AMERICAN BANKRUPTCY INSTITUTE

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Restructuring Opportunities in Health Care and Life Sciences

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CONCURRENT SESSION

2024

Restructuring Opportunities in Healthcare and Life Sciences

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Overview

- Current State of the Industry
- Healthcare Provider Distress
- Hot Topics in Case Law
- Regulatory Challenges
- Emerging Companies in the Life Sciences Space
- Tools for Restructuring Professionals

Current State of the Industry

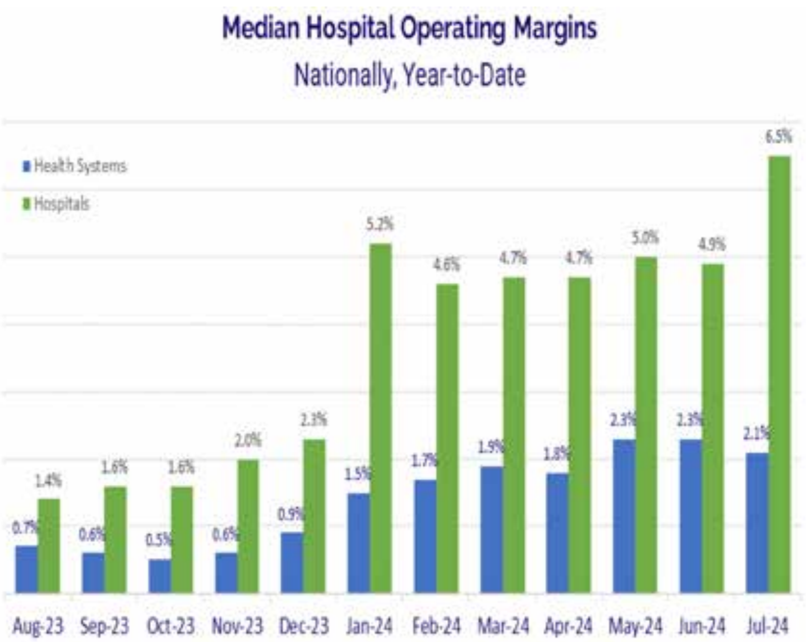
- COVID related distress and post-COVID inflation and labor challenges still plague our healthcare system.
- Hospitals are facing significant headwinds from labor and other expense increases, but also from a continued **shift to out-patient facilities**. This is a secular trend that will continue to **disadvantage older community hospitals**.
- Hospitals that experimented with **new forms of leverage**, such as sale lease backs are having significant difficulties navigating this downturn. Ex. Steward Health Care (May 2024) and Watsonville Hospital (December 2021)
- Regulators are focusing on the for-profit operation of community hospitals, especially related transactions and the use of sale leasebacks to circumvent restrictions on borrowing against real estate.

Hospital margins are low but getting stronger.

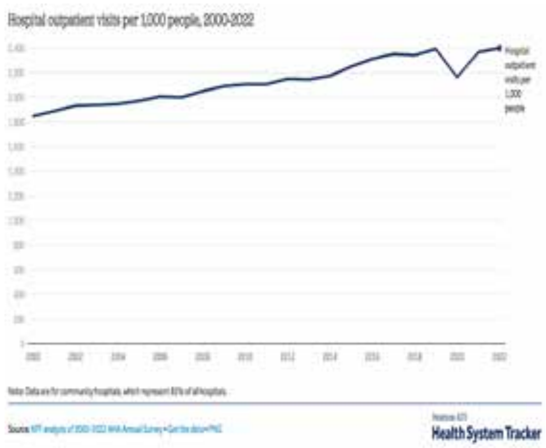
Health systems margins… not so much.

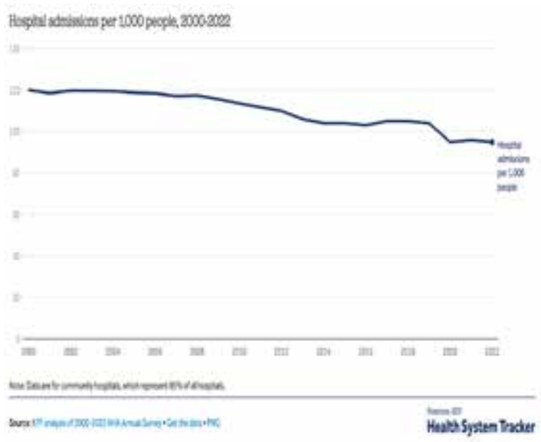
Hospital Expenses:

Total non-labor expense rose 10.8% from July 2023 to July 2024. Medicine up 17.3%, supplies 16.4%, purchased services 12%, and labor 5.7%.



Source: https://www.stratadecision.com/monthly-healthcare-industry-financial-benchmarks/





Outpatient visits are trending higher, and profit margins are significantly better for outpatient services.
Outpatient visits are now above pre-pandemic levels.
Hospital admissions continue to trend down. These forces combine to pressure the margins of community hospitals, especially if they are competing with strong outpatient centers.

Labor — A Positive But Expensive Trend
Hospitals are weaning themselves off expensive contract labor, but they are doing that by paying their hourly employees more.

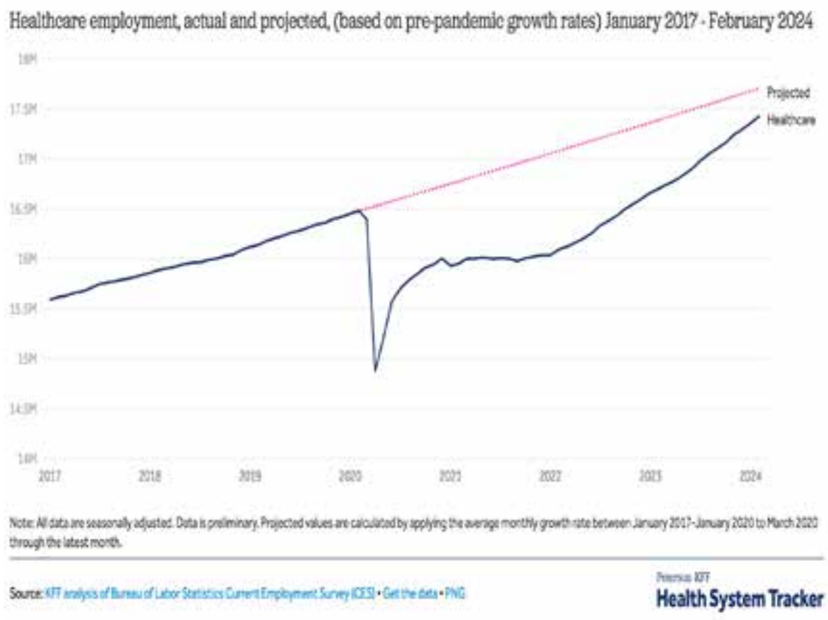
Strata, Performance Trends Report Second Quarter 2024

Reductions in contract labor and shifts to higher paid hourly employees has not addressed the shortage of healthcare employees.

Healthcare employment is still substantially below projections.

Staffing shortages continue to drive wages higher and increase the need for expensive overtime.

Healthcare job openings are up 64% from Jan. 2020, all non-farm job openings are only up 27%.



Regulatory Challenges

- Increased governmental regulatory oversight on for-profit hospitals and private equity related deals is leading to some firms declining to invest in or lend to community hospitals.
- Hospitals are increasingly reliant on public sources of funding, and we have seen the creation of healthcare districts and the use of eminent domain to take for-profit hospitals and convert them into public not-for-profit hospitals.
- Impact of anticipated future regulation

Healthcare Provider Distress

- Healthcare providers comprise a significant portion of chapter 11s in the past several years. Provider types include hospitals/healthcare systems, senior care, treatment centers, and clinics.
- Common cash flow impacts leading to distress include:
  - Ongoing fallout from COVID
  - Staffing shortages and labor cost pressure
  - Payor mix or payor disputes
  - Chronic operating margin issues and economies of scale (reduced due to higher interest rates/inflation and labor costs)
- Recent case studies: *Verity Health System, Borrego Health, Epworth Villa, Friendship Village, The Harborside, Nashville Senior Care, In re Senior Choice*

Hot Topics in Health Care Case Law

- Staying Medicaid Program Payment Termination
- Staying Recoupment v. Setoff of Supplemental Payments
- Sales Free & Clear of State Consent Rights
- Judicial Review by Administrative Mandate
- Sales of Provider Agreements Without Cure
- Subchapter V
- Non-Profit Cases

Emerging Company Considerations

- Life Sciences / Health Care emerging companies face more unique considerations
- Historically, venture capital funds invested small amounts of capital to these companies and provided short runways to assess potential growth. Lagging or failed investments were liquidated quietly often through ABC, and often few assets aside from IP.
- VC community was smaller in size and key players generally familiar with each other. Funds typically specialized in either early stage or late stage investing.
- More recently, access to capital for EMC has tightened and late-stage financing has become less accessible (although health care has weathered the storm comparatively well).

Emerging Company Opportunities

- In light of the challenging chapter 11 framework, distressed alternatives can be particularly valuable for these companies to consider.
- Leveraging relationships and distressed financial tools to unlock value through transactions, financing, or restructuring pathways
  - Financing alternatives / liquidity maximization
  - Mergers, acquisitions, and dispositions of non-core assets
  - Operational enhancement
  - Liability management / structural optimization / governance
- Facilitate enhanced return to venture investors to encourage access to capital
  - Salvage and re-deploy mature technologies and assets
  - Improve effectiveness of invested capital
- Mitigate tail liability risks and provide downside protection
  - Avoid cost and distraction of follow-on litigation

Tools for Restructuring Practitioners

Scenario	Benefits	Considerations
Wind Down Under Applicable State and Non-US Law	• Potentially lowest-cost option, depending on applicable state and non-US law.	• Likely only feasible if the Company pays in full (i) funded debt, (ii) employee payroll, along with applicable severance obligations upon termination, (iii) rent through end of lease term, and (iv) trade creditor claims. • No "free and clear" sales or management releases. • Company may want to hire a third party to facilitate the process.
Article 9 Foreclosure	• Can be more cost efficient and less public than in-court options, like chapter 7 or 11 liquidations. • Company can block any foreclosure process it does not support by filing for bankruptcy. • Efficient where substantial majority of debt is secured, dollar amounts are low or collateral is discrete.	• Company may have less control over the process if it does not have alternatives available (such as chapter 7 or chapter 11). • Is only maximally efficient if debtor and creditor interests are aligned. • May not be as efficient if creditor body or extent of liabilities are unknown/too large. • May trigger anti-assignment provisions in lease or contracts.
ABC	• Can be more cost efficient and less public than in-court options, like chapter 7 or 11 liquidations. • Company chooses the assignee (as opposed to court-appointed trustee). • Assignment leaves corporation with no assets upon which a creditor could levy.	• Company management does not control the timing or process; requires majority shareholder consent. • No automatic stay of claims against the Company. • May trigger anti-assignment provisions in lease or contracts. • Although assignee can sell assets without court approval, any court action challenging an assignee's action can be costly and time-consuming. • No "free and clear" sales or management releases.
Chapter 7 Liquidation	• Cost to initiate the chapter 7 process is relatively low.	• Litigation prosecuted by appointed chapter 7 trustee and a likely plaintiffs firm (to pursue speculative litigation); Company management does not control the case. • Risks significant litigation against the Company's directors and officers. • Case likely to extend several years with sustained, costly litigation. • Potential reputational harm and negative publicity.
Chapter 11 Liquidation	• Provides opportunity to fully wind down company and bring finality to the situation in 4 to 6 months. • Company may be able to utilize "strong arm" powers to reverse certain prepetition transactions or liens, if not properly recorded. • May allow public relations narrative of "rehabilitation."	• More expensive to administer than a chapter 7. • Broad releases may not be approved by bankruptcy court. • Risk of conversion to chapter 7 without adequate funding.

Faculty

Nicholas A. Koffroth is a partner with Fox Rothschild LLP in Los Angeles, where he focuses his practice on complex bankruptcy cases and financial restructuring matters. His bankruptcy experience includes work in the commercial real estate, health care, commercial lending and entertainment sectors. Mr. Koffroth has broad-based experience in nearly all facets of bankruptcy and insolvency matters. His bankruptcy practice includes chapter 11 plan restructuring and related litigation, § 363 sales, valuation disputes, single-asset real estate cases, debtor-in-possession (DIP) financing, adversary proceedings, bankruptcy appeals and claim disputes. Mr. Koffroth represents a broad range of bankruptcy stakeholders. He has represented debtors in matters ranging from the second-largest hospital bankruptcy case in U.S. history to subchapter V cases, and he has represented official committees of creditors in health care bankruptcy cases, official committees of equity securityholders in post-confirmation litigation, and an ad hoc committee in negotiations related to confirmation of a real estate Ponzi-scheme case. He also represents a wide range of other bankruptcy stakeholders, including secured and unsecured creditors, landlords, tenants, franchisors, franchisees, and directors and officers. Mr. Koffroth handles pre-trial practice, motions practice, fact and expert discovery, witness preparation and appellate practice, and he counsels clients regarding litigation strategy, settlement and future liability. He has drafted briefs in appeals before various U.S. district courts and bankruptcy appellate panels, the Ninth Circuit Court of Appeals and the U.S. Supreme Court. In addition, Mr. Koffroth works extensively with lenders and commercial mortgage-backed securities (CMBS) servicers regarding real property-secured loan litigation. He also represents lenders in the entertainment space and has obtained favorable rulings for prints and advertising lenders in connection with bankruptcy sales. In addition to writing nationally published articles, Mr. Koffroth is a regular contributor to the firm's "In Solvency" blog, which covers current bankruptcy and financial restructuring issues. He serves on the advisory board of ABI's Southwest Bankruptcy Conference and is a member of the Los Angeles Bankruptcy Forum, the Beverly Hills Bar Association's Bankruptcy Section, the American Bar Association's Business Bankruptcy Committee (for which he serves as vice chair of its Content and Publications Subcommittee), and the California Bankruptcy Forum Conference, for which he co-chairs its Young Insolvency Professionals group. Mr. Koffroth received his B.A. in 2008 from the University of California, Los Angeles and his J.D. in 2012 from Loyola Law School.

Samuel A. Newman is a partner in Sidley Austin LLP's Restructuring group in Los Angeles. He represents companies and their owners through restructurings, including out-of-court restructurings and chapter 11 cases, and he advises clients in a wide variety of transactions involving distressed assets. Mr. Newman's clients include technology, health care, real estate and hospitality companies. His representative clients include Canyon Partners LLC, Fortress Investment Group, Redmile Group, Fundamental Advisors LP, Capstone Investment Advisors and z-Capital Management LLC. A nationally top-ranked lawyer for more than a decade, Mr. Newman has been recognized in *Chambers USA: America's Leading Business Lawyers* (2009-23) as a leading bankruptcy lawyer and named in *The Best Lawyers in America* (2013-22) in the area of Bankruptcy and Creditor/Debtor Rights. Most recently, he led The M&A Advisor's "Information Technology Deal of the Year" as counsel to Wave Computing, Inc. in its chapter 11 case. Mr. Newman is on the board of trustees of the Boys and Girls Clubs of America and the National Council of the American-Israel Public Affairs Committee. He previously held political and fundraising positions with the Democratic National Committee in Washington, D.C., and served in legislative and policy positions for Sen. John Glenn of Ohio and Reps. Gary Ackerman of New York and Rob Andrews of New Jersey. Mr. Newman received his B.S. in foreign service from Georgetown University's School of Foreign Service in 1992 and his J.D. *magna cum laude* from Georgetown University Law Center in 2001, where he was elected to the Order of the Coif.

Jeremy E. Rosenthal is a partner with Force 10 Partners LLC in Beverly Hills, Calif., where he specializes in guiding public and private companies through challenging situations by developing and implementing creative solutions in complex distressed situations. He has significant experience guiding companies, boards, sponsors and lenders through negotiated workouts, asset sales, recapitalization and bankruptcy solutions. Mr. Rosenthal has served as CEO or CRO in numerous challenging environments. He has managed the restructuring of a hospital and of businesses in the real estate, financial services, manufacturing, logistics, hospitality and apparel industries. He also has served as an independent director or trustee for several distressed companies, including in the e-commerce, fintech, electric vehicle and aerospace industries. In addition, he has served as trustee for creditor trusts and has liquidated investments held by financial service companies as part of organized wind-downs. Prior to joining Force 10 Partners, Mr. Rosenthal was a restructuring partner at the international law firm Sidley Austin LLP. He was recognized in *The Best Lawyers in America* for eight years in Bankruptcy and Reorganization Law. Mr. Rosenthal received his B.A. from the University of California, Berkeley and his J.D. from the University of California at Los Angeles (UCLA) School of Law, graduating Order of the Coif.

Helena G. Tseregounis is a partner in the Los Angeles office of Latham & Watkins LLP, where she represents clients in all aspects of domestic and cross-border corporate reorganizations and restructurings. She guides companies, creditors, buyers, creditors' committees and other interested parties across the insolvency life cycle, including chapter 11 bankruptcy proceedings, distressed-asset acquisitions, bankruptcy-related litigation and out-of-court restructurings. Shealso regularly advises companies on successful strategies to address mass tort and legacy liabilities, including those relating to asbestos, environmental and product liabilities, and she has represented clients in numerous mass tort bankruptcies. Ms. Tseregounis is a current member of the firm's Recruiting Committee and is active in promoting women's advancement in the legal industry. She spearheaded a program in the firm's Los Angeles office that provided mentorship to women associates with a focus on career development and attorney retention. Ms. Tseregounis is a former co-chair of the Los Angeles Women Lawyers Group and a former member of the Los Angeles *Pro Bono* Committee. While in law school, she was involved with the Federal Criminal Justice Clinic and externed for Hon. Robert E. Gordon of the Appellate Court of Illinois. Ms. Tseregounis received her B.A. in English literature and business in 2009 from Indiana University and her J.D. with honors in 2012 from the University of Chicago Law School.