



# Lenders, Landlords Can Turn to Healthcare Receiverships for Troubled Facilities

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**T**he healthcare industry presents challenges for operators, landlords, lenders, vendors, and others doing business within the sector. The industry is virtually always in turmoil amid reimbursement rate modifications, new enforcement efforts, and the ongoing evolution of the delivery of medical care.

With the advent of the Affordable Care Act (ACA), certain players in the industry have faced new financial pressures from accountable care organizations (ACOs), for example. An ACO is comprised of a group of healthcare providers, such as physicians, hospitals, home health agencies, nursing homes, and therapy companies, that delivers coordinated care to a patient population.

A healthcare provider that is not a member of an ACO may experience a decline in census and a corresponding decline in revenue, given that ACOs' patient populations receive care from competing providers who are part of the group. With the new administration in Washington, D.C., in place and promising to repeal or overhaul the ACA at some point, the industry may face yet another series of changes that could negatively impact certain providers.

If a healthcare business experiences one or more of these financial stressors, its cash flow can dramatically decrease or be jeopardized altogether. In particular, over the past several months, certain pockets of the senior living industry have shown financial distress. For a lender or landlord in the senior living space, these business risks create uncertainty and may negatively impact the lender's collateral position or the landlord's real estate investment.

As lenders and landlords explore their options for exercising remedies to protect their investments, more and more often, they are opting to pursue healthcare receiverships to do so. A receivership may be a more cost-effective vehicle than a bankruptcy filing to preserve and realize value in a default situation.

## Receivers

Generally, if a borrower defaults under a commercial real estate loan, a mortgage lender may exercise the right to foreclose against the real property to eliminate any subordinate liens and remove the borrower from possession of that property. A lender, however, may not want to take title to the real

property for various reasons. In such circumstances, as part of the foreclosure action the lender may request that the court appoint a receiver to take control of and act as custodian of the property and related business pending resolution of the foreclosure action.

In certain circumstances, the appointment of a receiver is almost automatic. In Illinois, as an example, the appointment of a receiver is required when requested by the mortgage lender if the remedy is provided for in the loan documents (as is the standard practice). See 735 ILCS 5/15-1702(a) (emphasis added) ("[w]henever a mortgagee entitled to possession so requests, the court *shall* appoint a receiver"). In other states and under federal law, especially in the landlord-tenant setting, the appointment of a receivership is not necessarily automatic. See, e.g., OH ST § 2735.01 ("[a] receiver may be appointed..."). In these circumstances, courts consider various factors to determine whether the appointment of a receiver is appropriate.

For example, when a federal court is considering the appointment of a receiver, it weighs such factors as whether the parties have consented, as well as "fraudulent conduct by the defendant, imminent danger of the property being lost, concealed, injured, diminished in value or squandered; inadequacy of available legal remedies; lack of less drastic equitable remedies; and likelihood that the appointment will do more good than harm." *Wells Fargo Bank Minnesota, N.A. v. Finelli*, No. 5:06-CB-1922, 2006 WL 2864381 at \*2 (N.D. Ohio Oct. 4, 2006) (citing 12 Wright, Miller & Marcus, Federal Practice & Procedure: Civil 2d § 2983 at 26-29). In addition, federal courts have considered "(1) the adequacy of the security; (2) the financial position of the borrower . . . (7) the plaintiff's probable success in the action and the possibility of irreparable injury to the plaintiff's interest in the property; and (8) whether the plaintiff's interests sought to be protected will in fact be well-served by a receivership." *PNC Bank Nat. Ass'n v. Goyette Mech. Co.*, 15 F. Supp. 3d 754, 758 (E.D. Mich. 2014).



Typically, the plaintiff in a receivership action (e.g., the lender) designates a specific person or entity, who, absent objection, is appointed as receiver. In certain states, only individuals may be appointed as receivers. In others, legal entities may be appointed as receiver. Sometimes, the receiver must be domiciled in the state where the receivership action is commenced. In such instances, domiciled individuals associated with experienced receiver companies can be considered, or separate subsidiary or affiliated entities can be formed in the state of the appointment.

The receiver is granted full power and authority to operate and manage the property. Thus, the receiver takes control of the property from the defaulted borrower (or tenant) to maximize value for all creditors, including the lender (or landlord). The specific scope of the receiver's appointment is determined by court order. The order appointing the receiver sets out the duties and powers granted to the receiver and such other matters as agreed to by the court. The scope of a receiver's duties may simply involve obtaining custody of the real property and collecting rents. Alternatively, the scope of the receiver's authority may be substantially broader—as is often true in the healthcare industry—and may include operating the business and displacing existing management.

Upon court approval of the appointment of a receiver, the receivership estate is established. The receivership estate consists of all assets of the business, which are utilized for going forward operations and otherwise preserved for the benefit of the creditors. The receivership estate generally is only liable for paying debts that arise after the receiver's appointment. Any debts that predate the receiver's appointment will be paid if there are available funds after all of the receivership estate's debts are satisfied.

### Stabilizing Operations

A healthcare receivership applies to real property that involves a healthcare business, typically a senior living facility, such as a nursing home, assisted living facility, or similar business. While lenders certainly can seek appointment of receivers for healthcare businesses, healthcare receiverships recently have been used increasingly

by landlords. In the senior living space, many leases contain provisions under which the tenant agrees that upon default the landlord is entitled to the appointment of a receiver as a remedy.

A healthcare receivership is a powerful remedy for lenders and landlords as it allows for a receiver to take over, stabilize, and potentially improve operations, and facilitate an orderly transition of the business operations to a new operator or owner. All of this can be achieved in a healthcare receivership without displacing residents, disrupting patient care, or jeopardizing any licenses needed to operate the business.

The healthcare receiver typically has operating experience in the industry and is experienced at turning around troubled healthcare businesses and at running a sale process. In certain circumstances, a lender or landlord may have identified a new owner or operator for the senior living facility prior to commencement of the receivership, and the receiver is put in place to facilitate an orderly transition of the business to the new owner or operator. In other instances, the receiver may run a process to sell the facility, while at the same time operating the business and attempting to implement operational and financial improvements.

Because of the complexities of a healthcare business, any healthcare receivership requires substantial planning before the lender or landlord commences an action in court.

During the healthcare receivership, the receiver is responsible for running the operations and maximizing the value of that business. To improve the chances of success, the receiver will want to conduct substantial due diligence regarding the business operations, cash flow, licensure requirements and status, regulatory issues, and other matters. By doing this work up front, the receiver will be able to effectively take over the business operations upon appointment.

The powers and duties of a healthcare receiver may include:

- Managing the business and property under the tenant's/operator's licenses until the landlord enters into a new lease with a new tenant/operator or the business is sold through the foreclosure process
- Cooperating with and assisting the new tenant/operator/owner

in obtaining the necessary licenses to operate the business

- Entering into an interim management agreement with an entity affiliated with the receiver or with the new tenant/operator/owner, pending transition of the business to such entity

All of these rights and powers of the receiver ensure that the residents and patients are protected because there is no disruption in the business, just a new person in charge of overseeing operations. In addition, licenses are not jeopardized due to any change of ownership. The change of ownership will happen later when a new lease is entered into between the landlord and the new tenant/operator or a sale transaction is closed.

Moreover, a lender or landlord does not take on the risk of operating a healthcare business and instead has a receiver, who typically has deep operational experience in the senior living industry, in charge of maintaining the business and licenses pending an orderly transition of the business. As the receiver may also improve operational results, the sale value may be enhanced.

### Potential Pitfalls

A healthcare receivership has many unique issues that a lender or landlord must consider, in addition to who the receiver should be, before electing this remedy. Those include:

- **Licensure.** The receiver must be authorized to operate under the existing operator's licenses to ensure that there is no interruption in the business operations. Absent such authorization, the healthcare facility would have to close and all patients/residents would be transferred. This would result in a substantial loss of value for the lender or landlord. This can be avoided by careful drafting of the receiver order and using a receiver experienced in the healthcare industry.
- **Management.** The lender, landlord, and/or receiver must identify an operator for the business. This requirement can be met by having the receiver enter into an interim management agreement with the proposed new operator until the new operator has obtained the necessary licenses. Alternatively, the receiver or the receiver's





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management company may act as the interim operator.

- **Funding.** The receivership will need sufficient funds to operate the business during the receivership. In healthcare receiverships commenced by landlords, this may be problematic. Many senior living facilities have corporate structures under which the tenant is one legal entity and the operator is another legal entity. The operator, not the tenant, may have the right to the proceeds of receivables (the cash flow) and may have its own working capital lender. The landlord may need to work out an arrangement with the working capital lender to ensure that the healthcare business can function smoothly during the receivership. Alternatively, the landlord may need to extend a loan to the receiver to ensure that the business has sufficient funds to operate.
- **Staff.** Maintenance of staff is critical for patient care and maintaining value during a receivership. The receiver must have a well-thought-out communication plan to explain

to management and staff the goals of the receivership and the expected change of ownership transaction. In addition, the receiver will need to implement incentives to keep staff in place, if necessary.

- **Patients/Residents.** To ensure ongoing cash flow, the receiver must maintain, if not improve, the census of patients and residents. Therefore, the receiver must ensure that patients/residents and their family members are well-informed regarding the process and understand that there will be no changes in the levels of care and services provided.
- **Bankruptcy Filing.** As a defense to the receivership, the tenant may decide to commence a bankruptcy case either before or after the receiver is appointed. If this occurs, a landlord or lender may consider attempting to have the bankruptcy case dismissed, given the pendency of the receivership. Moreover, if a landlord has commenced a receivership and the lease itself has terminated (or will terminate with the passage

of time and no cure rights exist), the landlord may be able to obtain relief from the automatic stay to continue with the receivership.

### A Unique Remedy

A healthcare receivership is a unique remedy for a lender or landlord that is attempting to preserve the value of its collateral. Given licensure and other regulatory issues, a healthcare business is difficult to liquidate and realize value. Moreover, patients and residents at the healthcare business must be properly cared for and any disruption in the continuum of care can be detrimental.

By utilizing a receivership, a lender or landlord can realize and preserve value with minimal disruption to patient care or the operation of the business. Receiverships can facilitate a change of ownership through a sale or new lease, and provide a new owner/operator with time to obtain the necessary licenses to operate the business. In the interim, the receiver is the custodian of the business and will stabilize and possibly improve operations. With the receiver in place, lenders and landlords have a chance to achieve a favorable outcome in a difficult situation. ■