933	\$5,000
44-49	\$113,370	\$13,000
50-55	\$133,626	\$11,000
56-61	\$243,599	\$21,000

2016 Triennial Survey of Consumer Finances  
Board of Governors of the Federal Reserve System

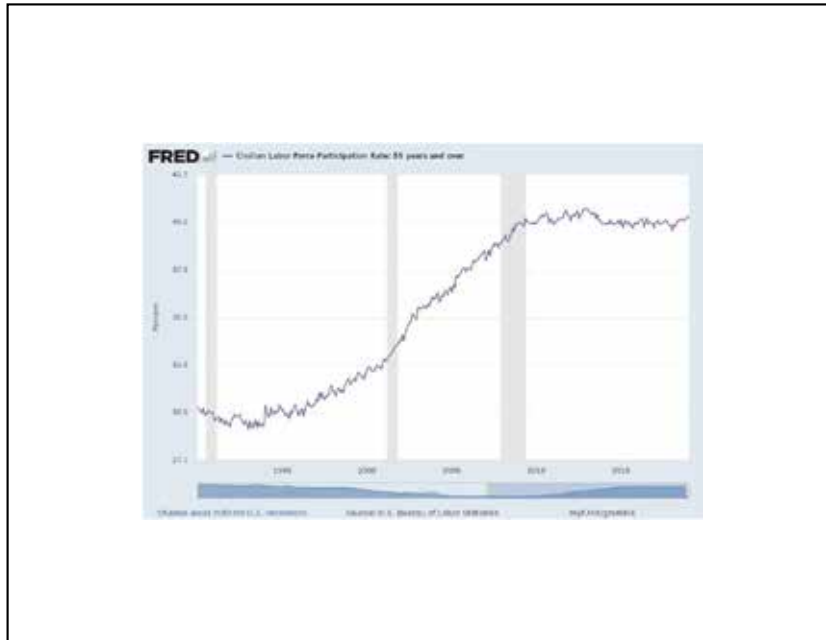
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## Retirement Savings Crisis

Age Group	% With Zero Savings	% >\$0 but < \$10,000
18-34	58%	19%
35-54	42%	10%
55-64	41%	7%

2016 Triennial Survey of Consumer Finances  
Board of Governors of the Federal Reserve System

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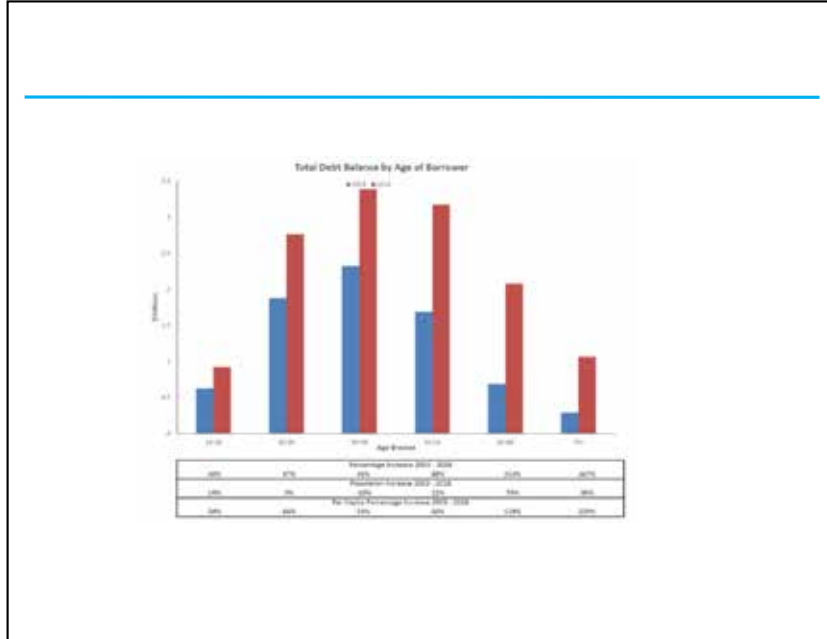
## Retirement Savings Crisis

- 58% of working age Americans have less than \$10,000 saved for retirement
- 46% of working age Americans have nothing saved

2016 Triennial Survey of Consumer Finances  
Board of Governors of the Federal Reserve System

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Share of New Bankruptcies by Age Bracket

Year	Age Bracket					
	18-29	30-39	40-49	50-59	60-69	70+
2000	16.3%	30.7%	27.1%	15.8%	6.1%	4.0%
2004	13.2%	27.4%	28.3%	18.8%	8.0%	4.3%
2010	7.1%	23.5%	29.5%	23.4%	11.7%	4.8%
2014	6.3%	21.2%	28.6%	24.6%	13.4%	5.9%
2018	7.6%	21.0%	26.0%	23.2%	14.2%	7.9%
Increase	-53%	-32%	-4%	47%	134%	99%

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## Retiree Issues

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- Plan exemptions while still working
- Obvious-maximize 401K and IRA
- Homestead Exemption Planning
  - Not as easy as it used to be
  - Still options—but must plan ahead. Pay down of mortgage on eve of filing creates problems today
  - Florida, Texas, Kansas, Iowa and Oklahoma 100% protected
  - MN-\$390,000 or \$975,000 if agricultural use (better than most)
- Application of means test when retired
- Co-signed student loans
- Inheritances coming to retirees
- Joint ownership of home with children
- Life estates
- Reverse mortgages

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Healthcare Industry

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## Why Should You Care?

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- **The United States spends more than \$3.3 trillion annually on healthcare with a greater per capita spending (\$10,348 in 2016), and as a percentage of its GDP (18%), than any other nation.**
  - National healthcare expenditures were approximately \$3.675 trillion in 2018.
- **National healthcare expenditures are forecast to increase by \$2.3 trillion in only ten years!**
  - National healthcare expenditures were \$3.3 trillion in 2016 and are expected to grow to \$5.7 trillion by 2026.
  - National healthcare spending will be approaching 20% of GDP by 2026.
  - In 1960, national healthcare spending was approximately 5% of GDP.
  - The proportion of the U.S. population older than 65 years will increase from 13.0% in 2010 to 18.8% in 2025.

The statistics on this page are courtesy of FTI Consulting and Alvarez & Marsal.

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## Why Should You Care?

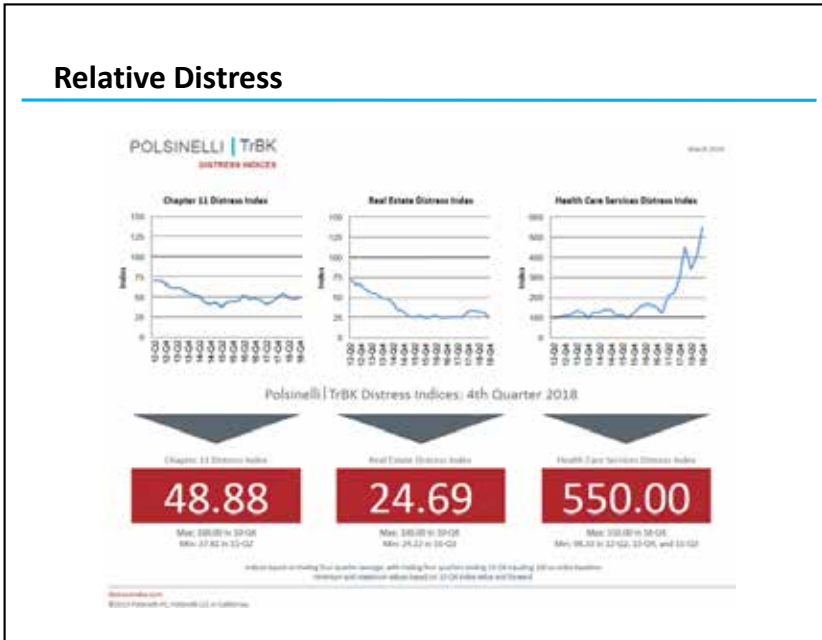
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- **Public health insurance, including Medicare and Medicaid, paid 41% of all healthcare spending in 2018 (approximately \$1.4 trillion).**
- **33% of U.S. adults went without recommended healthcare in 2017 due to cost.**
- **Telehealth could eliminate 30% to 50% of all MD visits**
  - Additional MD visits could be eliminated through remote monitoring sensors and other technological advancements.

***Increased Healthcare Costs and Rising Unaffordability =  
Disruption and Transformation In the Healthcare Industry =  
Opportunity!***

The statistics on this page are courtesy of FTI Consulting and Alvarez & Marsal.

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### Leveraged Loan Market

Industry	Account		Average		% of Industry			
	Outstanding (\$ MIL)	(%)	Size (MIL)	(%)	First Lien	Second Lien	Subordinated	Low-Cost
Technology	176.9	13	181	11	100.0	0	0	79
Pharmaceuticals	140.9	11	171	10	100.0	0	0	87
Automotive & Transportation	130.9	10	174	10	100.0	0	0	76
Telecommunications	88.1	7	86	5	100.0	0	0	81
Gaming, Lodging & Restaurants	88.1	7	88	5	77.2	0	0	53
Banking & Finance	86.1	7	90	5	175.1	0	0	100
Health	82.9	6	77	5	102.1	0	0	78
Chemicals	58.3	4	77	5	108.8	0	0	100
Transportation	53	4	68	4	100.0	0	0	76
Manufacturing & Metals	48.2	4	49	3	107.6	0	0	74
Industrial/Manufacturing	22.8	2	78	5	102.1	0	0	75
Utilities, Power & Gas	14.7	1	31	2	100.0	0	0	100
Energy	13.3	1	77	5	100.0	0	0	77
Defense & Entertainment	10.2	1	45	3	102.5	0	0	75
Insurance	9.2	1	77	5	100.0	0	0	100
Food, Beverage & Tobacco	8.7	1	34	2	100.0	0	0	100
Automotive	8.0	1	30	2	100.0	0	0	100
Building & Materials	7.8	1	67	4	100.0	0	0	100
Other	7.7	1	31	2	100.0	0	0	100
Government Contractors	7.2	1	48	3	100.0	0	0	100
Paper & Containers	3.8	1	31	2	100.0	0	0	100
Real Estate	3.7	1	36	2	77.1	0	0	100
Marine & Mining	1.8	1	23	1	100.0	0	0	100
Supermarkets/Drug Stores	1.8	1	18	1	100.0	0	0	100
Total	1,114.46	100	1,718	100	100	0	0	84

B2L = Broadly syndicated loans, LMO = Large middle market.  
 Source: Fitch IBCA Leveraged Loan Default Index, S&P Global LSTA, Bloomberg

- A leveraged loan is a type of loan that is extended to companies that already have considerable amounts of debt. Lenders consider leveraged loans to carry a higher risk of default, and as a result a leveraged loan is more costly to the borrower (Investopedia.com).
- These analyses consider rated and unrated, active institutional leveraged loans with a minimum deal size of \$100 million. The loan facilities are all denominated in U.S. dollars and are comprised of institutional term loans, drawn acquisition facilities, and bridge loans.

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## High Yield Bond Market

Industry	Amount Outstanding (\$ B)	% of Market	% of Sector Rated BBB	% of Sector Rated B	% of Sector Rated Weighted Average CCC vs BB	Weighted Average Coupon	Median Coupon
Energy	102.1	15.6	42.7	41.0	14.3	6.5	6.4
Healthcare & Pharmaceuticals	102.1	15.6	25.3	72.2	22	6.29	6.39
Telecommunications	100.2	15.0	25.0	75.0	3.0	6.0	6.0
Retailing & Consumer	96.6	14.7	40.5	59.5	3.1	6.1	6.1
Technology	72.8	11.0	47.3	52.7	21.6	6.5	6.8
Building & Materials	52.6	7.9	58.0	42.0	11.8	6.1	6.0
Transportation & Logistics	49.0	7.4	29.0	71.0	16.0	6.2	6.0
Utilities	48.8	7.4	59.5	40.5	1.4	6.1	6.0
Services & Miscellaneous	47.2	7.1	49.2	50.8	11.7	6.0	6.1
Manufacturing & Metals	46.3	7.0	36.8	63.2	14.8	6.8	6.4
Financial Services	46.0	7.0	50.0	50.0	9.0	6.6	6.4
Media	38.4	5.8	44.8	55.2	28.7	6.2	6.3
Real Estate	37.3	5.6	44.5	55.5	9.9	6.9	6.6
Industrial/Manufacturing	32.8	5.0	51.4	48.6	8.8	6.8	6.3
Transportation	32.3	4.9	61.8	38.2	12.7	6.2	6.2
Utilities/Power & Gas	30.0	4.5	73.0	27.0	3.6	6.0	6.0
Chemicals	29.4	4.4	59.8	40.2	11.9	6.1	6.1
Paper & Packaging	22.8	3.5	60.2	39.8	14.4	6.0	6.0
Food, Beverage & Tobacco	20.9	3.1	51.1	48.9	17.3	6.3	6.1
Automotive	18.8	2.8	44.1	55.9	23.5	6.2	6.3
Consumer Products	18.8	2.8	29.3	70.7	24.8	6.2	6.1
Telecom & Entertainment	16.0	2.4	1.6	98.4	26.4	6.4	6.3
Insurance	11.8	1.8	41.5	58.5	14.1	6.0	6.0
Biopharmaceuticals/Drug Invent	9.1	1.4	5.7	94.3	14.4	6.8	7.3
Total	1,172.4	100.0	46.1	53.9	13.4	6.4	6.2

BBB - Not rated  
Source: Fitch U.S. High Yield Default Index, Bloomberg

- Based on the two main credit rating agencies, high-yield bonds carry a rating below "BBB" from S&P, and below "Baa" from Moody's.

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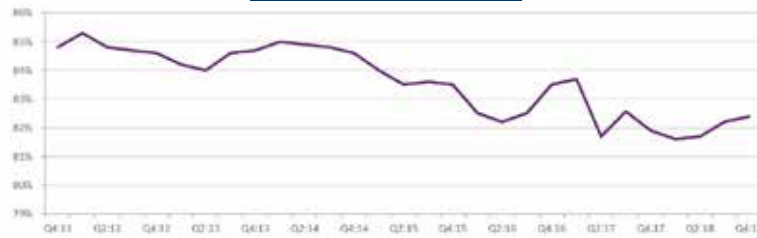
## Shifting Demographics

### Skilled Nursing Occupancy Under Pressure Recently, However...

Skilled nursing occupancy rates have exhibited a slow decline in recent years as a result of the following influences:

- Advances in technology make it more feasible to deliver post-acute care in the home or lower cost settings like assisted living.
- Managed care, which continues to increase its share of payor mix, is motivated to push patients to lower cost settings like the home and tends to have shorter lengths of stay.
- Competition for Medicare days, which typically have higher margins, continues to increase for skilled nursing operators.
- As a result, skilled nursing occupancy rates have exhibited a slow decline. While many of these competitive pressures are likely to persist, the increased demand coming with shifting demographics should help to reverse this trend.

U.S. Skilled Nursing Market: Occupancy



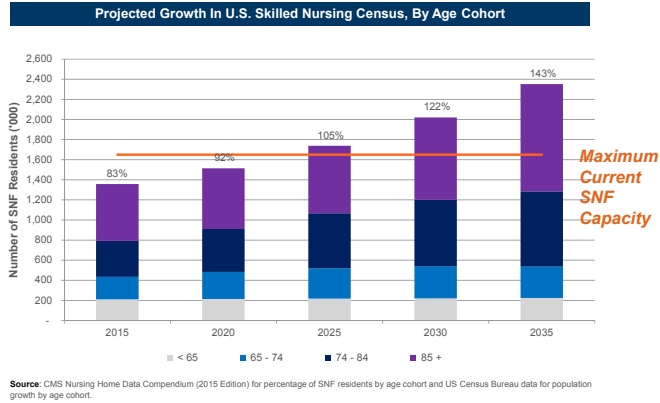
Source: National Investment Center for Seniors Housing and Care (NIC) Skilled Nursing Data Report

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## Shifting Demographics

...Longer Term, Increased Demand Should Help Occupancy

Longer term, absent new supply or competition, SNF (skilled nursing facility) occupancy can exceed its current capacity in the next decade.



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## Challenges Facing the Healthcare Industry

- Operational challenges
- Physician recruitment
- Nurse shortages
- Declining census
- Bad debt/charity care
- Risk management
- Regulatory costs
- Escalating cost of care



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### Main Funding Source – Medicare/Medicaid Reimbursements

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### Cuts in Reimbursement

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- Physicians and hospitals continue to see flat or lower reimbursements.
- About 70% of doctors are accepting new Medicaid patients, while about 80% are accepting new Medicare patients or private coverage.
- CMS anticipates cuts in both fiscal years 2018 and 2019.
- There are various penalties and other reductions in reimbursements for physicians and hospitals that can negatively impact the bottom line.

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## Macro Impact - Technology

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- **Telemedicine** presents a real opportunity for care improvement and cost savings, especially in rural settings.
  - Has reimbursement caught up?
- **Cybersecurity and privacy risks**
  - Patient medical data is flowing from wearable devices and smartphones – this will only increase as technology improves and tech prices fall.
  - More data means more potential for data exposure
    - Ransomware attacks targeting healthcare facilities
    - Equifax and Yahoo breaches demonstrate how vulnerable large systems can be.
    - When patient data is involved, privacy concerns and HIPAA mandates raise the stakes.
  - Protected patient data is sometimes improperly exposed during bankruptcy proceedings.
  - Anyone involved with a healthcare business needs a robust cybersecurity policy to ensure patient privacy.

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## Macro Impact - Emerging Crises

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- **Opioids – over-prescription, abuse, and addiction**
  - The pain-management revolutions of the '90s and early 2000s led to increased prescription – this continued long after addiction risks became evident.
  - More than 64,000 people died of drug overdoses in 2016 - more than Americans who died in the Vietnam War.<sup>1</sup>
- **Autism and other Behavioral Health issues**
  - Increased recognition of behavioral health and developmental disabilities necessitates more intervention.
  - According to the CDC, 1 in 45 children born have autism spectrum disorder.<sup>2</sup>

1. Zimmerman, Brian (2017, October) More Americans died of drug overdoses in 2016 than in the Vietnam War. Retrieved from <https://www.beckershospitalreview.com/opioids/more-americans-died-of-drug-overdoses-in-2016-than-in-the-vietnam-war.html>

2. Pawlak, Vanessa (2017, August 11) Healthcare 2017+: Fueling the Country's Next Generation System of Care. Retrieved from <https://www.linkedin.com/pulse/healthcare-2017-fueling-country's-next-generation-system-pawlak>

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## Why We Are Focused on the Healthcare Industry Today?

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- Highly Regulated Industry
- Consolidation/Mergers
- Always in Turmoil
- Many Opportunities For
  - Lenders
  - Buyers
  - Professionals



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## Acronyms/Terms You Need to Know

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- The **Centers for Medicare & Medicaid Services (CMS)**, f/k/a The **Health Care Financing Administration (HCFA)**
  - A federal agency under the U.S. Department of Health and Human Services (HHS)
  - It administers Medicare
  - Also works with various state governments to administer Medicaid and other programs
  - Note: Medicare Part A projected to be insolvent by 2026

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### Acronyms/Terms You Need to Know

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- **Stark Law**
  - Prohibits physician referral to labs (as example) in which they have a financial interest.
- **Federal Anti-Kickback Statute**
  - Illegal to knowingly or willingly offer, pay or solicit remuneration in exchange for referring a patient, or in exchange for goods and services for which payment may be made by Medicare.
- **False Claims Act**
  - Federal law that allows individuals (whistleblowers/relators) with information about fraud against a government program to report that information and receive an award for stepping forward.

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### Acronyms/Terms You Need to Know

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- **Surveys**
  - Generally, a survey is a periodic, resident-centered inspection that gathers information about the quality of service furnished in a facility to determine compliance with the requirements of participation in Medicare/Medicaid programs.
  - There are standard surveys, expanded surveys, extended surveys, partial extended surveys, post survey revisits, abbreviated standard surveys, complaint investigations, state monitoring visits, etc.
- **Special Focus Facility**
  - Skilled nursing homes with more problems, more serious problems and/or a consistent history of problems.
  - May receive fines, monitors and/or termination from the Medicare/Medicaid program.
- **Star Rating**
  - Quality rating system of 1 to 5.

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## Ways in Which Healthcare is Different

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### Funding the Typical Healthcare Business

- **Provider Agreements with Medicare/Medicaid – Executory Contracts or Statutory Entitlements**
  - **The Provider Agreement is Likely an Executory Contract**
    - *In re Vitalsigns Homecare, Inc.*, 396 B.R. 232, 239 (Bankr. D. Mass. 2008) (“majority of bankruptcy courts considering Medicare-provider relationship conclude that the Medicare provider agreement, with its attendant benefits and burdens, is an executory contract”)
    - Assumption of the Agreement Includes All Overpayments (Known and Unknown), Penalties, Fines, Etc.
  - **One Bankruptcy Court Has Held That Provider Agreements Are Statutory Entitlements.**
    - *In re B.D.K. Health Management, Inc.*, 1998 WL 34188241 (Bankr. M.D. Fla. 1998) (provider agreements are statutory entitlements that can be sold free and clear)
  - **Typically, These Issues are Resolved With the State/Federal Government and/or Any Buyer Prior to a Sale or Reorganization.**

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## Ways in Which Healthcare is Different

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### Funding the Typical Healthcare Business

- **Setoff vs. Recoupment**
  - The Automatic Stay Doesn’t Stop Recoupment
  - Minority View -- *In re University Medical Center*, 973 F.3d 1065 (3rd Cir. 1992) (viewed Medicare provider agreement as series of one year contracts; recoupment limited to one year under the agreement)
  - Majority View – *In re Slater Health Center, Inc.*, 398 F.3d 98 (1st Cir. 2005); *Holyoke Nursing Home Inc. v. Health Care Financing Administration*, 372 F.3d 1 (1st Cir. 2004); *In re TLC Hospitals Inc.*, 224 F.3d 1008 (9th Cir. 2000); *U.S. v. Consumer Health Services of America Inc.*, 108 F.3d 390 (D.C. Cir. 1997) (Medicare allowed to recoup all over payments without violating the automatic stay)
- **The “Strumpf”/Administrative Freeze**
  - Temporary Halt to Medicare/Medicaid Reimbursements Pending Investigation of Overpayments and Setoff Rights

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## Ways in Which Healthcare is Different

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### Patients

- Protection of patient information under non-bankruptcy law (HIPAA, Pub. L. 104-191; <http://www.hhs.gov/ocr/hipaa>)
- Protection of patient records under applicable law (storage and disposal – Section 351)
- Patient Care Ombudsman - Section 333
- Transfer of Patients – Section 704(a)(12)
- Patient Defined – Section 101(40A)
- Patient Record Defined – Section 101(40B)

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## Ways in Which Healthcare is Different

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### Healthcare Bankruptcy Specific Provisions

- Healthcare Business Defined - Section 101(27A)
- Payment of Costs For Healthcare Business Closures - Section 503(b)(8)
- Compliance with State Law/Sale of Non-Profits/AG Approval - Sections 363(d) and 1129(a)(16)
- Transfer of Property From Non-For-Profit to For-Profit Must Comply with State Law - Section 541(f)
- Exclusion From Participation in the Medicare Program or Any Other Federal Healthcare Program Not Barred By Automatic Stay - Section 362(b)(28)

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## Ways in Which Healthcare is Different

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### Administrative Solvency

- **Closure Costs**
  - Government approved closure plan
  - Transfer patients/residents
  - Dispose Medical Waste
  - Storage/Disposal of Medical Records
- **Ombudsman Fees**
- **Overpayments**
- **Vendors – 503(b)(9) Claims and Critical Vendors**
- **UST Quarterly Fees**
- **Fair Use & Occupancy vs. Rent Due Landlords**
  - In SNF case, if debtor leases property, debtor can reject the lease but typically continues operating the facility to maintain the license pending transition to an operator of landlord's choice.
  - See *In re Imperial Beverage Group, LLC*, 457 B.R. 490 (Bankr. N.D. Tex. 2011) (discussion of the difference between 365(d)(3) and 503(b))

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## Ways in Which Healthcare is Different

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### Non-Profits

- No involuntary
- Tax-exempt bonds
- AG Approval of Sales
- Board Challenges

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## Ways in Which Healthcare is Different

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### Jurisdiction Over Medicare/Medicaid Disputes

- 42 U.S.C. § 405(h) (part of the Social Security Act) provides: “No action against the United States, the [Secretary] 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.” This section is made applicable to the Medicare Act via operation of 42 U.S.C. § 1395ii.
- Jurisdiction over cases “arising under” Medicare exists only under 42 U.S.C. § 405(g), which requires an agency decision in advance of judicial review. This has been held to mean that unless and until a provider exhausts Medicare’s administrative remedies (4 steps) it cannot seek relief in federal court.

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## Ways in Which Healthcare is Different

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### Jurisdiction Over Medicare/Medicaid Disputes -- Cases

- *In re Bayou Shores SNF*, 828 F.3d 1297 (11th Cir. 2016) (“Because we are persuaded that the 1984 amendments to § 405(h) were a codification and not a substantive change, we align ourselves with the Seventh, Eighth, and Third Circuits and hold that § 405(h) bars § 1334 jurisdiction over claims that ‘arise under [the Medicare Act].’”)
- *In re Town & Country Nursing Home Services, Inc.*, 963 F.2d 1146 (9th Cir. 1992) (“The BAP rejected the Secretary’s arguments and found ‘the better reasoned position’ to be that ‘where there is an independent basis for bankruptcy court jurisdiction, exhaustion of administrative remedies pursuant to other jurisdictional statutes is not required.’ ... We agree.”)

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## Ways in Which Healthcare is Different

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### Jurisdiction Over Medicare/Medicaid Disputes -- Cases

- ***Family Rehabilitation Inc. v. Azar***, 886 F.3d 496 (5th Cir. 2018) (District Court found that it lacked subject matter jurisdiction over a TRO request to prevent recoupment under Medicare; reversed by Fifth Circuit).
- ***Adams EMS, Inc. v. Azar***, 2018 WL 3377787 (S.D. Tex. 2018) (TRO issued against Secretary of HHS to stop recoupment of alleged Medicare overpayment based on “the alleged failure to provide procedures for, and to timely adjudicate, an administrative appeal from the overpayment and recoupment findings.”)

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## Ways in Which Healthcare is Different

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**Healthcare Receivership:** A unique remedy for lenders or landlords attempting to preserve the value of their collateral

- Court order specifies the duties of the Receiver
  - Receiver oversees operations, and stabilizes and improves the business before transition to a new operator or new owner.
  - Receiver can oversee or manage the business and property until foreclosure sale to a third party and/or a new lease is entered into with a third party.
  - Receiver insulates lender/landlord from risks associated with operating a healthcare business.

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## Receivership (cont'd)

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### Healthcare Receivership: Often preferable to bankruptcy

- Cost Effective
  - Establishes receivership estate
  - Assets preserved for creditors
  - Pay post-receivership debts
- Allows for orderly transition to new operator or new owner
  - Without displacing residents
  - Without disrupting patient care
  - Without jeopardizing licenses
- Allows a new operator or owner time to obtain licenses
- May be in federal or state court (depending on plaintiff and/or diversity jurisdiction)

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## Polish-Up Issues for the Next Cycle

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1. Retiree Chapter 7/13s
2. Health Care
3. Fraud clawbacks/Ponzi scheme law
4. Manufacturing
5. Chapter 12
6. Agriculture liens and security interests
7. Subordination/intercreditor agreements and issues
8. Recharacterization and equitable subordination
9. Sale processes (363, Article 9, Receiver, ABC, Ch. 128)
10. Receiverships/ABCs

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### More Polish Up Considerations

11. Environmental Issues
  - Farm
  - Manufacturing
  - Health Care Industry
12. Privacy Issues
  - Retail
  - Trade Secret
  - Data Mining
  - Customer Lists
  - GPDR Regulations
  - HIPPA
13. Close Out Costs
14. The Economics and Regulations affecting particular Industries

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### While Waiting – Polish Your Skills!

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**To Fully Engage When the Calls Come!**

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