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Cautionary Tales Provide Lessons From Lack of Bankruptcy Planning

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How many times have we heard in recent months that there will soon be a tsunami of bankruptcy filings in the long term care industry? Many commentators have noted that, despite the easing of the pandemic, the industry continues to be plagued by fundamental challenges such as staffing shortages, dropping census, potential litigation regarding liability, rising interest rates, and the impending requirements to pay back the government for COVID-19 relief. Despite these predictions, the rate of bankruptcy filings continues to be relatively low. Recent cases, however, provide useful insights into the process and lessons that may be helpful in the event of future filings, and which highlight opportunities for savvy lenders, investors, and operators.

The case of *QHC Facilities* provides a cautionary tale for family-owned and operated centers. QHC Facilities owns and operates eight skilled nursing facilities and two assisted living centers in Iowa, with a total of about 750 residents. After owner and CEO Jerry Voyna, passed away in the summer of 2021, his wife, Nancy Voyna, assumed the role of CEO. The company filed for bankruptcy in December 2021. Although the company asserted the filing was caused by staffing shortages, we suspect the death of her husband, followed by many operational issues both regulatory and financial, are likely the real culprits. The company's failure to retain financial advisors until November 2021 indicates a lack of sufficient pre-bankruptcy planning. Perhaps as a result, the case was marred from the outset, with potentially avoidable fights over cash collateral, appointment of the financial advisor, and an early motion to appoint a trustee. After what appeared to be a relatively smooth auction process in mid-March, the successful bidder failed to close and, at an emergency hearing, the court designated the back-up bidder as the buyer of the company's assets. It remains unclear whether the sale will close, and the case may result in administrative insolvency.

There are several lessons to be learned from this case. The need for a succession plan for a family business is obvious, of course. The loss of the chief executive, coupled with the industry pressures, makes the need to quickly consult with advisors apparent to those gifted with hindsight. Some of the most difficult restructures are of small, closely held enterprises, where concerns about spending on professionals often lead to damaging delays. Timely engagement of outside professionals and pre-bankruptcy planning could have allowed the debtors to reach agreement on cash collateral and other initial issues, thereby avoiding expensive and time-consuming disputes. Just as potential debtors should not be afraid to seek advice, other stakeholders, such as lenders, lessors, and trade creditors, should not hesitate to broach hard topics and demand appropriate action. To us, this case should bring home the lesson to every stakeholder the need to identify and address timely business challenges.

A much larger and, hopefully more successful, proceeding is that of *Gulf Heath Care, LLC*, and its affiliates (a total of 62 entities) in Delaware. After previously divesting itself of 20 facilities prior to the bankruptcy filing, the debtors' operations included 28 skilled nursing facilities throughout Georgia, Florida, and Mississippi. The debtors did not own any real estate, having leased the remaining facilities from two landlords. There was secured senior debt owed to a related entity of $14 million, which was dwarfed by the secured obligations owed to the Delta Group ($49 million) arising out of a pre-petition acquisition of certain facilities and the unsecured debt. As one would expect, the debtors indicated at filing that diminishing census counts, increasing operating costs (particularly staffing costs,) and federal policy regarding vaccination requirements had all

contributed to the operational struggles. Finally, the debtors noted extended payment terms ended and the Centers for Medicare & Medicaid Services was beginning to collect the approximately $25 million in payments under the COVID-19 Accelerated and Advanced Payments program. Although the amended plan (filed March 1, 2022) has not been confirmed, it appears to be a liquidating plan providing for partial distributions to various creditor bodies from the proceeds of a series of compromises of potential estate claims.

Considering the status of the case, it may be too early to identify lessons to be learned, but one thing does appear clear. If a debtor's cause for filing is outside of their control, like COVID-19 induced economic induced stresses, or rising costs of labor, inflation or recession, rehabilitation may prove elusive. Chapter 11 offers tools to help remedy business problems. The ability to reject unfavorable leases, restructure secured and most priority debt, restructure or reduce unsecured debt or sell off noncritical assets or operations all can help stabilize a struggling business, but do nothing to fix problems that arise outside of the business. Whether one is experiencing recession, raging inflation or an uncontrolled pandemic, bankruptcy tools cannot change the economy. They just give the company a decent burial. So, debtors, their lenders, and their creditors need to focus on the root causes of the financial distress for each situation to obtain solutions that have the potential to avoid disaster, i.e., an administratively insolvent debtor. This is why open communication among debtors, equity holders, lenders, lessors, and other creditors is preferable in just about every situation.

The lessons don't end there. One company's distress is often an opportunity for the next. Although the distressed sale of the debtor's assets in either a bankruptcy section 363 sale or by a liquidating plan is likely unattractive to unsecured creditors, it offers the savvy player an opportunity to acquire assets at distressed pricing. Again, just as we noted above of the debtor and the creditors, procrastination will only hinder success. Those interested in acquiring assets may find that the inability to rehabilitate offers a prime opportunity to acquire. Those who take advantage of the tools available early in the case, such as agreeing to act as a stalking horse, will likely find themselves better positioned than the person who waits to participate in an ongoing auction. A lender, especially if under water, may find the use of cash collateral and even debtor-in-possession financing as a plan sponsor key to encourage unrealistic equity holders that a sale is the best resolution. Although such a course of action may not result in full recovery, it may well mitigate losses.

In sum, operators, lenders, lessors, and other parties can, with the right focus, meet the challenges created by COVID-19 and, in some instances, turn them into opportunities.

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