JW HealthBrief

Everything Old Is New Again

FHA Programs Regain Luster


YEN H. TRAN

JW Announces New Senior Counsel

Yen Tran is senior counsel in the Business Transactions section of Jackson Walker's Dallas office. She represents clients in a broad range of corporate, health care, and immigration matters.

Ms. Tran received a B.A. degree, *magna cum laude*, from the University of Dallas. She also earned her J.D. degree, *magna cum laude*, from the University of Houston as well as her LL.M. degree.

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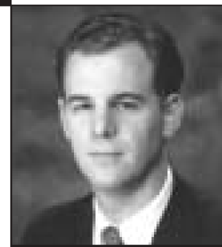
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With interest rates at their lowest point in over 20 years[1], combined with a 20.7% increase between 1990 and 2000 in the number of Texans age 65 and older,[2] many of Texas's long term care providers are wondering why more opportunities are not available for expansion and development of nursing homes and assisted living projects. Unfortunately, pressures such as nursing staff shortages, low government reimbursement and skyrocketing liability insurance premiums have made many lenders nervous about the industry. In Texas, where these problems have been much more severe, nursing home and assisted living providers have even fewer funding options. Although most commercial lenders continue to maintain negative attitudes toward the health care industry,[3] interestingly the Department of Housing and Urban Development ("HUD") has not only maintained its programs for accessing capital markets, but in recent years has made significant improvements in the processing and administration of its programs.

Operated through the Federal Housing Administration ("FHA") and in existence since 1959, HUD's funding programs for nursing homes and assisted living facilities currently have more than $8.6 billion in outstanding mortgages.[4] Although in the past a major concern with the funding option was the disparity in processing among local HUD offices, during 2000 HUD implemented "Multi-family Accelerated Processing," or "MAP," as a means of creating a uniform set of standards for processing applications. The key to MAP is the opportunity to engage private third parties to complete required appraisals and market studies. As a result, these reports are completed in weeks, rather than the months previously taken by many HUD offices. In addition, once applications are submitted for processing, HUD headquarters in Washington, D.C. has laid out specific processing timeframes to further hold accountable local offices.

With these improvements, and recognizing the lack of capital otherwise available to the industry, it is a prudent time for nursing home and assisted living providers to re-examine their interest in HUD's Section 232/223(f) program for acquisitions and refinancing and the Section 232 program for new construction and substantial rehabilitation.

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In This Issue

Piercing the Corporate Veil in Texas


MONTE F. JAMES

Texas is experiencing a liability insurance crisis in the healthcare industry. Premiums have skyrocketed in areas of the state generally considered to be plaintiffs' oriented and in high risk specialties. The majority of nursing homes operate without liability insurance from a third party insurer.

One protection for owners faced with potential costly uninsured malpractice claims is to properly create legal entities for ownership and management of the business. While this is prudent planning; it is not foolproof. Texas, like most states, provides legal mechanisms to pierce through the legal entity and hold the owner liable.

The general rule in Texas is that limited liability exists for the shareholder of a corporation, member of a L.L.C. or partner of a limited liability partnership in a tort context.[1] However, exceptions exist where a parent company totally dominates and controls its subsidiary, operating the subsidiary as its business conduit.[2]

There are two principal equitable theories under which a corporation's veil can be pierced in Texas: alter ego and single business enterprise. Alter ego and single business enterprise are not synonymous; they are separate and distinct equitable theories that are similar in purpose. This article deals with those equitable theories in the tort context as opposed to a contractual dispute.

One important distinction between alter ego and single business enterprise is that the alter ego theory generally involves proof of fraud, i.e., proof that the corporation is organized and operated as a tool or business conduit of another corporation.

Alter Ego

Under Texas law, the alter ego doctrine allows the imposition of liability of a corporation for the acts of another corporation when the subject corporation is organized or operated as a mere tool or business conduit. It applies "when there is such unity between the parent corporation and its subsidiary that the separateness of the two corporations has ceased and holding only the subsidiary corporation liable would result in injustice." Alter ego is demonstrated "by evidence showing a blending of identities, or a blurring of lines of distinction, both formal and substantive, between two corporations." An important consideration is whether a corporation is underfunded or undercapitalized, which is an indication that the company is a mere conduit or business tool. Lack of liability insurance in the high risk health care industry would be a factor that could weigh heavily in determining whether the subsidiary is underfunded. At the same time, determining whether a subsidiary is the alter ego of its parent, no one factor is determinative.

Texas courts use a multifactor test in determining alter ego. In applying these factors, "courts are concerned with the reality and not form, with how the corporation operated and the individual defendant's relationship to that corporation." Finally, resolution of the alter ego issue is heavily fact-specific. This means there would be a jury trial in most such determinations.

"In lieu of articulating a coherent doctrinal basis for the alter ego theory," the Fifth Circuit has developed a laundry list of factors to be used in determining whether a subsidiary is the alter ego of its parent. These factors include whether:

1. *The parent and the subsidiary have common stock ownership;*
2. *The parent and the subsidiary have common directors or officers;*
3. *The parent and the subsidiary have common business departments;*
4. *The parent and the subsidiary file consolidated financial statement and tax returns;*
5. *The parent finances the subsidiary;*
6. *The parent caused the incorporation of the subsidiary;*
7. *The subsidiary operates with grossly inadequate capital;*
8. *The parent pays the salaries and other expenses of the subsidiary;*
9. *The subsidiary receives no business except that given to it by the parent;*
10. *The parent uses the subsidiary's property as its own;*
11. *The daily operations of the two corporations are not kept separate;*
12. *The subsidiary observes the basic corporation formalities, such as keeping separate books and records and holding shareholder and board meetings;*
13. *The directors and officers of the subsidiary act independently in the interest of that company, or whether they take their orders from the parent and act in the interest of that company, or whether they take their orders from the parent and act in the parent's interest; and*
14. *The connection of the parent's employee, officer or director to the subsidiary's tort or contract giving rise to the suit.*

Also note that control is a normal part of a parent/subsidiary relationship, and blending of corporation activities is in and of itself not sufficient to show that the subsidiary is the alter ego of the parent.

Single Business Enterprise

The single business enterprise doctrine applies when two or more businesses act as one. Under the doctrine, when

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Piercing the Veil *(cont.)*

corporations are not operated as separate entities, but integrate their resources to achieve a common business purpose, each corporation may be held liable for the liabilities incurred in pursuit of that business purpose. Like the alter-ego doctrine, the single business enterprise doctrine is an equitable remedy, which applies when the corporation form is "used as part of an unfair device to achieve an inequitable result."

Some factors courts have considered in determining whether corporations have been maintained as separate entities include:

1. *Common employees and offices;*
2. *Centralized accounting;*
3. *Payment of wages by one corporation to another corporation's employees;*
4. *Common business names;*
5. *Services rendered by the employees of one corporation on behalf of another corporation;*
6. *Undocumented transfers of funds between corporations; and*
7. *Unclear allocation of profits and losses between corporations.*

One important distinction between alter ego and single business enterprise is that the alter ego theory generally involves proof of fraud, i.e., proof that the corporation is organized and operated as merely a tool or business conduit of another corporation. To recover under a finding of a single business enterprise, no proof of fraud is required; instead, the single business enterprise theory relies on equity analogies to partnership principals of liability.

Statute Of Limitations

When does the Statute of Limitations run against the parent entity or shareholder? There are two Texas Supreme Court cases on point. The first case in this area is *Gentry v. Credit Plan Corporation of Houston. Gentry* is a case where the plaintiff sued the subsidiary corporation within the appropriate limitations period and a short time from the incident giving rise to the cause of action. The plaintiff later added the parent corporation, more than two years after the alleged cause of action accrued. The parent corporation argued limitations, and the Texas Supreme Court held that limitations were tolled as to the parent company.

Gentry was an alter ego case. The Texas Supreme Court held that the purpose of tolling limitations in alter ego cases is to prevent the use of a corporate entity as a cloak for fraud or illegality or to work an injustice. Another explanation for the Supreme Court's ruling in this regard is that the parent and subsidiary corporations were in a sense identical entities.

The second Texas Supreme Court case is *Matthews Construction Company, Inc. v. Rosen.* In *Matthews Construction*, the Supreme Court revisited the *Gentry* decision and reaffirmed the law in this area by the holding that once a subsidiary entity is sued, limitations are tolled as to the alter ego or parent entity until the judgment against the subsidiary becomes final. In *Matthews Construction,* the plaintiff prosecuted the case to judgment against the subsidiary and then filed a subsequent separate lawsuit against the parent, after limitations would have run against a non-related entity. Again, the Supreme Court held that the claim against the parent company was essentially the same as pursuing the claim against the subsidiary; therefore, limitations had not run against the parent.

Analysis

As you can see there is not a bright line test for what is safe in this arena. Both alter ego and single business enterprise theories are factual determinations which would require a jury trial in most cases. The specific facts of each situation must be evaluated in light of the law to determine the extent of exposure an individual shareholder or parent/sister entity may possess.

Footnotes:
1. The phrase corporation used in this article might denote other business entities such as an L.L.C. or L.L.P.; however, there are no Texas cases on point that apply this analysis to such entities.
2. Most of the law established in this area deals with a parent company controlling a sub sidiary. However, the same analysis and law applies when one sister company controls another sister company.

Medical Malpractice Cases: 1977 Damages Cap Applies To Prejudgment Interest

LINDA J. COLE

The Texas Supreme Court recently issued a divided opinion limiting the exposure some health care providers will face when sued under the Medical Liability and Insurance Act. In *Columbia Hospital Corporation of Houston v. Moore*, the Supreme Court held that prejudgment interest assessed under the Medical Liability and Insurance Act was subject to the statutory damages cap. This decision followed the court's recent decision in *Horizon/CMS Healthcare Corporation v. Auld*, 34 S.W.3d 887 (Tex. 2000). In *Auld*, the court had held that subchapter P's prejudgment interest damages are subject to the statutory cap.

Background of the *Moore* case

In 1996, Katherine Moore underwent surgery at Columbia Bellaire Medical Center to repair an umbilical hernia. Mrs. Moore was sent home shortly after surgery. Five days after being discharged, Mrs. Moore became ill requiring her to return to Columbia's emergency room with an elevated temperature and nausea. Mrs. Moore was re-hospitalized when it was discovered that her bowel had been injured during surgery. The family alleged that there was a failure by Columbia's intensive care unit staff to monitor Mrs. Moore properly after she underwent surgery to repair the hole in her small intestine, which had caused her to dehydrate. The family alleged that the dehydration progressed to the point where Mrs. Moore developed blood clots in both of her legs. Mrs. Moore's physician ordered tests performed to verify the diagnosis of clots on a stat basis, but the family alleged the testing was delayed for several hours because the hospital did not have a technician on staff and relied on a mobile technician. Mrs. Moore was transferred to another facility, where both her legs were amputated as a result of gangrene. Mrs. Moore later died from multi-organ failure syndrome, alleged by the family to have been caused by the blood clots and the gangrene which had developed in her legs as a result of the lack of blood supply caused by the blood clots.

Mr. Moore and Mrs. Moore's two daughters and the estate sued the hospital and Mrs. Moore's two treating physicians under the wrongful death and survival statutes. The jury found for the Moore's awarding $3 million in actual damages. The physicians settled with the family after judgment. The trial court then applied the cap, thereby reducing Columbia's actual damages to $1.3 million, but excluded prejudgment interest from the damage cap.

Court of Appeals Decision

In a 2-1 decision, the First Court of Appeals affirmed the trial court's ruling that prejudgment interest was excluded from the damage cap. The appeals court held that the 1995 enactment of subchapter P, which mandates prejudgment interest on past damages, shows a legislative intent to exclude prejudgment interest from the cap. The First Court's decision further limited the damages applicable to a single defendant. In the *Moore* case, as well as numerous other cases, Plaintiffs' lawyers had multiplied the damage cap by the number of culpable defendants to calculate the total damages allowed. The Supreme Court left intact the First Court's holding that disallowed the practice of multiplying the damage cap by the number of defendants. The only issue before the Supreme Court was whether the trial court erred in excluding prejudgment interest from the damage cap.

Texas Supreme Court's Opinion

The damage cap, found at article 4590i, section 11.02(a), subchapter K of the Revised Civil Statues, provides:

> **In an action on a health care liability claim where final judgment is rendered against a physician or healthcare provider, the limit of civil liability for damages of the physician or health care provider shall be limited to an amount not to exceed $500,000.**

In the *Moore* case the cap was adjusted to account for inflation and then applied to reach a $1,305,691.00 award to the Plaintiffs.

The majority in *Moore* found that subchapter K was a centerpiece of the original Medical Liability and Insurance Improvement Act passed in 1977 in order to "reduce excessive frequency and severity of health care liability claims." Tex.Rev.Civ.Stat. art. 4590i, § 1.02(b)(1). In 1995, the Legislature added subchapter P to the Medical Malpractice Act, providing for a particular "computation of prejudgment interest in healthcare liability claims. The relevant portion of this provision, section 16.02(b), dictates that in such claims "the judgment must include prejudgment interest on past damages found by the trier of fact, but shall not include prejudgment interest on future damages found by the trier of fact." Subchapter P explicitly states that its computation applies "[n]otwithstanding" the general judgment interest statute, but makes no mention of subchapter K's damages cap.

The Court of Appeals held that the Legislature's addition of subchapter P's prejudgment interest provisions to the Act evidenced an intent to exclude prejudgment interest from the damages cap prescribed in subchapter K. The court further held that section 16.02(b)'s mandatory language must be given effect by adding prejudgment interest, when applicable to the capped damage amount. The Supreme Court disagreed.

In *Horizon/CMS Healthcare Corporation v. Auld*, the Supreme Court addressed a similar question. In *Auld*, the court ruled that prejudgment interest is a form of damages that the Legislature intended to be capped under the law, Texas Revised Civil Statutes, Article 4590i, § 11.02(a)(subchapter K). However, the court at that time did not address whether

Recent Law Increases Number of State Sponsored J-1 Waivers for Foreign Physicians

YEN H. TRAN

Most physicians who are graduates of foreign medical schools enter the United States to do their medical residency under the J-1 visa. Upon completion of their training, J-1 physicians are required to return to their home country or country of last residence for a period of two years before they are eligible to obtain another nonimmigrant visa or permanent residency. This home residency requirement can be waived under limited circumstances. One of the grounds for a J-1 waiver is based on sponsorship by an interested governmental agency.

Under the Conrad Program, an interested state health agency can sponsor a doctor for a J-1 waiver in exchange for the doctor agreeing to work a minimum period of time in an underserved area. The Conrad Program expired in May 2002, but recent federal legislation has extended the program retroactively until 2004 and increased the number of visa waiver requests for each state per fiscal year from 20 to 30.

On December 3, 2002, the Waiver Review Division of the State Department issued a Policy Statement interpreting the recent legislation to allow states that have reached the numerical limitation of 20 requests for 2002 to submit up to 10 additional visa waiver requests for fiscal year 2002. The states may use these waiver numbers for cases that were filed and pending at the time states exhausted the then-applicable allotments of 20 waiver requests per year. A state must request a waiver for one of the 10 extra numbers by September 30, 2003.

The Conrad Program plays an even more important role in meeting the health care needs of underserved communities since the termination of the J-1 waiver program sponsored by the U.S. Department of Agriculture in February 2002. The USDA Program had brought more than 3,000 doctors to rural America over the last eight years. In the past, not all states made full use of the Conrad Program, relying instead on USDA sponsorship to recruit physicians to rural and underserved areas. With Idaho's recent decision to implement a Conrad 30 Program, all 50 states now have such programs.

In addition to the Conrad Program, foreign physicians can apply for J-1 visa waivers through the Appalachian Regional Commission (for primary care), the U.S. Dept. of Veterans Affairs (for various specialties), and the U.S. Dept. of Health and Human Services (for research).

Other bills introduced in Congress this year relating to foreign health care professionals included a bill to address the current severe nursing shortage by creating a category of nonimmigrant visas for nurses and a bill that would

In the past, not all states made full use of the Conrad Program, relying instead on USDA sponsorship to recruit physicians to rural and underserved areas.

make the Conrad State Program permanent. Neither bill was passed but these issues are expected to be raised again next year.

Medical Malpractice Cases *(cont.)*

the Legislature's 1995 enactment of subchapter P – mandating prejudgment interest on past damages negated the capping requirement because the claim in *Auld* predated that provision.

In *Moore*, the court held that the addition of subchapter P to the Act did nothing to change the nature of the prejudgment interest awarded. Justice Enoch, writing for the majority, concluded that "subchapter P was enacted for the same purpose as subchapter K and the act itself to limit, not expand, a healthcare provider's liability and both provisions should be read in a manner that will advance the overarching goal."

The jury found for the Moore's awarding $3 million in actual damages. The physicians settled with the family after judgment. The trial court then applied the cap, thereby reducing Columbia's actual damages to $1.3 million, but excluded prejudgment interest from the damage cap.

Supreme Court Chief Justice Tom Phillips writing for the dissent concluded that the Legislature didn't have prejudgment interest in mind when it enacted the Medical Liability and Insurance Improvement Act. At that time, the common law did not provide for prejudgment interest on such claims. It was not until eight years later, in *Cavnar v. Quality Control Parking, Inc.*, 696 S.W.2d 549, that the Supreme Court recognized for the first time that prejudgment interest should be paid in personal injury, wrongful death and survival actions. Irrespective of Justice Phillips' dissent, prejudgment interest is now limited to the damage cap.

Everything Old Is New Again *(cont. from page 4)*

Key characteristics of the programs include:

Section 232/223(f)- Allows nursing homes and assisted living providers to refinance up to 100% of outstanding debt and refinancing expenses (assuming a maximum 85% loan to value), for up to 35 years, non-recourse to the owner. Non-recourse specifically means that the program underwrites the mortgage based solely on the strength of the underlying project. No personal or corporate guarantee is required; in fact, the program cannot even accept such a guarantee. Many for-profit nursing homes are currently locking in 35-year interest rates, including a 0.50% point annual mortgage insurance premium, at less than 6.40%.

Section 232- For nursing home and assisted living providers interested in new construction or substantial rehabilitation, this program offers a similar non-recourse funding option. The program will help fund up to a 90% loan to value on for-profit projects and up to a 95% loan to value on non-profit projects. In addition, the program allows up to 40-year mortgage terms, further improving a project's cash flow.

Fortunately, or perhaps ironically, at a time when regulatory pressures and a lack of sufficient reimbursement are hampering providers efforts to improve care and expand, it is a federal program that is not only offering a viable funding option, but also an opportunity to access interest rate levels not seen in over a generation.

Mr. Wilson is a Vice President with the firm of Lancaster Pollard & Co. which offers a full range of investment banking services to health care providers.

For additional information on HUD's long term care financing programs, providers should visit HUD's website at www.hud.gov or contact Jackson Walker L.L.P. attorneys Carla Cox at (512)236-2040 or Dan Hayes at (713)752-4334.

Footnotes:
1. Based on 10-year Treasury Bill, Bloomberg Financial Markets, November 14, 2002.
2. 2000 U.S. Census.
3. Phoenix Management Lending Survey, June 20, 2002.
4. "A New Look at FHA Prepayments and Defaults." Merrill Lynch Global Securities Research and Economics Group. September 26, 2002.