

HEALTH CARE LAW ALERT

Westchester Meadows Continuing Care Retirement Community Bankruptcy Raises Concerns for Residents

On December 9, 2015, Westchester Meadows, a New York State continuing care retirement community (CCRC) declared bankruptcy, sending nerves rattling across CCRCs. Bankruptcy sounds, and can be, ominous for CCRC residents and management. It can raise both long and short-term questions and concerns. Residents wonder whether they will be assured of a place to live for the rest of their lives as their health declines, which is what they signed up for when they first entered the community. Some residents might have vague recollections of “refund rights” and “escrow” accounts and wonder if they are financially protected. Also, beyond residents at the bankrupt CCRC itself, residents of other CCRCs may become concerned about the stability and security of their own CCRC and their legal protections and rights. Thus, CCRC management should become familiar with the Westchester situation and plan how to respond to questions as they arise.

Background

What is a CCRC? CCRCs are retirement communities that accept individuals aged 62 and over who are capable of living independently. These individuals enter into contracts under which they pay the CCRC; in turn, the CCRC agrees to provide them with a residence for the rest of their lives, including residential options with increased health services as their healthcare needs change. Typically, a CCRC resident pays a sizeable, one time “entrance fee” prior to moving in, followed by monthly fees thereafter. The monthly fees remain relatively static regardless of the increased health services the resident may require over time. In New York, CCRCs are highly regulated, both by the Department of Health (for the clinical services provided in the CCRCs rehabilitation and skilled nursing units), and the Department of Financial Services (for the financial risk or insurance component of their operations).

CCRCs can use entrance fees for operations, subject to certain regulatory limitations. First, CCRCs are required to escrow entrance fees only during the construction of improvements that are specifically linked to the entrance fees in question. In other words, after a period of time, entrance fees simply become part of a CCRCs operating budget – they are not held in escrow for the benefit of the residents. Second, in some instances a resident may be entitled to a

refund of a portion of his or her entrance fee. Specifically, a CCRC must refund a portion of a resident's entrance fee upon the termination of a contract (by the resident's death or otherwise), subject to the CCRC's right to retain certain monthly deductions from the amount of the resident's original entrance fee. These allowable monthly deductions cannot exceed a one-time 4% administrative fee and a 2% monthly fee. After a certain number of months, when the deductions the CCRC is entitled to keep equal the entrance fee already paid, a resident is entitled to no refund unless the CCRC contractually guarantees a refund. Many CCRCs choose to make contractual refund guarantees beyond what is required by law, however, to attract residents who view payments to CCRCs as a part of their estate and asset protection plans.

Westchester Meadows' Path to Bankruptcy

Westchester Meadows operates a 120-unit CCRC which, in addition to its independent living units, includes 20 skilled nursing beds, an adult day healthcare program and a 10 bed enriched housing unit. Formed in 2002, Westchester Meadows initially offered residents "life care" contracts (sometimes referred to as "Type A" contracts) which guaranteed residents unlimited care in the community's adult care and skilled nursing facilities, should they become unable to live safely in independent living units. According to the bankruptcy petition, the 2008 housing crisis caused low occupancy rates in Westchester Meadows' independent living units, weakening its financial position.

In 2009, in an attempt to entice more individuals to join the community, Westchester Meadows started offering a "continuing care" resident contract (a "Type B" contract) which guaranteed residents only 60 days of adult care and skilled nursing services, after which they would have to pay out of pocket for those services. In addition, Westchester Meadows guaranteed these residents a refund of a portion of their entrance fee, depending on their date of enrollment – a benefit not afforded under the original, "life care" contract. In 2013, Westchester Meadows again revised the contract it offered to potential new residents, this time eliminating the refund guarantee. Under the new terms, a resident would receive no refund other than the declining balance of its entrance fee, as required by law.

Unfortunately, none of these actions reversed the financial spiral consuming Westchester and it was forced to file for protection under the bankruptcy laws.

Ripples from Westchester's Bankruptcy

There is no guarantee that at the end of the bankruptcy process, residents will continue to be entitled to the benefits under the contracts they entered into with a CCRC before it filed for bankruptcy. It is possible that the bankruptcy court, as part of the plan for resolving the bankruptcy, will take the position that the resident contracts can be rejected. This means that the court will consider the residents' contractual rights to adult care or skilled nursing care or a refund of their entrance fees to be "unsecured" and, thus, subordinate to other "secured" debts owed by the bankrupt CCRC. Frequently, the secured debts include mortgages and bonds that financed the CCRC's construction.

Courts facing this issue have not reacted consistently. For example, in 2009, a bankruptcy court in Pennsylvania approved the sale of a CCRC's assets to a third party and eliminated all obligations to make good on pre-bankruptcy resident contracts. In contrast, a 2014 New York bankruptcy case resulted in an agreement under which pre-bankruptcy resident contracts survived the bankruptcy. In that case, it appears the CCRC took affirmative steps to preserve residents' contractual rights when negotiating a resolution of the case with its secured bondholders.

The court in the Westchester Meadows case has determined that the residents' contractual rights are unsecured, and that the secured creditors such as banks and lenders are entitled to have their debts paid before Westchester Meadows can pay any of its residents. Even so, on January 19, 2016, the court ordered Westchester Meadows to refund entrance fees paid by residents who entered into such contracts after the bankruptcy petition was filed. This suggests that the court is sensitive to the consequences of stripping Westchester Meadows' residents of their contractual rights.

Lessons Learned

As residents of other CCRCs learn of Westchester Meadows' fate, CCRC management and Boards may have to respond to significant panic and concern. Having a plan to address such concerns will help CCRC management reduce residents' anxiety. These plans should include preparing staff to answer questions, hosting town hall and resident meetings and designating specific staff to answer questions as they arise.

A CCRC that finds itself in financial distress should consider how to strategically position itself in order to protect its residents. CCRC management should, with advice of counsel, engage with secured creditors so that the parties can cooperate in managing the financial distress with the least amount of disruption to residents' rights.

Please do not hesitate to contact one of our Firm's health law attorneys identified below if you would like more information on this issue.

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