Can you Force a Delinquent Health Care Tenant Into Bankruptcy In the Midst of a Pandemic? Should You?

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Health Care Financial Restructuring Co-Chairs Robert Miller and Gary Torrell Discuss the Options

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Gary Torrell: In the case that you mention, our client owns and leases space in a medical office building to a variety of tenants, mostly health care providers. One tenant hasn't paid rent in months and other creditors have filed liens against the tenant's fixtures and equipment. Our landlord client would like the rent payments, of course, but would like to avoid a long and acrimonious dispute. The specific question was whether it's possible to "force" the problem tenant into bankruptcy and, if so, whether that's a good idea.

Miller: Our first step was to take a closer look at what it might mean to "force" the tenant into bankruptcy. The vast majority of bankruptcies, including those that are described as "forced" in the media, are voluntary petitions filed by the debtor seeking the protection of the bankruptcy system in response to creditor actions or financial circumstances. For example, a company that is insolvent might consider bankruptcy in a bid to reduce its debt load by filing a petition under Chapter 11 of the U.S. Bankruptcy Code, which governs reorganizations through bankruptcy. If a debtor plans to cease operations and wind down its business, it may choose instead to file a petition under Chapter 7, triggering the appointment of a trustee to liquidate the assets and distribute the proceeds according to the priorities in the Bankruptcy Code. In both situations, however, the critical feature is that the debtor controls the decision. While it's possible that the problem tenant may decide to file for bankruptcy at a later date, the tenant hasn't suggested that it has any plans to file a voluntary petition soon.

Torrell: There is an alternative approach that allows qualified creditors to literally force a company into bankruptcy by filing an involuntary petition. Section 303 of the Bankruptcy Code sets out the main requirements. If the target debtor has twelve

or more creditors, then three creditors with undisputed and liquidated claims totaling at least $15,775 must jointly sign and file the involuntary bankruptcy petition. If the target debtor has fewer than twelve creditors, then any single creditor with an undisputed, liquidated claim of at least $15,775 (and who is not closely affiliated with the debtor), may file the involuntary bankruptcy petition alone, so long as the other requirements are met. The "involuntary debtor" can either (a) contest the petition, which is rare if there are several undisputed, liquidated claims, or (b) agree to remain in bankruptcy and convert the case to a voluntary case—usually a Chapter 11 case.

If the problem tenant decides to remain in bankruptcy, the Bankruptcy Code requires it to become current and remain current on all rent that becomes due on and after the date the involuntary petition was filed, and do so within 60–90 days. Nevertheless, landlords do not often file or join an involuntary bankruptcy petition because under state law landlords typically have quicker remedies available to evict a non-paying tenant. Also, there is a risk to the creditors who file an involuntary petition: if the debtor contests the filing and the court agrees the creditors did not have good grounds to file it, then the court can order the creditors to reimburse the debtor for its legal fees and costs incurred to have the involuntary case dismissed and, in extreme cases, the court can award damages to the debtor for a petition filed in bad faith.

Section 303 of the Bankruptcy Code is not designed to give additional protections to landlords or creditors. In fact, these creditors often find that the bankruptcy process delays and reduces payment because the bankruptcy court stays a creditor's enforcement of contract rights against a debtor. This stay gives the debtor time to work out a negotiated resolution with each creditor, which usually means that a creditor receives less than the full value of its claims. It is unusual for a creditor to make use of the involuntary bankruptcy process.

Miller: Our client had not pursued its state law remedies, at least in part because of California's eviction moratorium and other challenges associated with the ongoing pandemic. Even so, our client concluded any attempt to "force" its problem tenant into bankruptcy was not in its best interest because of the risks associated with such action, including the likelihood of additional delays and a decreased payout. Rather, our client began negotiating an informal settlement in an effort to bring quick resolution to the issue without the need to institute formal proceedings.

Torrell: That was the right course of action for our client. But more businesses will likely consider filing bankruptcy over the next year or two to cope with financial distress tied to the pandemic, especially healthcare companies managing an ever-shifting regulatory and reimbursement landscape. Plus, there's a new Subchapter of the Bankruptcy Code that makes it easier, quicker and less expensive for smaller businesses to get through the Chapter 11 reorganization process. As part of the CARES Act, the debt limit to use this "small business reorganization" process was temporarily tripled to $7.5 million for cases filed by March 27, 2021. I expect many financially distressed small companies, like our client's problem tenant, to consider filing bankruptcy in the last quarter of this year or the first quarter of next year.

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Gary Torrell is a partner in HLB's Los Angeles office and serves as co-chair of the Health Care Financial Restructuring Practice Group. Robert Miller is senior counsel in HLB's Los Angeles office and serves as co-chair of the Health Care Financial Restructuring Practice.

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