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CORPORATE COLONIALISM

Webs of shell corporations hurt nursing home care

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In our last column, we wrote about a troubling development in the nursing home industry. As patient safety problems became epidemic, crying out for a firm regulatory hand, the current administration reacted by decreasing regulatory oversight, essentially instructing state and federal regulators to stand down.

These regulatory changes are the result of extensive lobbying by the nursing home industry itself. As the director of one nursing home trade group put it, nursing homes "don't have the resources to get everything done from A to Z."

One might be forgiven for assuming that nursing home operators are victims of excessive "red tape" or that Medicare and Medicaid reimbursement rates are too low to allow quality care. The truth is very different.

In many cases, the reason for that lack of resources can be traced to self-dealing, profit-taking and liability-shifting by nursing home owners at the expense of patient care. In August 2017, the National Union of Healthcare Workers published a report detailing how for-profit nursing home owners drain resources meant to provide quality patient care by creating a web of shell corporations with interlocking ownership to provide "consulting" services to individual nursing homes, charge rent to them and loan them money at exorbitant interest rates, among other things.

The group's report shined a spotlight on Brius Healthcare, California's largest nursing home company. Brius' owner, Shlomo Rechnitz, is a Los Angeles billionaire. Through Brius, he owns 80 for-profit nursing homes that receive 80 percent of their funding through Medicare and Medicaid.

According to the group report, Brius nursing homes paid $67 million in 2015 to purchase goods and services from more than 65 companies controlled by Rechnitz or his relatives. One company created by Rechnitz charged his nursing homes $3.5 million to provide "financial advice" and review their profit-and-loss statements. Other Rechnitz companies, the report notes, appear to exist solely as "paper landlords" that charge his nursing homes above-market rents.

According to a January *New York Times* exposé titled, "Care Suffers as More Nursing Homes Feed Money Into Corporate Webs," this corporate colonialism also serves to shield from liability the people making the money from poor care. When injured residents sue one of these nursing homes, they often find a company that is underfunded, underinsured or uninsured and the people who siphon the resources claim to be mere consultants.

These "related-party transactions" became increasingly popular, according to the *Times*, after a 2003 article in the *Journal of Health Law* encouraged nursing home owners to separate their business into detached entities to shield themselves from liability. According to the law review authors, holding real estate in separate real-property entities that then lease the property to the operating entities does not make sense from the standpoint of "administrative simplicity" but it makes eminent sense in protecting the assets by making them unavailable to judgment creditors of the operating entity.

According to the *Times*, nursing home owners who set up these interconnected corporate webs often siphon money from the nursing home itself while exerting control over them by setting tight budgets that directly affect the nursing home's ability to maintain safe staffing levels.

The *Times* article cited a 2012 conference for nursing home executives in Nashville, Tenn., in which a nursing home defense lawyer presented a slide titled, "Pros of Complex Corporate Structure." The slide proudly proclaimed that "Many plaintiffs' attorneys will never conduct corporate structure discovery because it's too expensive and time consuming."

Though it can indeed be costly and time-consuming to pursue, corporate structure discovery is vitally important to any lawyer seeking to hold nursing home profiteers accountable. In Illinois, the "direct participant" theory provides a powerful tool do just that. In *Forsythe v. Clark USA Inc.*, 224 Ill.2d 274 (2007), the Illinois Supreme Court held that a parent company that mandates an overall business and budgetary strategy and surpasses the control usually exercised as a normal incident of ownership, can be liable as a direct participant.

Forsythe involved a fire at a Clark Refining facility. The plaintiffs argued that Clark Refining's parent company, Clark USA, was negligent in mandating an overall business strategy, through its president, that focused on increased productivity at the refinery at the expense of safety.

As in many nursing home corporate webs, the CEO of Clark Refining was also the president of Clark USA. The Supreme Court noted that, in interlocking directorships, there is ordinarily a presumption that an officer is acting on behalf of the corporation for whom he claims to be acting. That presumption fades away, however, when the actions of the officer are contrary to the interests of the subsidiary but clearly benefit the parent.

Though *Forsythe* involved a parent/subsidiary relationship, its holding is directly applicable to the nursing home corporate shell game. According to the health-care workers report, the "siphoning" of scarce resources from nursing home facilities through "overpriced related-party transactions" is a direct cause of staffing shortages and patient injury.

As we've noted in the past, it's all about following the money. CL

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