A Tough Pill To Swallow: The Potential Impact of Affordable Care Act Reforms on Commercial Landlords

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2017 will undoubtedly signal significant changes on the healthcare reform front. The Trump Administration and a Republican-controlled Congress will continue efforts to dismantle the Affordable Care Act (ACA) through executive orders, funding cuts, moratoriums and regulatory reforms. These actions will have sizeable impacts on the insurance industry, especially for private companies and plans created under and/or expanded through the ACA.

It is both reasonable and prudent to anticipate a ripple effect that will impact commercial property landlords, who should understand their rights and obligations under their leases and state law in the event that insurance industry tenants become financially distressed as a consequence of ACA reforms.

For example, the ACA authorized the establishment of certain private Consumer Operated and Oriented Plans (CO-OP) to "foster the creation of qualified nonprofit health insurance issuers to offer qualified health plans in the individual and small group markets." CO-OPs were originally envisioned to be consumer-friendly alternatives to for-profit insurers and a means to increase competition within the insurance industry, resulting in more insurer choices and greater coverage options. The ACA provided certain risk spreading mechanisms commonly referred to as the "Three R's" (risk adjustment, reinsurance and risk corridors) to limit a CO-OP's potential losses by participating in the marketplace. However, recent legislation such as the American Taxpayer Relief Act of 2014 and the Consolidated and Further Continuing Appropriations Act of 2015 rescinded certain CO-OP loan program appropriations, prohibited loans to new ACA program participants and failed to allocate certain additional risk corridor benefit payments necessary to keep many ACA qualified health plans solvent. Moreover, unlike other private insurers, CO-OPs are precluded from selling stock to raise capital and are often unable to find alternative sources for capital infusions. As a result, numerous CO-OP programs created under the ACA have either failed or are in jeopardy of failing as they are unable to meet cash flow demands and satisfy state solvency requirements.

Under the McCarran-Ferguson Act, insurance companies are exempt from most federal regulations. As a result, entire bodies of federal law, including bankruptcy, are generally inapplicable to the insurance industry, and state regulatory agencies are responsible for overseeing insurance activities within their state. Such agencies are empowered under applicable state laws to place financially troubled insurance companies into court-supervised rehabilitation or liquidation proceedings. In New Jersey, this process has been codified through the Life and Health Insurers Rehabilitation and Liquidation Act (NJ R&L Act).

Rehabilitation and liquidation proceedings are similar to bankruptcy proceedings. Typically, the state insurance commissioner (or their deputy) serves in a capacity similar to a bankruptcy trustee or debtor in possession, overseeing the rehabilitation or liquidation of the insurance

company. By way of comparison, a rehabilitation proceeding is akin to a Chapter 11 bankruptcy reorganization, while a liquidation proceeding is akin to a Chapter 7 bankruptcy liquidation.

Once a rehabilitation or liquidation order is entered by the Court, the insurer in its corporate form prior to the order ceases to exist and a new entity, overseen by the Rehabilitator and/or Liquidator, is created. All of the assets of the former entity are transferred to the Rehabilitator/Liquidator, who is granted extensive powers over the insurer's assets and the operation or winding down of the new entity. Such rehabilitation and/or liquidation efforts should be of immediate concern to landlords, as the space needs of the insurer tenant will likely be reduced or eliminated as part of the rehabilitation/rehabilitation process.

Notably, the NJ R&L Act expressly protects the entity in rehabilitation/liquidation from any claim of anticipatory breach of any contract to which the insurer is a party. Therefore, landlords may not declare a breach of the lease upon the entry of a rehabilitation and/or liquidation order. By contrast, the Rehabilitator/Liquidator is expressly empowered to cancel, reform or revoke any contract to which the insurer is a party, including leases. As the business judgment of a Rehabilitator/Liquidator is generally respected by courts, motions to reject or reform leases are frequently granted.

Based on the foregoing, it is critical for landlords to closely monitor reforms to the ACA as a means of determining whether they could adversely impact the financial standing of any tenants. Through proper drafting and monitoring, a landlord can attempt to proactively address leasing concerns in lieu of having the lease subject to the judicial process and potential reformation and/or termination under the NJ R&L Act. Moreover, should an insurer tenant seek rehabilitation or liquidation under the NJ R&L Act, it is important for the landlord to consult with a legal advisor who has the experience and expertise to guide them through the rehabilitation/liquidation process and promptly engage the Rehabilitator/Liquidator in negotiations in order to attempt to resolve any potential leasing disputes.

Mr. Schiller's Biography