

A spotlight on continuing care retirement communities in financial distress

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“Vulnerability is the degree to which a population, individual or organization is unable to anticipate, cope with, resist and recover from the impacts of disasters.”¹

Elderly individuals are among the most vulnerable members of our society. Those who also require acute medical care are even more vulnerable. State and federal policymakers alike have acknowledged as much by enacting elder-abuse laws that are specifically designed to protect these populations, with abusers potentially facing both civil and criminal liability.

One cannot help but wonder whether enough is being done to protect elderly individuals as they face the challenges of receiving much-needed medical care. The issues will only accelerate as the baby-boomer generation ages.

This is critical for residents of continuing care retirement communities, known as CCRCs. The California Department of Social Services defines CCRCs as age-qualified retirement communities offering “a long-term continuing care contract that provides housing, residential services, and nursing care, usually in one location, and usually for a resident’s lifetime.”

Common characteristics include providing assisted and independent living, skilled nursing and memory care facilities in one location, with the ability to move along the continuum of care depending on a resident’s needs at any given time. CCRCs offer a form of long-term care insurance.

Residents pay a one-time, upfront entrance fee — which can range from \$100,000 to over \$1 million — in exchange for a guaranteed suite of basic services, often at discounted rates. Residents typically sell their homes to pay for these substantial entrance fees.

What happens to those entrance fees and the promises of lifetime care at discounted rates when a CCRC faces financial distress or, worse, ends up filing for bankruptcy? Bankruptcy and applicable nonbankruptcy state laws do not adequately shield residents from the catastrophic consequences of losing entrance fees or the discounted medical services promised to them for their lifetime.

A CCRC operator may seek to use bankruptcy to replace its CCRC structure with a more traditional, all-rental senior living facility. An operator may consider bankruptcy if it believes that its assets are more marketable as a senior living facility, that its continuing care

contracts are no longer profitable given current market conditions, or that CCRC statutes are too onerous.

This is true even though at the development phase, access to municipal bonds or large entrance fees to absorb initial costs may have stoked the creation of a CCRC in lieu of an all-rental senior living facility.

A bankruptcy filing may cause operators to look to bankruptcy to sell CCRCs free and clear of any resident’s interest in the community by utilizing Section 363(f) or 365(a) of the Bankruptcy Code.

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An operator’s rights to sell assets in bankruptcy are not unfettered. The 9th U.S. Circuit Court of Appeals recently held that the broad definition of “adequate protection” contained in Section 363(e) and afforded to objecting parties that hold an interest in property “makes it a powerful check on potential abuses of free-and-clear sales.”² Other courts have followed suit.³

Section 365 governs the assumption or rejection of “executory contracts”⁴ and allows a party to effectively end a contractual relationship, leaving its counterparty with a claim for damages. It also includes important limitations.

Section 365(n) allows an intellectual property licensee to retain its rights when a licensor in bankruptcy seeks to reject the license agreement.

Real property lessees⁵ have the right to remain in possession when a lessor uses Section 365(h) to reject a lease in bankruptcy. Timeshare-interest purchasers have the option to retain their timeshare rights when a seller seeks to reject a timeshare plan in bankruptcy.⁶ Neither of these provisions addresses “continuing care” contracts that are unique to CCRCs.

Most continuing care contracts deliberately avoid using terms such as “lease,” “landlord” and “rent.” Some expressly state that residents shall have no estate, leasehold or other property interest in their occupied units or in the CCRC. The contracts instead offer a hybrid of services and occupancy rights in exchange for “monthly service fees.”

The contract’s label, in and of itself, is not dispositive of its true nature, as courts look to substance over form.⁷ On the other hand, courts look to the language of a contract to determine the intent of the parties when the language is clear and explicit and does not lead to absurd results.⁸

While these statutes offer other safeguards to CCRC residents, such as a security interest in collateral that is intended to protect entrance fees, they do not preclude operators from rejecting continuing care contracts in bankruptcy.

Unfortunately, the statutes that govern these contracts, such as Sections 1770 of the California Health and Safety Code, are devoid of explicit references to continuing care contracts constituting leases or rental agreements to use real property.

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Neither the bankruptcy code nor its legislative history define what constitutes a rental agreement or a lease. Without such guidance from Congress, bankruptcy courts are left looking to state law to determine property rights in the assets of a bankrupt’s estate.⁹

In so doing, some courts have held that oil and gas leases, for instance, constitute an agreement to use real property, whereas others have held that logging contracts governing the purchase of timber from landowners do not.¹⁰

At least one court has noted in dicta that Section 365(h) would allow residents of a life-care facility to remain in possession notwithstanding the rejection of their contracts by a facility operator.¹¹ An Illinois appellate court has taken a contrary view, however, noting that a CCRC’s obligations are “significantly different in both character and scope from the obligations of a ‘lessor’ of ‘residential real property.’”¹²

WHAT FATE WILL RESIDENTS OF THESE DISTRESSED CCRCs FACE?

CCRC bankruptcies are on the rise.¹³ Uncertainty looms for society’s most vulnerable elderly residents while case law continues to develop in this area. State legislatures and

Congress alike can clarify those rights and provide additional protections for these residents.

Solutions exist.

California’s continuing care contract statutes, codified in Chapter 10 of Division 2 of the state’s Health and Safety Code, can be revised to identify these contracts as leases or rental agreements to use real property.

Sections 363 and 365 of the Bankruptcy Code can be modified to extend continuing care residents the same protections that are afforded to intellectual property licensees, real property tenants and timeshare interest purchasers.

Lawmakers and courts will determine the fate of some of the most vulnerable members of our society. Only time will tell how lawmakers and courts craft these solutions, but for some of the most vulnerable members of our society, time is of the essence.

Notes

¹ *Environmental Health in Emergencies and Disasters: A Practical Guide* (World Health Organization 2002).

² *Pinnacle Rest. at Big Sky LLC v. CH SP Acquisitions (In re Spanish Peaks Holdings II LLC)*, 872 F.3d 892, 899-900 (9th Cir. 2017) (holding that “[a] bankruptcy court must provide adequate protection for an interest that will be terminated by a sale if the holder of the interest requests it”).

³ See, e.g., *Dishi & Sons v. Bay Condos, LLC*, 510 B.R. 696, 711-12 (S.D.N.Y. 2014) (affirming bankruptcy court’s conclusion that adequate protection under Section 363(e) of the Bankruptcy Code entitled lessee to continued possession of property, notwithstanding sale of property under Section 363(f)).

⁴ While the bankruptcy code does not define an “executory contract,” most courts have adopted the following definition: “a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other.” V. Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 Minn. L. Rev. 439, 460 (1973); *In re Texscan Corp.*, 976 F.2d 1269 (9th Cir. 1992); *Sharon Steel Corp. v. Nat’l Fuel Gas Distrib. Corp.*, 872 F.2d 36, 39 (3d Cir. 1989); and *In re Streets & Beard Farm P’ship*, 882 F.2d 233, 235 (7th Cir. 1989).

⁵ 11 U.S.C.A. § 365(m) defines leases of real property to “include any rental agreement to use real property.”

⁶ 11 U.S.C.A. § 365(h)(2)(A).

⁷ See *Steiner v. Thexton*, 48 Cal. 4th 411 (2010); see also *Bachenheimer v. Palm Springs Mgmt. Corp.*, 116 Cal. App. 2d 580 (1953).

⁸ See Cal. Civ. Code §§ 1638, 1639; see also *Bank of the West v. Super. Ct.*, 2 Cal. 4th 1254, 1264 (1992).

⁹ *Butner v. United States*, 440 U.S. 48, 54, 99 S. Ct. 914, 917, 59 L.Ed.2d 136 (1979); *In re Harris Pine Mills*, 862 F.2d 217, 220-21 (9th Cir. 1988) (concluding that whether an agreement is a lease or rental agreement for purposes of Section 365(m) of the Bankruptcy Code generally depends on state law).

¹⁰ Compare *In re Powell*, 482 B.R. 873 (Bankr. M.D. Pa. 2012) with *In re Harris Pine Mills*, 862 F.2d at 220-21.

¹¹ *In re Independence Village Inc.*, 52 B.R. 715 (Bankr. E.D. Mich. 1985).

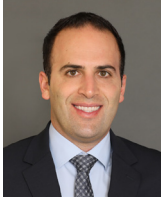
¹² *Jackim v. CC-Lake Inc.*, 363 Ill. App. 3d 759, 766 (2005).

¹³ *In re Air Force Village West Inc.*, No. 19-11920 (Bankr. C.D. Cal.), and *In re Clare Oaks*, No. 19-16708 (Bankr. N.D. Ill.), were both CCRC cases filed in the last year alone. Perkins Coie LLP was retained as counsel for

the committee of unsecured creditors in each case. Perkins Coie LLP has previously served as counsel to a qualified bidder in a sale of a CCRC in bankruptcy.

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