

# Polsinelli | TrBK Distress Indices Special Report: Causes of Healthcare Distress in 2014, Executive Summary

real challenges. real answers.<sup>SM</sup>



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DISTRESS INDICES

# Introduction

Welcome to the Executive Summary of the first Polsinelli | TrBK Distress Indices Special Report: Causes of Healthcare Distress in 2014.<sup>1</sup>

We believe that studying distress in the U.S. economy provides helpful information to successful companies and investors in the space about how to remain successful and avoid the pitfalls of other industry participants.

The continuing implementation of the Affordable Care Act in 2014 was, in many ways, a watershed for healthcare in the United States. In addition,

the healthcare industry has been rapidly changing for several years as the demographics of the country have shifted, the regulatory environment has evolved, and technology has come more and more to the forefront. The Special Report examines how companies have faltered in this rapidly changing healthcare environment, which enables participants in the market such as healthcare companies, funds that invest in the space, and the wider public, to glean significant insights based on where the healthcare industry has been in the past and where it is likely headed in the future.

<sup>1</sup> By Bobby Guy, Robert Dempsey, Jeremy Johnson, and Shanti Katona. The team greatly appreciates the efforts of colleagues Tara Cyr, Sara Iams, Reid Johnson, Dayna LaPlante, Ryan Thurber and Joseph Van Leer.

# Understanding the Indices and this Report

The Special Report is based on the data used to calculate the Polsinelli | TrBK Healthcare Services Distress Research Index (the “Healthcare Services Distress Index”). The Healthcare Services Distress Index is one of three Polsinelli | TrBK Distress Indices produced quarterly and calculated from screened Chapter 11 filing data. To be included in the Healthcare Services Distress Index, a healthcare company must have assets greater than \$1 million, be an entity rather than an individual, and must have selected the “Healthcare Business” designation on its initial Chapter 11 petition (a designation that generally fits companies providing patient services). Further detail on the methodology, preparation and publication of the indices can be found at [www.distressindex.com](http://www.distressindex.com).

In preparing the Special Report, the team analyzed all of the companies that were included in the calculation of the Healthcare Services Distress Index in 2014. This consists of 83 companies (the “Index Companies”). As the Distress Indices are calculated on a rolling four-quarter basis, this is the same set of companies that was used to calculate the index value for the Fourth Quarter of 2014. The Index Companies represent numerous subsectors in the healthcare services industry including hospitals, surgery centers, clinics, physician practices, senior living, imaging, and community centers, among others.

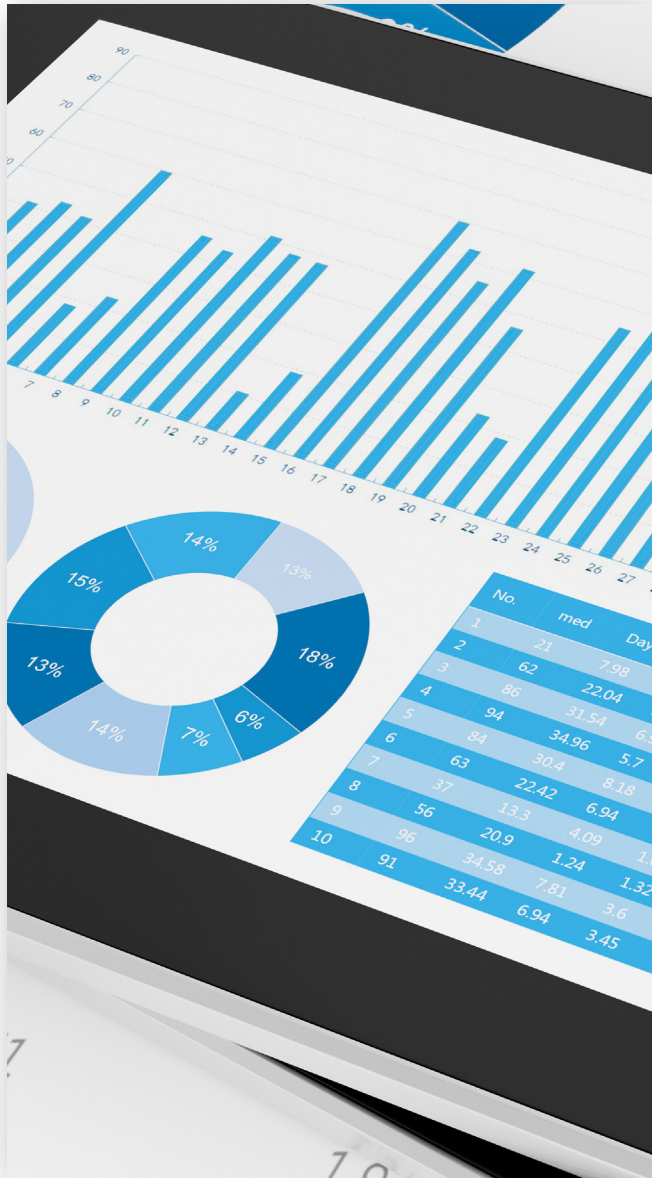
One major difference between the Healthcare Services Distress Research Index (indeed, all of the Polsinelli | TrBK Distress Indices) and many

other commonly known financial indices is that the Healthcare Services Distress Index is not limited to publicly-traded companies. Instead, it includes companies regardless of whether they are publicly-traded or privately-held. As a result, the Healthcare Services Distress Index provides a broader picture



than is usually available through the public markets, encompassing Main Street as well as Wall Street. The Healthcare Services Distress Index acts as a proxy for distress in the healthcare services sector. Accordingly, the causes cited by the Index Companies for their business difficulties are anticipated to provide a snapshot of the challenges that may be faced by healthcare services companies throughout the sector.

# Overview of the Analysis



The team examined certain primary sources for the Index Companies to determine the causes cited by each company for its Chapter 11 filing. In the rare case where information was not readily available in publicly filed bankruptcy documents, the team also reviewed press reports where available to find causes. The causes were then divided into 17 categories, based on the reasons disclosed by the Index Companies for each of their filings. There are 15 primary categories, plus a 16th category for “Other” and a 17th category for “Undisclosed.” In order to minimize inconsistencies in categorization and to ensure that the categories accurately represented the cited causes, the categories were created after collecting the actual causes cited by the Index Companies. Each final category was given specific criteria based upon certain general definitions. There was no pre-determination as to how many categories would exist, and instead, the categories were created to fit the causes emerging from the data.

Notably, the causes outlined in the Special Report are the causes identified by the Index Companies themselves. The authors have not done an independent examination of the causes, but have relied on what are, in many cases, statements made in court filings by principals of the Index Companies.

# Causes of Health Care Distress in 2014

The Index Companies cited the following reasons as the top six causes of their Chapter 11 filings in 2014:

CAUSES BY CATEGORY	PERCENTAGE OF INDEX COMPANIES CITING CAUSE <sup>2</sup>
Tort Litigation	24.10%
Payment Delay	21.69%
Bad Merger/Overexpansion	20.48%
Labor/Employee Litigation	20.48%
Management Issues	20.48%
Reimbursement Changes	20.48%

- Tort Litigation registered as the most frequently cited cause by the Index Companies in 2014, with Payment Delay close behind. Four additional causes tied for third place.
- On a combined basis, Payment Delay and Reimbursement Changes – both of which often relate to government reimbursement of healthcare providers — were cited as contributing factors in more than 40% of the financial struggles of the Index Companies. Payment Delay was sometimes the result of actions of the Index Companies, and other times the alleged result of government activity or budget constraints; Reimbursement Changes were generally the result of regulatory modifications affecting reimbursement rates or methods.
- One large group of cases filed by affiliated skilled nursing facilities in California helped drive Tort Litigation, Payment Delay, and Labor/Employment Litigation into the top six causes.

<sup>2</sup>Note that most of the Index Companies cited more than one reason for their Chapter 11 filings, whether two, three, or as many as four reasons.

# Understanding the Categories

A brief explanation of the categories is helpful in understanding the underlying causes that the Index Companies cited for their business difficulties. Note that the team rejected having a category related to “creditor litigation” or “non-payment of expenses,” as such categories would confuse cause with effect. Creditor litigation and non-payment of expenses are effects that occur because a business is not generating sufficient revenue to cover expenses, and the purpose of the Special Report is to determine the underlying causes that led to the business failure.

The top six categories are defined generally as follows:

1. **Tort Litigation** refers to patient or resident litigation against the healthcare provider, rather than all non-contract litigation.
2. **Payment Delay** refers to collection difficulties, usually specific to Medicare and Medicaid, including slow pay or delays in reimbursement.
3. **Reimbursement Changes** refers to changes occurring under the Affordable Care Act, the “Sequester” (automatic cuts to the budget of the federal government that took effect in 2014)<sup>3</sup>, and reductions or perceived low levels of reimbursement for certain industries.
4. **Management Issues** refers to firing of the management team, management incompetence, employee misconduct, failed internal controls resulting in unnecessary losses, alleged management company incompetence, and major disputes with a management company.
5. **Labor/Employee Litigation** refers to claims and judgments based on federal and state labor violations (fair labor standards act, etc.) and union disputes, employee discrimination, workers compensation contributions, and class actions related to the foregoing.
6. **Bad Merger/Overexpansion** refers to unprofitable or badly-integrated merger situations that burden the acquirer, and growth initiatives that fail, including due to inadequate start-up capital and construction overruns.



<sup>3</sup> See, e.g., <http://thehill.com/homenews/news/301199-here-comes-sequester-part-2>.

# How to Obtain the Full Report With Underlying Data

This Executive Summary is an abridgement of the Polsinelli | TrBK Distress Indices Special Report: Causes of Healthcare Distress in 2014. The full report is produced by Polsinelli Financial Indices, LLC ([www.distressindex.com](http://www.distressindex.com)) and is available for purchase directly from the TrollerBK.com bankruptcy service ([www.TrollerBK.com](http://www.TrollerBK.com)).

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The Indices are published quarterly, generally within 45 days after the end of each calendar quarter, and are overseen by an Index Advisory Committee consisting of Bobby Guy (Polsinelli), Robert Dempsey (Polsinelli), Richard Romero (CBIZ Valuation Group, LLC), Prof. Matthew S. Shotwell, Ph.D (Vanderbilt University)<sup>4</sup>, and a

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<sup>4</sup> Matthew S. Shotwell, Ph.D., is Assistant Professor, Department of Biostatistics, Vanderbilt University, and acts as an independent consultant in connection with the Polsinelli | TrBK Distress Indices. No affiliation between the indices and Vanderbilt University is expressed or implied.