Steward Health Downfall Prompts Calls For Tighter Regs

By **Emily Lever** · 2024-07-03 14:36:25 -0400 · Listen to article

The magnitude of the financial troubles plaguing bankrupt hospital operator Steward Health Care has turned the Chapter 11 case into a flash point that should prompt a regulatory overhaul, according to a new report released by advocacy group Private Equity Stakeholder Project.

The sign for Norwood Hospital, a Steward Health Care facility, is seen in Norwood, Massachusetts. Steward Health sought Chapter 11 protection in Texas in May, reporting about $9 billion in debt. (AP Photo/Steven Senne, File)

A trio of culprits — Steward's executives, its landlord Medical Properties Trust and the private equity firm Cerberus Capital Management, which owned Steward from 2010 to 2020 — all caused and profited from the system's collapse, according to the report published June 26 titled "The pillaging of Steward Health Care: How a private equity firm and hospital landlord contributed to Steward's bankruptcy."

"The liabilities of this system are huge; it's the biggest hospital system bankruptcy in decades," Mary Bugbee, the author of the report, told Law360. "The depths of the financial troubles are outlier, but they're not an outlier in terms of private equity."

Starting in 2016, Steward's history is littered with sale-leaseback transactions with MPT that inflated real estate valuations, which Steward had to pay back in rent, setting hospitals up to fail, said Bugbee, who at the end of the report recommended banning or drastically curtailing sale-leaseback deals for hospital real estate.

"Sale leasebacks are going to cut into operational costs, paying vendors, and paying down debt," she added. "We need to have more eyes looking at these transactions."

The sale-leasebacks were part of the trio's plan to strip the healthcare system of its assets at the expense of "safety net" hospitals, a term often used to mean facilities that do not turn away patients who have no insurance or ability to pay, according to the report. Steward **filed for Chapter 11 protection** in Texas in May with $9 billion in debt.

Bugbee said Steward's troubles can be traced back to its 2010 acquisition by Cerberus, saying regulators did not place strict enough conditions on the transaction and should have more carefully considered the potential impact of the real estate deal on patient care.

In real estate transactions involving hospitals or healthcare facilities, "regulators need to treat real estate as part of the healthcare company," Bugbee said.

Cerberus didn't respond to a request for comment.

The report recaps a decade-long timeline of Steward's creation, expansion and collapse, juxtaposing CEO Ralph de la Torre's purchase of a $40 million yacht with accounts of one Steward-operated hospital in Florida becoming infested with bats and covered in bat guano. Its aim, the author wrote, is to recommend policy solutions to prevent Steward's fate befalling another hospital company.

"The story of how Steward was pillaged is a story about corporate greed, where a private equity firm, hospital executives and a hospital landlord siphoned money out of a failing health system," the report read. Bugbee is a senior healthcare research coordinator at PESP, a research-focused nonprofit that says it aims to "hold private equity companies accountable for the impacts they have on the people and planet."

Steward's counsel and spokesperson didn't respond to requests for comment.

Short seller Viceroy Research went further than PESP's report, alleging in a 2023 report titled "Medical Properties (dis)Trust" that in MPT's sale-leasebacks, "rent is round-tripped via 'fake' purchases of massively inflated assets."

"MPW appear to constantly overpay for fire sale assets, sometimes by as much as 10x," Viceroy wrote, referring to MPT by its stock ticker symbol, "which in turn allow debt-crippled tenants to meet their financial rent obligations as and when they fall due in the short term."

In a letter published shortly thereafter on its Twitter account, Viceroy, which at the time had a short position on MPT's stock, claimed it had evidence that MPT had been able to round-trip more than $2 billion through its "mutually parasitic" relationships with its tenants.

MPT sued Viceroy for defamation over the report in March 2023, calling the allegations "malicious fiction, concocted to manipulate the market and to drive profits from short-selling."

Viceroy and MPT didn't respond to requests for comment.

The Steward case **has sparked investigations** from the U.S. Securities and Exchange Commission and attorneys general in Massachusetts and Arizona and a proposed bill from Sen. Elizabeth Warren, D-Mass., to jail private equity execs who "loot" healthcare companies.

Steward has become a "poster child" for the worst-case scenario of private equity involvement in healthcare, but regulating private equity would not address the root cause of debacles like Steward's, according to Carolyn Johnsen, a bankruptcy attorney at Dickinson Wright.

Steward is also a case of "a management situation that is borderline questionable or over the line fraudulent" coupled with excessive lender power over a distressed borrower, Johnsen argued.

"When you look at most of these cases, there is some sort of failure that they had to get in bed with equity to bail them out," Johnsen told Law360. "It's no different than a hard-money lender; they have a lot of control."

Some of the leases Steward inked with MPT locked the hospital into paying rent through 2041, an arrangement Johnsen described as "really onerous" and analogous to a "loan to own" debtor-in-possession lender that comes to fully control a debtor.

In the face of aggressive tactics by investors, lender liability used to be an option to fight back, Johnsen said. Imposing lender liability involves proving that the lender has such a degree of control over a business that it can be held liable for the business' actions.

But if a company negotiates any type of forbearance agreement with a lender, it has become standard for forbearance documents to include a waiver of lender liability, Johnsen added.

In that case, "your client is really stuck," Johnsen said.

Part of what allows private equity funds to gain control of hospitals or nursing homes is an absence of public funding, which leaves the door open to private entities hunting for a distressed investment, Bugbee said.

"A lot of hospitals are inherently unprofitable. When there's no other buyer that wants to buy that hospital, it does feel like they're saviors to some extent," Bugbee said. "But when you have a safety net hospital that is not profitable, investors can pillage it."

"They can use debt to expand the system," she added, "to pay themselves debt funded dividends, they can take the money and run, and hospitals are left holding the bag."

Steward is represented by Gabriel A. Morgan, Ray C. Schrock, Clifford W. Carlson, Stephanie N. Morrison, Candace M. Arthur, David J. Cohen, Jason George and Loren Findlay of Weil Gotshal & Manges LLP.

The defamation case is Medical Properties Trust, Inc. v. Viceroy Research LLC et al., case number 2:23-cv-00408, in the U.S. District Court for the Northern District of Alabama.

The case is In re: Steward Health Care System LLC et al., case number 4:24-bk-90213, in the U.S. Bankruptcy Court for the Southern District of Texas.

--Additional reporting by Rick Archer, Jared Foretek, Clara Geoghegan, Jade Martinez-Pogue and Alex Wittenberg. Editing by Alex Hubbard.

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4:24-bk-90213

Court
Texas Southern

Nature of Suit

Date Filed
May 06, 2024

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