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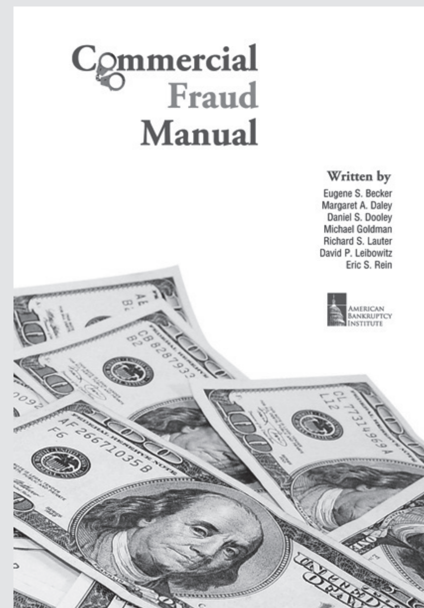

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United States Department of Justice
Executive Office for United States Trustees

Report to Congress:

Criminal Referrals by the United States Trustee Program Fiscal Year 2013

(As required by Section 1175 of the Violence Against Women and Department of Justice Reauthorization Act of 2005, Public Law 109-162)

April 2014

TABLE OF CONTENTS

EXECUTIVE SUMMARY 1

INTRODUCTION.......... 2

I. NUMBER AND TYPES OF CRIMINAL REFERRALS 3

II. OUTCOMES OF CRIMINAL REFERRALS 5

III. COMPARISON WITH CRIMINAL REFERRALS MADE IN PREVIOUS YEAR 6

IV. PROGRAM EFFORTS TO PREVENT BANKRUPTCY FRAUD AND ABUSE......... 7

SUMMARY 8

EXECUTIVE SUMMARY

The Director of the Executive Office for United States Trustees is required to submit an annual report to Congress under the provisions of Section 1175 of the Violence Against Women and Department of Justice Reauthorization Act of 2005 (P.L. 109-162). Section 1175 states:

> The Director of the Executive Office for United States Trustees shall prepare an annual report to the Congress detailing – (1) the number and types of criminal referrals made by the United States Trustee Program; (2) the outcomes of each criminal referral; (3) for any year in which the number of criminal referrals is less than for the prior year, an explanation of the decrease; and (4) the United States Trustee Program's efforts to prevent bankruptcy fraud and abuse, particularly with respect to the establishment of uniform internal controls to detect common, higher risk frauds, such as a debtor's failure to disclose all assets.

The United States Trustee Program (Program) made 2,074 bankruptcy and bankruptcy-related criminal referrals during Fiscal Year (FY) 2013. This represents a 2.2 percent decrease from the 2,120 criminal referrals made during FY 2012. The five most common allegations contained in the FY 2013 criminal referrals involved tax fraud, false oath or statement, concealment of assets, bankruptcy fraud scheme, and identity theft or use of false/multiple Social Security numbers.

Of the 2,074 criminal referrals, as of January 30, 2014, formal criminal charges had been filed in connection with 10 of the referrals, 1,296 of the referrals remained under review or investigation, 766 of the referrals were declined for prosecution, and two were administratively closed.

In FY 2013, the Program was an active member of the President's Financial Fraud Enforcement Task Force (FFETF), three national working groups, and bankruptcy fraud and other specialized working groups and task forces in districts across the country. Program staff contributed to the prosecution of bankruptcy and bankruptcy-related crimes by serving as Special Assistant U.S. Attorneys in cases, assisting with investigations, and providing support as expert

and fact witnesses. The Program employs a variety of strategies to identify fraud including the Program's Internet email "Hotline" which enables individuals to report suspected bankruptcy crimes. A link to the FFETF's Web site also is provided on the Program's Web site to facilitate the reporting of financial crimes not involving bankruptcy.

INTRODUCTION

Section 1175 of the Violence Against Women and Department of Justice Reauthorization Act of 2005 (P.L. 109-162) requires the Director of the Executive Office for United States Trustees (EOUST) to submit a "report to Congress detailing – (1) the number and types of criminal referrals made by the United States Trustee Program; (2) the outcomes of each criminal referral; (3) for any year in which the number of criminal referrals is less than for the prior year, an explanation of the decrease; and (4) the United States Trustee Program's efforts to prevent bankruptcy fraud and abuse, particularly with respect to the establishment of uniform internal controls to detect common, higher risk frauds, such as a debtor's failure to disclose all assets."

The Program is the component of the Department of Justice whose mission is to promote the integrity and efficiency of the bankruptcy system for the benefit of all stakeholders – debtors, creditors, and the public. The Program consists of 21 regions with 93 field office locations nationwide and an Executive Office in Washington, DC. Each field office is responsible for carrying out numerous administrative, regulatory, and litigation responsibilities under title 11 (the Bankruptcy Code) and title 28 of the United States Code.[1/]

The Program has a statutory duty to refer matters to the United States Attorneys' offices (USAOs) for investigation and prosecution that "relate to the occurrence of any action which may constitute a crime." 28 U.S.C. § 586(a)(3)(F). The statute also requires that each United States Trustee shall assist the United States Attorney in "carrying out prosecutions based on such

---

[1/] The Program has jurisdiction in all federal judicial districts except those in Alabama and North Carolina.

action." With the enactment of 18 U.S.C. § 158, which requires designation of a prosecutor and a Federal Bureau of Investigation (FBI) agent in each district to address bankruptcy-related crimes, Congress reaffirmed the importance of the USAOs and the FBI working in cooperation with the Program to protect the integrity of the bankruptcy system.

I. NUMBER AND TYPES OF CRIMINAL REFERRALS

The Program tracks criminal referrals using its automated Criminal Enforcement Tracking System (CETS). Program personnel enter information into CETS that relates to each criminal referral and are required to update information for each referral at least once every six months. The system is designed to provide an accurate measure of criminal enforcement actions, assist in trend identification, and facilitate management improvements.

In FY 2013, the Program made 2,074 bankruptcy and bankruptcy-related criminal referrals. Each referral may be sent to multiple agencies, but it is counted only once in CETS. Similarly, each referral may contain multiple allegations. The breadth of allegations involved in criminal referrals is evident in Table 1, with referral allegations in more than 45 separate categories. The five most common allegations contained in the FY 2013 criminal referrals involved tax fraud (37.9%), false oath or statement (31.7%), concealment of assets (25.8%), bankruptcy fraud scheme (21.5%), and identity theft or use of false/multiple Social Security numbers (16.6%).

Table 1: Criminal Referrals by Type of Allegation

Type of Allegation	Referrals	
	Number	Percent*
Tax Fraud [26 U.S.C. § 7201, et seq.]	786	37.9%
False Oath/Statement [18 U.S.C. § 152(2) and (3)]	657	31.7%
Concealment [18 U.S.C. § 152(1) and (7)]	535	25.8%
Bankruptcy Fraud Scheme [18 U.S.C. § 157]	446	21.5%
ID Theft and Use of False/Multiple SSNs	344	16.6%
Mail/Wire Fraud [18 U.S.C. §§ 1341 and 1343]	124	6.0%
Perjury/False Statement	110	5.3%
Mortgage/Real Estate Fraud	86	4.1%
Concealment/Destruction/Withholding of Documents [18 U.S.C. § 152(8) and (9)]	84	4.1%
Bank Fraud [18 U.S.C. § 1344]	68	3.3%
Forged Documents	55	2.7%
Sarbanes/Oxley [18 U.S.C. § 1519]	48	2.3%
Federal Program Fraud	39	1.9%
Embezzlement [18 U.S.C. § 153]	38	1.8%
Conspiracy [18 U.S.C. § 371]	33	1.6%
State Law Violations	32	1.5%
Post-Petition Receipt of Property [18 U.S.C. § 152(5)]	25	1.2%
Money Laundering [18 U.S.C. §§ 1956 and 1957]	23	1.1%
Investor Fraud	22	1.1%
False Claim [18 U.S.C. § 152(4)]	21	1.0%
Disregard of Bankruptcy Law/Rule by Bankruptcy Petition Preparer [18 U.S.C. § 156]	19	<1%
Professional Fraud	13	<1%
Misuse of Seals of Courts/Seals of Departments or Agencies [18 U.S.C. §§ 505/506]	11	<1%
Obstruction of Justice	10	<1%
Threats of Violence	9	<1%
Insurance Fraud	8	<1%
Corporate Fraud	7	<1%
Health Care Fraud [18 U.S.C. § 1347]	7	<1%
Bribery [18 U.S.C. § 152(6)]	6	<1%
Criminal Contempt [18 U.S.C. § 402]	6	<1%
Internet Fraud	6	<1%
Serial Filer	5	<1%
Corporate Bust-Out/Bleed-Out	4	<1%
Credit Card Fraud/Bust-Out	4	<1%
Counterfeiting	2	<1%
Terrorism	2	<1%
Adverse Interest/Officer Conduct [18 U.S.C. §154]	1	<1%
Anti-Dumping/Countervailing	1	<1%
Child Pornography [18 U.S.C. § 2252A]	1	<1%
Drug Offense	1	<1%
Environmental Destruction	1	<1%
Extortion	1	<1%
False Personation	1	<1%
Fee Agreement in Case Under Title 11 [18 U.S.C. § 155]	1	<1%
Murder	1	<1%
Race/Hate Crime	1	<1%

* Percent based on 2,074 referrals. Each referral often contains more than one allegation, so the sum of the percentages for referrals will exceed 100 percent.

II. OUTCOMES OF CRIMINAL REFERRALS

Table 2 shows the collective outcome/disposition of the 2,074 criminal referrals the Program made during FY 2013 as of January 30, 2014.[2/] Of the 2,074 referrals, 1,296 referrals (62.5%) remained under investigation or review, 10 referrals (0.5%) resulted in formal charges, 766 referrals (36.9%) were declined for prosecution, and two referrals (<0.1%) were administratively closed.[3/]

Table 2: Outcome/Disposition of FY 2013 Referrals (as of 01/30/14)

Outcome/Disposition[1]	Referrals	
	Number	Percent[2]
Under Review in United States Attorney's Office	798	38.5%
With Investigative Agency	498	24.0%
Formal Charges Filed (Case Active)	6	0.3%
Formal Charges Filed (Case Closed)	4	0.2%
– At least One Conviction or Guilty Plea	4	
– At least One Pre-trial Diversion	0	
– At least One Dismissal	0	
– At least One Acquittal	0	
Prosecution Declined by United States Attorney	766	36.9%
Administratively Closed	2	<0.1%

1) Outcome and disposition information will change over time. The information contained within Table 2 reflects information contained within CETS as of January 30, 2014.

2) Rounded percent based on 2,074 referrals.

[2/] The Program is not the source of official disposition information. CETS is designed primarily to track referrals made by the Program to U.S. Attorneys. While Program staff work with local USAOs to update disposition information semi-annually, delays in reporting, as well as differences in tracking systems, may result in reporting variances between the agencies.

[3/] Administratively closed referrals may still be under review/investigation by agencies (other than a USAO) that have not historically provided updates on referrals. After a referral has been open for a period of time and if the USTP is not able to verify the outcome/disposition, the Program will administratively close the file in CETS. Referrals that are administratively closed may be reopened at a later date.

The 10 cases referenced in Table 2 in which formal charges were filed between October 1, 2012, and January 30, 2014, are prosecutions that originated from a FY 2013 referral as derived from CETS.[4/] It is important to note that white-collar criminal referrals like those made by the Program often require significant time and resources to investigate. As a result, it generally takes more than two years before there is a reportable action in CETS. Therefore, it is reasonable that a high percentage of cases referred in FY 2013 are still under investigation or review.

III. COMPARISON WITH CRIMINAL REFERRALS MADE IN PREVIOUS YEAR

As shown in Table 3, the number of criminal referrals made during FY 2013 represents a 2.2 percent decrease from the number of referrals made in FY 2012.

Table 3: Comparison Between Criminal Referrals in FY 2012 and FY 2013		
FY 2012	**FY 2013**	**Percent Change**
2,120	2,074	-2.2%

Prior to FY 2013, the Program experienced seven consecutive years of growth in the number of bankruptcy and bankruptcy-related criminal referrals it made. The slight decline in FY 2013 may be attributable to several factors, including fewer staff onboard and reduced bankruptcy filings. Notwithstanding these challenges, FY 2013 referrals exceeded the number of referrals made in FY 2011 and nearly met the number made in FY 2012.

[4/] Table 2 reflects only disposition information related to referrals the Program made in FY 2013. It does not reflect the entirety of prosecutions with bankruptcy charges brought by the Department of Justice in FY 2013. A reporting of all prosecutions would include those that originated from Program referrals in prior fiscal years, as well as prosecutions related to referrals not made by the Program.

IV. PROGRAM EFFORTS TO PREVENT BANKRUPTCY FRAUD AND ABUSE

The Program is committed to identifying and referring for prosecution bankruptcy fraud and other crimes, and has systems in place to detect fraud schemes. The Program's Office of Criminal Enforcement (OCE) oversees and coordinates the Program's criminal enforcement efforts, and has significantly strengthened the Program's ability to detect, refer, and assist in the prosecution of criminal violations. Through issuing guidance and resource materials, providing extensive training, participating in national working groups, and working with its law enforcement partners, the Program has established the necessary systems to effectively combat fraud and abuse that threaten the integrity of the bankruptcy system.

Highlights of the Program's criminal enforcement efforts in FY 2013 include the following.

Bankruptcy Fraud and Other Specialized Working Groups and Task Forces. The Program is an active member of the President's Financial Fraud Enforcement Task Force and the Mortgage Fraud, Bank Fraud, and Identity Theft Working Groups sponsored by the Department of Justice's Criminal Division. The Program also participates in more than 90 local bankruptcy fraud working groups, mortgage fraud working groups, and other specialized task forces throughout the country. Members of these working groups and task forces include representatives from the USAOs, FBI, United States Postal Inspection Service, Internal Revenue Service, Offices of the Inspector General for the Social Security Administration and the Department of Housing and Urban Development, United States Secret Service, Office of the Special Inspector General for the Troubled Asset Relief Program, and Immigration and Customs Enforcement, among others.

Special Assistant United States Attorneys and Other Staff Support. Approximately 25 Program attorneys in field offices across the country are designated as Special Assistant U.S Attorneys to assist USAOs in the investigation and prosecution of bankruptcy and bankruptcy-related crimes. Other Program staff members also are called upon to assist with investigations and to provide expert or fact testimony at trial. In addition, in FY 2013, the OCE

designated three Program trial attorneys as part-time regional criminal coordinators to provide support, assistance, and training to Program personnel regarding the identification and referral of suspected bankruptcy fraud.

Training. During FY 2013, the OCE and Program staff provided bankruptcy and bankruptcy-related fraud training to more than 2,500 federal, state, and local law enforcement personnel, Program employees, and private bankruptcy trustees throughout the country. This included specialized Live Meeting distance training for Program staff on identity theft and on detecting and combatting bankruptcy-related schemes undertaken by rescue fraud perpetrators against financially distressed homeowners**.**

Bankruptcy Fraud Internet "Hotline." In FY 2013, the USTP documented 693 email submissions via the National Bankruptcy Fraud Hotline (USTP.Bankruptcy.Fraud@usdoj.gov).

SUMMARY

The United States Trustee Program continued to combat fraud and abuse in the bankruptcy system in FY 2013. Through detecting and referring fraud schemes, collaborating with its law enforcement partners, and providing specialized training, the Program will continue its enforcement efforts to protect the integrity of the bankruptcy system.

Medicaid Fraud Issues Arising in Bankruptcy

I. Setoff vs. recoupment

A. The equitable doctrine of recoupment is not limited to pre-petition claims; therefore, recoupment 'may be employed to recover across the petition date.'" *In re District Memorial Hospital of Southwestern North Carolina, Inc.,* 297 B.R. 451, 454-56 (Bankr. W.D.N.C. 2002) (holding that distinctive Medicare and Medicaid systems of estimated payments and later adjustments qualified as single "transaction," for recoupment purposes) (citations omitted). "The equitable doctrine of recoupment is not limited to pre-petition claims; therefore, recoupment 'may be employed to recover across the petition date.'" *Id. (citing Sims v. United States Dep't of Health and Human Serv. (In re TLC Hosps., Inc.)*, 224 F.3d 1008, 1011 (9th Cir. 2000)).

B. Setoff requires relief from stay.

II. Vendor Holds

A. *Personal Care Products Inc. v. Hawkins*, 635 F.3d 155, 159 (5th Cir. 2011) ("Nothing in Texas or federal law extends a property right in Medicaid reimbursements to a provider that is the subject of a fraud investigation.").

III. 11 U.S.C. §362(b)(4) [the police and regulatory exception to the automatic stay]

A. Pecuniary interest vs. public policy

B. State court concurrent jx to determine whether stay applies

C. Obtaining and enforcing judgments

a. government can obtain and enforce injunctive relief, the government may obtain but *not* enforce (*i.e.,* collect) a money judgment against a debtor. *Murray v. United States Department of Treasury (In re Murray)*, 128 B.R. 517, 519 (Bankr. N.D. Tex. 1991) (Defendant's administrative proceeding was exempted from the automatic stay because it was "not an action to collect or enforce a judgment," but was "one to fix and ascertain ... liability.").

b. In *Commonwealth Oil*, the Fifth Circuit observed that "[w]ere we to find that any

order which requires the expenditure of money is a 'money judgment,' then the exception to section 362 for governmental police action...would...be narrowed into virtual nonexistence.... [W]e cannot ignore the fundamental fact that, in contemporary times, almost everything costs something." *Commonwealth Oil*, 805 F.2d at 1186, quoting *Penn Terra*, 733 F.2d at 277-78.

D. Civil actions by a governmental unit to enforce the governmental unit's police or regulatory power cannot be removed to district court. 28 U.S.C. §1452(a).

IV. *Qui tam* (whistleblower) lawsuits

A. Often still under seal when bankruptcy filed

B. 1141(d)(6)(A), the portion owed to the private person is excepted from discharge in a corporate Chapter 11 case. Also nondischargeable are any debts owed to a "person" under "any similar State statute." Because the language excepts from discharge only a debt owed to a "person," the portion owed to the government is fully dischargeable as with any other claim. 79 Am. Bankr. L.J. 603.

V. Dischargeability issues for individual Medicaid providers

A. Section 727

B. Section 523(a)(2) and (7)

The Sperling Law Office, P.C. v. Anderson, et al.

Civil Action No. GLR-11-2905

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MARYLAND

2012 U.S. Dist. LEXIS 142546

August 10, 2012, Decided

COUNSEL: [*1] For The Sperling Law Office, PC, Plaintiff: Samuel Sperling, LEAD ATTORNEY, The Sperling Law Office PC, Baltimore, MD.

Catherine Anderson, Defendant, Pro se, Baltimore, MD.

For The Department of Health and Human Services, Defendant: Jason Daniel Medinger, LEAD ATTORNEY, Rod J Rosenstein, Office of the United States Attorney, Baltimore, MD.

JUDGES: George L. Russell, III, United States District Judge.

OPINION BY: George L. Russell, III

OPINION

Dear Counsel:

Currently pending before the Court is Defendant U.S. Department of Health and Human Services' ("DHHS") Motion to Dismiss. DHHS' Motion has been fully briefed and is ripe for disposition. No hearing is necessary. See *Local Rule 105.6* (D.Md. 2011). For the reasons that follow, the Motion to Dismiss is granted.

During the course of a personal injury lawsuit, Plaintiff Sperling Law Office, P.C. ("Sperling") served as counsel to Defendant Catherine Anderson ("Anderson"). Sperling negotiated a settlement of the lawsuit for an undisclosed amount of monetary compensation. Prior to the settlement's resolution, DHHS, through the Centers for Medicare & Medicaid Services ("CMS"), informed Sperling and Anderson of its entitlement to reimbursement of the conditional payments Medicare [*2] made to healthcare providers on Anderson's behalf. According to Sperling, Medicare agreed to accept $6,000 of the settlement proceeds as full reimbursement for its conditional payments because of Anderson's indigent financial condition. Anderson, however, disputes the existence of any agreement and claims an entitlement to the entire settlement amount.

Sperling filed this interpleader action on August 24, 2011, in the District Court for Baltimore City, Maryland, seeking a declaratory judgment as to the proper distribution of the $6,000 between DHHS and Anderson. 1 (See ECF No. 2). On October 11, 2011, DHHS filed a Notice of Removal pursuant to *28 U.S.C. §§ 1441*, *1442*. (ECF No. 1). Upon removal, DHHS filed a Motion to Dismiss Sperling's interpleader action for lack of subject-matter jurisdiction.

1 Sperling filed its initial Complaint on or about October 10, 2010, against Anderson and the CMS Administrator. The Amended Complaint, filed on August 24, 2011, converted the original Complaint into an interpleader action and added DHHS as a defendant.

Motions to dismiss for lack of subject-matter jurisdiction are governed by *Federal Rule of Civil Procedure 12(b)(1)*. The Plaintiff bears the burden [*3]

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of proving that subject-matter jurisdiction properly exists in the federal court. See *Evans v. B.F. Perkins Co., a Div. of Standex Int'l Corp., 166 F.3d 642, 647 (4th Cir. 1999)*. In a 12(b)(1) motion, the Court "may consider evidence outside the pleadings" to help determine whether it has jurisdiction over the case before it. *Richmond, F. & P. R. Co. v. United States, 945 F.2d 765, 768 (4th Cir. 1991)*; see also *Evans, 166 F.3d at 647*. The court should grant the 12(b)(1) motion "only if the material jurisdictional facts are not in dispute and the moving party is entitled to prevail as a matter of law." *Richmond, 945 F.2d at 768*.

DHHS avers that Sperling failed to exhaust administrative remedies because neither he nor Anderson secured a final determination, regarding the proper distribution of the settlement proceeds, from the Secretary of DHHS ("Secretary"). [2] Sperling counters that administrative exhaustion occurred because it reached a final agreement with Medicare. Moreover, Sperling contends it does not seek relief from the final agreement, but a judicial determination regarding the proper distribution of the proceeds in light of Anderson's demand for the entire settlement. [*4] The Court, however, lacks jurisdiction to make the requested determination.

2 DHHS also argues that Sperling lacks standing to bring this action. The Court need not address this argument because the action will be dismissed on another ground.

Title XVII of the Social Security Act, known as the Medicare Act (the "Act") and codified in *42 U.S.C. § 1395 et seq.*, is a "federally subsidized health insurance program . . . administered by the Secretary." *Heckler v. Ringer, 466 U.S. 602, 605, 104 S. Ct. 2013, 80 L. Ed. 2d 622 (1984)*. In 1980, Congress amended the Act to reduce healthcare costs. *Brown v. Thompson, 374 F.3d 253, 257 (4th Cir. 2004)*. Pursuant to the amendments, Medicare is considered a secondary payer required to make conditional payments for the care of Medicare beneficiaries whenever prompt payment from a primary insurer is unavailable. *42 U.S.C. § 1395y(b)(2)*. Medicare's payments are conditioned upon reimbursement within sixty days of Medicare receiving notice that payment has been, or will be, made ("MSP claim"). Id.; *42 C.F.R. § 411.24*. Parties who fail to reimburse Medicare within the proscribed time may be subject to interest charges. Id. Furthermore, Medicare's reimbursement may be withdrawn from a beneficiary's [*5] settlement proceeds. See, e.g., *Brown v. Thompson, 252 F.Supp.2d 312 (E.D.Va. 2003)*, aff'd on other grounds, *374 F.3d 253 (4th Cir. 2004)*. Beneficiaries who wish to challenge Medicare's MSP claim must utilize the administrative scheme provided by the Act. Specifically, beneficiaries must present a claim to the Secretary and then, absent a waiver, proceed through the Act's administrative appeals process. See *42 U.S.C. §§ 1395ff, 405(b)*; *42 C.F.R. §§ 405.701 et seq., 405.801 et seq.*

"The district courts shall have original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States." *28 U.S.C. § 1331*. Causes of action that arise under the Act, however, may be reviewed by the district court only after a final decision from the Secretary. *42 U.S.C. § 405(g)*. A decision is final "after the individual claimant has pressed his claim through all designated levels of administrative review." *Ringer, 466 U.S. at 606*. Moreover, "*§ 405(g)*, to the exclusion of *28 U.S.C. § 1331*, is the sole avenue for judicial review for all 'claim[s] arising under' the Medicare Act." *Id. at 615* (citation omitted). The Supreme Court of the United States has recognized that [*6] *42 U.S.C. § 405(g)* requires full exhaustion of administrative remedies prior to filing suit in the district court. *Ringer, 466 U.S. 602, 104 S. Ct. 2013, 80 L. Ed. 2d 622*; see also *Shalala v. Illinois Council on Long Term Care, Inc., 529 U.S. 1, 5, 120 S. Ct. 1084, 146 L. Ed. 2d 1 (2000)*. In Buckner v. Heckler, the United States Court of Appeals for the Fourth Circuit affirmed the district court's dismissal of the plaintiff's civil action because she failed to present her claim to the Secretary prior to filing suit. *804 F.2d 258 (4th Cir. 1986)*. Similarly, other federal circuits have affirmed dismissals of various claims arising under the Act due to a lack of full administrative exhaustion. See, e.g., *Michael Reese Hosp. & Med. Ctr. v. Thompson, 427 F.3d 436 (7th Cir. 2005)*; *Wilson v. United States, 405 F.3d 1002 (Fed. Cir. 2005)*; *Cathedral Rock of North College Hill, Inc. v. Shalala, 223 F.3d 354 (6th Cir. 2000)*.

Sperling's claim arises under the Act because "'both the standing and the substantive basis for the presentation'" of the claim is the Act. *Ringer, 466 U.S. at 615* (citation omitted). Namely, Sperling identified DHHS as the proper defendant and Medicare's entitlement to a portion of Anderson's settlement proceeds is governed [*7] by the Act. See *Buckner, 804 F.2d at 259*. According to Sperling, the $6,000 at the center of this dispute is the result of an alleged agreement

between the parties. Moreover, Sperling contends that this alleged agreement constitutes a final determination from the Secretary and, therefore, full administrative exhaustion. There is, however, no documentation to support this alleged agreement and Anderson's claim to the entire settlement amount was not presented to the Secretary prior to filing this action. The Act and applicable case law is clear that this Court does not have jurisdiction to review claims that arise under the Act without a final determination from the Secretary. Therefore, the Court lacks subject-matter jurisdiction over this matter.

For the foregoing reasons, DHHS' Motion to Dismiss (ECF No. 30) is GRANTED.

Despite the informal nature of this memorandum, it shall constitute an Order of the Court and the Clerk is directed to docket it accordingly.

Very truly yours,

/s/ George L. Russell, III

In re: TOWN & COUNTRY HOME NURSING SERVICES, INC., Debtor. LOUIS M. SULLIVAN, Secretary of Health and Human Services, Appellant, v. TOWN & COUNTRY HOME NURSING SERVICES, INC., Appellee.

No. 90-55621

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

963 F.2d 1146*; *1992 U.S. App. LEXIS 8830*; *26 Collier Bankr. Cas. 2d (MB) 1446*; *92 Cal. Daily Op. Service 3834*; *92 Daily Journal DAR 6026*; *37 Soc. Sec. Rep. Service 274

June 5, 1991, Argued and Submitted, Pasadena, California
May 5, 1992, Filed

PRIOR HISTORY: [**1] Appeal from the Ninth Circuit Bankruptcy Appellate Panel. Volinn, Mooreman and Perris, Judges, Presiding. BAP No. CC-88-1281-VMoP

Original Opinion Reported at *1991 U.S. App. LEXIS 29820*

COUNSEL: Mark B. Stern, United States Department of Justice, Washington, D.C., for the appellant.

Carl Grumer, Cooper, Epstein & Hurewitz, Beverly Hills, California, for the appellee.

JUDGES: Before: Alfred T. Goodwin, Harry Pregerson and Arthur L. Alarcon, Circuit Judges. Opinion by Judge Goodwin.

OPINION BY: GOODWIN

OPINION

[*1147] OPINION

GOODWIN, Circuit Judge:

The Secretary of Health and Human Services appeals the judgment of the Bankruptcy Appellate Panel reversing the bankruptcy court's decision in an adversary proceeding brought by debtor Town & Country Home Nursing Services, Inc. ("T&C"). Because we agree with the BAP that the government waived sovereign immunity under *11 U.S.C. § 106(a)* by offsetting against T&C's assets after T&C had filed a Chapter 11 petition, we affirm.

FACTS AND PROCEEDINGS BELOW

A. *Statutory and Regulatory Background*

T&C is a provider of in-home nursing services under the Medicare Act, *42 U.S.C. §§ 1395-1395ccc*. Under the Act, health care providers such as T&C are reimbursed [**2] by the government, usually through fiscal intermediaries such as the Blue Cross Association or subcontractors such as Blue [*1148] Cross of California ("B.C.C."). Congress authorizes the Secretary of Health and Human Services ("the Secretary") to reimburse providers on an interim provisional basis so that any errors resulting in overpayment or underpayment may be corrected. *See 42 U.S.C. § 1395g*; *42 C.F.R. § 413.60 (1990)*.

The intermediary reviews cost reports submitted by the provider and conducts audits when necessary. *42 U.S.C. § 1395h(a)*. The intermediary then issues a written notice which represents a determination of the total amount of reimbursement due the provider for the fiscal

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year. *42 C.F.R. § 405.1803*. If the final determination is higher than the total of the interim payments, the provider is reimbursed; conversely, if the determination is lower, the provider must refund the overpaid amount to the government. *See 42 C.F.R. § 413.64(f)*.

If a provider disputes the intermediary's final determination and the amount in controversy exceeds $ 10,000, the provider can request a hearing before the Provider Reimbursement Review Board within 180 days. *42 U.S.C. § 1395oo(a)*. The [**3] Board's decision may then be reviewed by the Secretary. After exhausting these procedures, the provider may seek judicial review of the final agency decision. *42 U.S.C. § 1395oo(f)(1)*.

B. *Statement of Facts*

T&C has participated in the Medicare program (Part A) since 1970 and, during the time relevant to this case, B.C.C. served as the fiscal intermediary. In late 1984, B.C.C. asserted that T&C had been overpaid approximately $ 555,000 for fiscal years 1982 through 1984. To resolve the overpayment dispute, T&C executed a promissory note in the amount of $ 555,539 in February 1985. The note was made payable to the government and required payment in minimum monthly installments of $ 16,835 plus interest.

From November 1984 through September 1985, B.C.C. offset approximately $ 21,000 per month against provider payments otherwise due and payable to T&C. B.C.C. then discovered that it had made an error in its calculations and determined that the correct amount of overpayment to T&C had been only about $ 250,000.

On July 19, 1985, T&C filed a petition under Chapter 11 of the Bankruptcy Code. After the petition was filed the government, through B.C.C., continued to offset the amount [**4] of overpayment to which it claimed it was entitled and ultimately offset the full amount it claimed was owed by T&C. Approximately $ 88,700 was deducted from provider payments after T&C filed its Chapter 11 petition.

C. *Proceedings Below*

In 1986, T&C initiated an adversary proceeding in bankruptcy court against the Secretary, B.C.C., Blue Cross of America, and the Health Care Financing Administration, the section of the Department of Health and Human Services that administers the Medicare program. As amended, the complaint asserted six claims for relief arising under the Bankruptcy Code and state law. The defendants moved to dismiss for lack of jurisdiction and also moved for judgment on the pleadings.

The bankruptcy court denied both motions in its order of January 6, 1988. Concerning those claims arising under various sections of the Bankruptcy Code, the court found that the government had waived sovereign immunity under *11 U.S.C. § 106(c)*. [1] Subsection (c) provides that sovereign immunity is waived for purposes of declaratory and injunctive relief in actions arising under sections of the Bankruptcy Code that contain trigger terms such as "creditor," "entity" or "governmental [**5] unit." *See United States v. Nordic Village, Inc.*, 112 S. Ct. ____; , *117 L. Ed.2d 181, 60 U.S.L.W. 4159, 4160-61, 112 S. Ct. 1011* (Feb. 25, 1992). The waiver of sovereign immunity for actions falling within the scope of *section 106(c)* does not depend on whether the government has filed a claim in bankruptcy court.

1 *Section 106* contains a limited waiver of sovereign immunity for "governmental units," including the United States, its agencies and instrumentalities, as well as state and local governments. *See 11 U.S.C. § 101(27)* (defining "governmental unit").

[*1149] With respect to the two state-law claims contained in the fourth and fifth counts of T&C's amended complaint, the bankruptcy court considered whether the government had waived sovereign immunity under *11 U.S.C. § 106(a)*. This subsection waives immunity for claims of the estate arising out of the same transaction and occurrence as a claim of a governmental unit. The bankruptcy court ruled that sovereign immunity under subsection (a) could be waived even if the government had [**6] filed no bankruptcy court claim. Thus, it allowed T&C to proceed with Count IV, which alleged breach of the implied covenant of good faith and fair dealing as well as breach of fiduciary duties, and Count V, which alleged intentional or negligent interference with prospective economic advantage and unfair business practices.

On reconsideration, the bankruptcy court modified its initial ruling. The court decided that the waiver of sovereign immunity contained in subsection (a) was predicated on the filing of a formal claim by the

government. Accordingly, in its order of March 14, 1988, the court held that it lacked jurisdiction with respect to the fourth and fifth counts because the government had not filed a proof of claim in bankruptcy court and therefore had not waived its immunity.

T&C appealed this dismissal to the Bankruptcy Appellate Panel ("BAP") pursuant to *28 U.S.C. § 158(b)*, and the BAP reversed. *In re Town & Country Home Nursing Servs., 112 Bankr. 329 (Bankr. 9th Cir. 1990)*. The BAP found that the actions of the government - specifically its offsetting against T&C's assets after T&C filed its bankruptcy petition - constituted a waiver of sovereign immunity [**7] with respect to the state-law claims. *Id. at 334*. The BAP held alternatively that the government, by its downward adjustment of payments to T&C, had effectively filed an "informal proof of claim" and that this action was sufficient to satisfy the requirements of *11 U.S.C. § 106(a)*. *Id*. The BAP further ruled that the exhaustion provisions of the Medicare Act and the Federal Tort Claims Act, *28 U.S.C. §§ 1346(b)* and 2671-2680 ("the FTCA"), have no bearing on T&C's claims because of the independent grant of jurisdiction to bankruptcy courts set forth in *28 U.S.C. §§ 157* and *1334*, as well as the waiver of sovereign immunity contained in *11 U.S.C. § 106*. *Id. at 334-35*.

DISCUSSION

We consider three issues on appeal. First, does the federal government waive sovereign immunity for compulsory counterclaims in bankruptcy court under *11 U.S.C. § 106(a)* when it obtains payment from a bankruptcy estate, even though it does not file a formal proof of claim? Second, did the government's self-help collection efforts constitute an informal proof of claim, thereby waiving sovereign immunity? Third, assuming that sovereign immunity was waived, does the [**8] bankruptcy court lack jurisdiction because the Medicare Act or Federal Tort Claims Act provides the exclusive remedy for T&C's claims?

Both parties agree that this appeal presents issues of law subject to *de novo* review. *See In re Taylor, 884 F.2d 478, 481 (9th Cir. 1989)*.

A. *Waiver of Sovereign Immunity*

1. *Statutory language*

Section 106 of the Bankruptcy Code provides:

(a) A governmental unit is deemed to have waived sovereign immunity with respect to any claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which such governmental unit's claim arose.

(b) There shall be offset against an allowed claim or interest of a governmental unit any claim against such governmental unit that is property of the estate.

(c) Except as provided in subsections (a) and (b) of this section and notwithstanding any assertion of sovereign immunity -

(1) a provision of this title that contains "creditor," "entity," or "governmental [*1150] unit" applies to governmental units; and

(2) a determination by the court of an issue arising under such a provision binds governmental units.

The [**9] BAP ruled that a governmental unit may waive sovereign immunity under *section 106(a)* for state-law counterclaims filed by the estate even when it has filed no formal claim in bankruptcy court. The BAP found that the government, by offsetting against monies owed to T&C, had achieved full satisfaction of its claim from the assets of the T&C estate. It concluded that "the threshold requirement in *§ 106(a)* of the existence of a governmental claim against the debtor is therefore satisfied, thereby waiving sovereign immunity as to claims by the estate against the defendants arising 'out of the same transaction or occurrence.' " *112 Bankr. at 334*. The BAP did not decide whether the mere existence of a governmental claim would be sufficient to constitute a waiver under subsection (a) because it found that the government's actions were tantamount to filing a claim which resulted in the recovery of funds. *See id. at 334 n.4*.

All parties agree that *section 106(a)* unambiguously waives sovereign immunity for compulsory counterclaims brought in response to a "claim" by a governmental unit. *See Irwin v. Department of Veterans Affairs, 111 S. Ct. 453, 457 (1990)* [**10] (noting that waivers of sovereign immunity must be express rather than implied). When a governmental unit formally invokes the jurisdiction of the bankruptcy court by filing a proof of claim, the government's exposure to

counterclaim liability under *section 106(a)* is unquestioned. *See, e.g., Nordic Village,* 112 S. Ct. at ___; *60 U.S.L.W. at 4160*; *Hoffman v. Connecticut Dep't of Income Maintenance, 492 U.S. 96, 101, 106 L. Ed. 2d 76 , 109 S. Ct. 2818 (1989)*. The question we must answer here, however, is narrower and apparently is one of first impression - whether the term "claim" as used in *section 106(a)* encompasses the government's conduct in extracting post-petition payment from the bankruptcy estate without resort to the proof of claim mechanism.

We begin with the statutory language itself as our starting point for interpreting *section 106(a)*. *See Ardestani v. INS, 116 L. Ed. 2d 496, 112 S. Ct. 515, 519 (1991)*. Conceding that the plain language of *section 106(a)* does not specify what governmental acts will trigger a waiver of immunity, the Secretary argues that the text makes clear that Congress intended to waive immunity only for compulsory counterclaims (as defined by the [**11] Federal Rules of Civil Procedure) brought in response to formal proofs of claim filed by the government in the bankruptcy court. The Secretary argues that the first reference to a "claim" in *section 106(a)* is to a claim against the governmental unit by the estate and that this reference clearly designates a formal claim filed in bankruptcy court. The second reference to a "claim" in *section 106(a)* parallels the first and defines the scope of the estate's claim. Logical inference, the Secretary urges, shows that by "claim" Congress meant a claim filed in bankruptcy court. By its terms, however, subsection (a) refers only to a "claim" and does not differentiate between those that are filed and those that are not. Although subsection (b) refers to a government's "allowed" claims - claims that have been filed and to which no objection has been raised - subsection (a) makes no such reference. This distinction indicates that subsection (a) waivers do not necessarily require the filing of a formal proof of claim. The Secretary's interpretation of the plain language of *section 106(a)* is therefore unpersuasive.

2. *Legislative history*

The Secretary further contends that the legislative [**12] history of *section 106(a)* demonstrates that a waiver of sovereign immunity hinges on the governmental unit's filing of a proof of claim in bankruptcy court. The Secretary stresses that the congressional reports explaining the rationale of subsection (a) demonstrate that sovereign immunity is not waived when the debtor or trustee files proof of a government claim; [*1151] rather, the governmental unit itself must file such a claim. The following passage is contained in both the House and Senate reports:

"Though this subsection creates a partial waiver of immunity when the governmental unit files a proof of claim, it does not waive immunity if the debtor or trustee, and not the governmental unit, files proof of a governmental unit's claim . . . ."

H.R. Rep. No. 595, 95th Cong., 1st Sess. 317, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5963, 6274; S. Rep. No. 989, 95th Cong., 2d Sess. 29-30, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5787, 5815-16. In reliance on this passage, the Secretary argues that Congress intended that even where the government has a right to payment that is injected into the bankruptcy proceeding, immunity is not waived absent the governmental [**13] unit's affirmative decision to file a proof of claim in bankruptcy court.

We are not persuaded by the Secretary's interpretation of the legislative history. Rather, we read the legislative history to support the BAP's conclusion that Congress intended subsection (a) to apply in certain circumstances even when the government does not file a formal claim. Significantly, the above-quoted joint explanatory statement was written *before* the final version of *section 106* was drafted. As the BAP recognized, the original draft of subsection (a) expressly required the filing of a proof of claim. *See* H.R. 8200, 95th Cong., 1st Sess. 324 (1977); S. 2266, 95th Cong., 2d Sess. 313 (1978), *reprinted in* L. King, Collier on Bankruptcy, App. 3, §§ III, VII (15th ed. 1991). As ultimately enacted, however, that requirement was omitted. The BAP properly focused on the deletion of this language. As a general canon of statutory construction, where the final version of a statute deletes language contained in an earlier draft, a court may presume that the earlier draft is inconsistent with ultimate congressional intentions.

On the basis of this more complete account of the legislative history, [**14] the BAP rightly concluded that on the facts of this case a proof of claim need not necessarily be filed to trigger the waiver of sovereign immunity set forth in *section 106(a)*. This result effectuates Congress's desire to prohibit the government from participating in the distribution of the bankruptcy estate without relinquishing part of its sovereign

immunity. *See supra,* H.R. Rep. No. 595, 95th Cong., 1st Sess. 317 ("The governmental unit cannot receive distribution from the estate without subjecting itself to any liability it has to the estate within the confines of a compulsory counterclaim rule. Any other result would be one-sided."); *see also In re OPM Leasing Servs., 21 Bankr. 993, 1001-02 (Bankr. S.D.N.Y. 1982)* (holding that West Virginia waived sovereign immunity by initiating adversary proceeding even though it had not filed a proof of claim); *In re Davis, 20 Bankr. 519, 520-23 (Bankr. M.D. Ga. 1982)* (rejecting the contention that "the filing of a proof of claim is a prerequisite for relief against the government" where Farmers Home Administration participated in bankruptcy court proceedings and demanded that trustee abandon certain [**15] property).

3. *Principles of sovereign immunity*

The Secretary also argues that basic principles of federal and state sovereign immunity preclude an expansive reading of *section 106*. The Secretary maintains that even if we reject his reading of the legislative history of *section 106*, we must interpret narrowly any waiver of immunity. *See Ruckelshaus v. Sierra Club, 463 U.S. 680, 685, 77 L. Ed. 2d 938 , 103 S. Ct. 3274 (1983)*. The Secretary argues that to the extent the provision is ambiguous, the waiver must be narrowly construed to apply only to the filing of formal claims by the government. Waivers of sovereign immunity, however, are not construed as strictly as the Secretary suggests. It is well established that when the federal government waives its immunity, the scope of the waiver is construed to achieve its remedial purpose. As the Supreme Court observed in *Block v. Neal, 460 U.S. 289, 75 L. Ed. 2d 67 , 103 S. Ct. 1089 (1983)*, "the exemption of the sovereign from suit involves [*1152] hardship enough where consent has been withheld. We are not to add to its rigor by refinement of construction where consent has been announced." *Id. at 298* (citations omitted); *see also Franchise Tax Board v. United States Postal Service, 467 U.S. 512, 521, 81 L. Ed. 2d 446 , 104 S. Ct. 2549 (1984)* [**16] (instructing that the scope of a waiver of sovereign immunity is ascertained "by reference to congressional policy"); *Indian Towing Co. v. United States, 350 U.S. 61, 69, 100 L. Ed. 48 , 76 S. Ct. 122 (1955)* (Frankfurter, J.) (holding that a court should not act as "self-constituted guardian of the Treasury [and] import immunity back into a statute designed to limit it"). The language and legislative history of *section 106(a)* manifest Congress's desire to waive immunity under circumstances such as those present in this case. The Secretary therefore cannot carry the day by invoking general maxims of judicial policy.

The government next points to *Eleventh Amendment* jurisprudence to bolster its analysis of congressional intent. *Section 106* waives immunity not only for the federal government and its agencies, but also for all "governmental units," including states and localities. *See 11 U.S.C. § 101(27)*. The Secretary argues that if subsection (a) operated to waive sovereign immunity in cases where a state did not invoke the jurisdiction of the bankruptcy court by filing a formal proof of claim, the subsection would raise problematic questions concerning Congress's authority to abrogate the [**17] *Eleventh Amendment*. The Secretary suggests that if Congress had intended to abrogate immunity in cases in which a state had not filed a claim in bankruptcy court, it would have done so explicitly. *See Atascadero State Hosp. v. Scanlon, 473 U.S. 234, 242, 87 L. Ed. 2d 171 , 105 S. Ct. 3142 (1985)* (requiring an "unmistakably clear" statement of congressional intent to abrogate the states' *Eleventh Amendment* immunity). Asserting that Congress should not be presumed to have created a substantial constitutional question, the Secretary contends that congressional concern with the scope of *Eleventh Amendment* immunity negates the possibility that *section 106* waives sovereign immunity whenever any governmental unit has a right to payment and asserts this right outside of bankruptcy court. [2]

2 To discredit the BAP's reading of the statute, the Secretary points to dictum in the plurality opinion in *Hoffman v. Connecticut Department of Income Maintenance, 492 U.S. 96, 106 L. Ed. 2d 76 , 109 S. Ct. 2818 (1989)*. In *Hoffman,* the Court held that in enacting *section 106(c)* - not *section 106(a)*, which is the focus of this appeal - Congress did not abrogate the *Eleventh Amendment* immunity of the states. Although Connecticut had potential claims against the debtor and refused to pay the debtor for Medicaid services because of past overpayments, the Court observed in passing that "neither *§ 106(a)* nor *§ 106(b)* provides a basis for petitioner's actions here, since [Connecticut] did not file a claim." *Id. at 101*.

In *Hoffman* the bankruptcy trustee relied

solely on subsection (c) in bringing a turnover proceeding under section 542(b) and a preference avoidance action under *section 547(b) of the Bankruptcy Code*. The Court thus had no occasion to consider the issue presented in the instant case.

Similarly, in *United States v. Nordic Village, Inc.,* 112 S. Ct. ___; , *117 L. Ed.2d 181, 60 U.S.L.W. 4159, 112 S. Ct. 1011 (1992)*, the Court relied on the reasoning of the *Hoffman* plurality to hold that *section 106(c)* does not authorize monetary recovery against the federal government. As in Hoffman, the Court noted in passing that subsections (a) and (b) - which were not at issue in the case - specify a waiver of sovereign immunity when the government has filed a proof of claim. *60 U.S.L.W. at 4160-61*. As in *Hoffman,* the Court in *Nordic Village* had no occasion to consider the question raised by this appeal.

[**18] The Secretary's speculation about congressional concern with *Eleventh Amendment* abrogation elevates form over substance. As discussed above, the BAP did not hold that the mere existence of a claim by a governmental unit is sufficient to waive immunity under *section 106(a)*. Rather, the BAP held more narrowly that on the facts of this case the government's self-help in lieu of a claim against assets of the estate was tantamount to filing a claim and therefore effected a waiver of sovereign immunity. We fail to see how this principle, even if applied in the context of counterclaims against state governmental [*1153] units, would give rise to *Eleventh Amendment* difficulties. [3]

3 It is well settled that a state may waive its sovereign immunity by affirmatively engaging in a federally regulated activity in which Congress clearly has made waiver of immunity a necessary condition of state participation. *See Parden v. Terminal Ry., 377 U.S. 184, 196, 12 L. Ed. 2d 233 , 84 S. Ct. 1207 (1964)*, *overruled in part, Welch v. Texas Dep't of Highways and Transp., 483 U.S. 468, 478, 97 L. Ed. 2d 389 , 107 S. Ct. 2941 (1987)*; *Gardner v. New Jersey, 329 U.S. 565, 573-74, 91 L. Ed. 504 , 67 S. Ct. 467 (1947)*.

[**19] The Secretary acknowledges that *section 106(a)* is invoked when the government seeks distribution from the bankruptcy estate by filing a claim. Here, the government obtained distribution from the estate without ever filing a formal proof of claim. The Secretary is thus put in the precarious position of arguing that whereas the mere filing of a claim is sufficient to waive sovereign immunity, the actual receipt of payment on a claim not formally filed produces no such waiver.

We hold that the government's actions in enforcing post-petition payment were the functional equivalent of filing a claim and that they were sufficient to waive sovereign immunity under *11 U.S.C. § 106(a)*. To hold otherwise would enable the government to achieve by self-help what it could not accomplish through the procedures of the bankruptcy court, *i.e.*, retain its immunity while extracting payment from the estate. The government had a choice concerning whether to force distribution from T&C's assets, and it chose to do so by pursuing post-petition offsets. Congress made the consequences of this action clear in the final language of *section 106(a)*, and the government cannot now ask us to raise a shield [**20] of immunity between it and the estate.

B. *Informal Proof of Claim*

The BAP ruled alternatively that even if *section 106* does condition a waiver of sovereign immunity on the filing of a claim, the government nonetheless waived its immunity in this case by asserting an informal proof of claim. We have held that even though no document is filed with the bankruptcy court, an informal proof of claim may arise out of demands against the estate or out of correspondence between a creditor and the trustee or debtor-in- possession which demonstrate an intent on the part of the creditor to assert a claim against the bankruptcy estate. *See In re Anderson-Walker Indus., Inc., 798 F.2d 1285, 1287-88 (9th Cir. 1986)*. Relying on *Anderson-Walker,* the BAP stated:

We conclude that the defendants' affirmative actions after the bankruptcy filing, namely offsetting their claim against estate assets, and giving notice to the debtor of such offset, were the equivalent of asserting an informal proof of claim. Implicit in such actions was the assertion of a claim. The offsetting and notice accomplished more than a mere proof of claim, having actually effected collection of [**21] the asserted clam. Since the defendants' action was at least equivalent to the submission of an informal proof of claim, sovereign immunity would be deemed waived even if *§ 106(a)*

conditioned the waiver of sovereign immunity on the government's filing of a proof of claim.

112 Bankr. at 334.

The Secretary maintains that the informal proof of claim doctrine was misconstrued by the BAP and has no relevance to this case. Observing that the doctrine was developed as an equitable rule to mitigate the harsh consequences of failing to meet filing deadlines, the Secretary contends that the BAP turned the doctrine on its head and converted it into a trap for unwary creditors. The Secretary asserts that where a creditor subsequently does not pursue a bankruptcy court claim, any demand against the estate has no legal status and therefore does not invoke the court's jurisdiction. We disagree. The government cannot have it both ways: it cannot obtain post-petition payment from the estate through offsetting and still maintain immunity from suit by electing not to file a formal proof of claim. The Secretary would have us construe the doctrine so as to give the government the luxury [**22] of being able to assert an amendable informal proof [*1154] of claim, and then wait and see whether it would be more advantageous to file a formal claim and risk exposure to counterclaims or simply to take the money and run with its immunity intact. Such a holding would vitiate the purpose of *section 106(a)*, which is to prevent a governmental entity from obtaining distribution from the estate without subjecting itself to claims by the debtor arising out of the same transaction or occurrence.

C. *Exclusive Remedies*

With respect to T&C's state-law tort and contract claims arising out of the government's setoff of Medicare overpayments, the Secretary contends that these claims would be barred even if the government had waived sovereign immunity in bankruptcy court because T&C's failure to exhaust administrative remedies under the Medicare Act would have precluded T&C from asserting its state-law claims outside bankruptcy.

The Secretary observes that the Medicare Act bars review of claims arising thereunder until administrative procedures have been exhausted. *See 42 U.S.C. 405(h)* (made applicable to the Medicare Act by *42 U.S.C. § 1395ii*); *Daniel Freeman Mem. Hosp. v. Schweiker, 656 F.2d 473, 475-76 (9th Cir. 1981).* [**23] [4] The Secretary argues that no cognizable claim arising under the Medicare Act may be asserted except as a challenge to a final agency decision. The Secretary further contends that even if a tort claim not subject to this exhaustion requirement could be asserted with respect to Medicare reimbursement, such an action could be brought only under the FTCA. The FTCA defines the government's limited waiver of immunity for tort liability, and the remedies provided in the statute are exclusive. *See 28 U.S.C. § 1346(b).* The Secretary argues that in defining the limits of the government's tort liability, Congress established as a jurisdictional prerequisite that tort claims be presented to the appropriate federal agency before being raised in federal court. *28 U.S.C. § 2675(a).* The Secretary concludes that this threshold requirement of administrative exhaustion precludes T&C's claims.

4 *Section 405(h)* provides:

> The findings and decision of the Secretary after a hearing shall be binding upon all individuals who were parties to such hearing. No findings of fact or decision of the Secretary shall be reviewed by any person, tribunal, or governmental agency except as herein provided. No action against the United States, the Secretary, or any officer or employee thereof shall be brought under *section 1331* or *1346* of Title 28 to recover on any claim arising under this subchapter.

[**24] T&C, on the other hand, contends that the bankruptcy court had a separate and distinct basis for exercising jurisdiction because T&C's counterclaims related to property of the estate, *see 28 U.S.C. § 1334(b)*, and were within the jurisdiction of the bankruptcy court, *see 28 U.S.C. § 157(b).* As the BAP noted, the courts have divided on this question. Some have held that the exhaustion requirements of statutes such as the FTCA and the Medicare Act bar bankruptcy court review. *See, e.g, In re St. Mary's Hosp., 123 Bankr. 14, 16-18 (E.D. Pa. 1991)*; *In re Berger, 16 Bankr. 236, 237-38 (Bankr. S.D. Fla. 1981).* Other courts have held that bankruptcy jurisdiction is not precluded. *See, e.g., Ashbrook v. Block, 917 F.2d 918, 921-23 (6th Cir. 1990)* (holding that *section 106(a)* mandates an automatic waiver of sovereign immunity and thereby impliedly repeals the FTCA's exhaustion requirement); *In re Shelby County Healthcare Servs., 80 Bankr. 555, 559-61 (Bankr. N.D. Ga. 1987)* (Medicare Act); *In re Kenny, 75 Bankr. 515,*

521 (Bankr. E.D. Mich. 1987) (FTCA).

The BAP rejected the Secretary's arguments [**25] and found "the better reasoned position" to be that "where there is an independent basis for bankruptcy court jurisdiction, exhaustion of administrative remedies pursuant to other jurisdictional statutes is not required." *112 Bankr. at 334*. We agree.

The Secretary objects to the BAP's holding on the ground that T&C could not have obtained new remedies for Medicare claims simply by filing a bankruptcy petition. The Secretary claims that, in essence, the BAP created a novel rule that a Medicare-provider in bankruptcy acquires state-law [*1155] causes of action unavailable to providers who do not file bankruptcy petitions. The Secretary further argues that under the BAP's ruling T&C is not required to comply with the jurisdictional prerequisites of the FTCA, a result which the Secretary says vitiates Congress's intention to limit the government's tort liability. In this vein, the Secretary urges that a statute governing specific subject matter must trump a broad, general statute unless Congress has explicitly articulated a contrary intent. *See Crawford Fitting Co. v. J.T. Gibbons, Inc., 482 U.S. 437, 445, 96 L. Ed. 2d 385 , 107 S. Ct. 2494 (1987).*

Reasoning that the broad grants of jurisdiction [**26] found in *28 U.S.C. §§ 157* and *1334* give district courts and bankruptcy courts original and exclusive jurisdiction over actions related to bankruptcy for which they otherwise would not have jurisdiction, the BAP found *section 106(a)* to be an independent grant of jurisdiction to the bankruptcy court regardless of the applicability of other statutes. The BAP's conclusions are consistent with our prior decisions. In *Kaonohi Ohana, Ltd. v. Sutherland, 873 F.2d 1302 (9th Cir. 1989)*, we stated:

"The district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11," of the bankruptcy code. *28 U.S.C. § 1334(b)*. . . . "The usual articulation of the test for determining whether a civil proceeding is related to bankruptcy is whether *the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy*. . . . An action is related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon handling and administration [**27] of the bankrupt estate."

Id. at 1306 (quoting *Pacor, Inc. v. Higgins, 743 F.2d 984, 994 (3rd Cir. 1984))* (emphasis in original). The Secretary's argument - that the filing of a bankruptcy petition does not confer federal jurisdiction over claims for which there would otherwise be no jurisdiction - has already been rejected in this circuit.

The Secretary's argument based on *42 U.S.C. § 405(h)* is likewise unpersuasive. *Section 405(h)* only bars actions under *28 U.S.C. §§ 1331* and *1346*; it in no way prohibits an assertion of jurisdiction under *section 1334*. *See, e.g., Shelby County, 80 Bankr. at 560*. The rationale underlying *section 1334*'s broad jurisdictional grant over all matters conceivably having an effect on the bankruptcy estate is clear. This section allows a single court to preside over all of the affairs of the estate, which promotes a "congressionally-endorsed objective: the efficient and expeditious resolution of all matters connected to the bankruptcy estate." *In re Fietz, 852 F.2d 455, 457 (9th Cir. 1988)* (citing H.R. Rep. No. 595, 95th Cong., 1st Sess. 43-48, *reprinted in* 1978 U.S. Code [**28] Cong. & Admin. News 5963, 6004-08). The language of *section 1334(b)* grants jurisdiction to the district court, and therefore to the bankruptcy court, over civil proceedings related to bankruptcy and accords with "the intent of Congress to bring all bankruptcy-related litigation within the umbrella of the district court, at least as an initial matter, irrespective of congressional statements to the contrary in the context of other specialized litigation." 1 L. King, *Collier on Bankruptcy, Par. 3.01[1]*[c]ii, at 3-22 (15th ed. 1991).

In enacting *section 106*, Congress intended to effect "a limited change from the result that would prevail in the absence of bankruptcy." S. Rep. No. 989, 95th Cong., 2d Sess. 29, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5787, 5815. At the time of the Bankruptcy Code's passage, Congress was aware that its prior enactments, such as the FTCA, had already prescribed certain conditions for the government's waiver of sovereign immunity. The legislative history of *section 106* indicates that Congress meant to alter this landscape by subjecting the government to an automatic exposure to liability as the price of its participation in the distribution of [**29]

the bankruptcy estate. *See id*.

AFFIRMED

General Fact Pattern[1]

An alleged "investment company," which is in actuality a Ponzi scheme, winds up in bankruptcy and a trustee is appointed. The trustee of the debtor-investment company, as well as a representative of the class of investors who were sucked into and invested in the Ponzi scheme, sue the bank where the debtor's single account was maintained, contending that the bank is liable (to both parties) for aiding and abetting the fraud, and for negligence. (Of course, the trustee is also busily suing various other parties to "claw back" funds that were paid out over the course of the fraud)

You already know the other facts from cases like Madoff and others: investors gave the fraudster ("Fraudster") money and Fraudster – using an alleged proprietary investment strategy – "invested" the funds in securities and sent fake monthly statements to the investors. When investors wanted to redeem funds from their accounts, Fraudster used money in the bank that was "invested" by other and subsequent investors to pay redemptions. There was just one bank account, into which all "investments funds" were deposited and from which all "redemption checks" were drawn, and which of course also supplied the funds for Fraudster's high-end lifestyle. Not one actual bona fide investment was ever made. Eventually, the house of cards came crashing down, leaving investors holding an empty bag. Looking for sources of recovery from which to compensate innocent investors (some more innocent than others), the trustee and the investors have looked to the bank where the account was maintained, contending that the bank knew, or should have known, about the fraud, but turned a blind eye.

A. **AIDING AND ABETTING**

1. **Elements**:

   a. The existence of a fraud.

   b. The defendant's actual knowledge of the fraud.

   c. The defendant's substantial assistance of the fraud.

Lawrence v. Bank of Am., N.A., 455 Fed. App'x 904 (11th Cir. 2012); *Wight v. BankAmerica Corp*., 219 F.3d 79, 91 (2d Cir. 2000); *Zazzali v. Hirschler Fleischer, P.C.,* 2012 WL 3597411 (D. Del. Aug. 21, 2012); *Facciola v. Greenberg Traurig LLP*, 2012 WL 910379 (D. Ariz. Mar. 19, 2012); *Platinum Estates, Inc. v. TD Bank, N.A.*, 2012 WL 760791 (S.D. Fla. Mar. 8, 2012); *In re Refco Inc. Sec. Litig.*, 2012 WL 996910 (S.D.N.Y. Jan. 17, 2012); *Groom v. Bank of Am.*, 2012 WL 50250 (M.D. Fla. Jan. 9, 2012); *In re Optimal U.S. Litig.*, 837 F. Supp. 2d 244 (S.D.N.Y. 2011); *Coquina Invs. v. Rothstein*, 2011 WL 4971923 (S.D. Fla. Oct. 19, 2011); *Cohain v. Klimley*, 2011

1 This outline was adopted from the Joint Final Pretrial Statement ("JFPTS") in the case of *Tom Tough, Trustee and Jane Duped v. Bigbank, N.A. (In re Bilker Investment Services, LLC)*, pending in the U.S. Bankruptcy Court for the District of New Swindle. The *Bilker* materials (which include the JFPTS) were prepared by Kathy Bazoian Phelps (Diamond McCarthy LLP) and The Honorable Steven Rhodes (Bankr. E.D. Mich.), and were most recently presented by Kathy, Judge Rhodes, and their "cast of characters" (which included Judge Rhodes as . . . the presiding Judge) at the ABI Central States Conference in June, 2014, in Lake Geneva, Wisconsin. An infinite amount of thanks to Kathy for her permissions, as well as to Judge Rhodes and the other *Bilker* cast members. You are highly encouraged to purchase The Ponzi Book: A Legal Resource for Unraveling Ponzi Schemes, authored by Kathy and Judge Rhodes, which is an "all you need to know" about Ponzi schemes. The Ponzi Book is available at www.theponzibook.com, where you can also read the Ponzi blog maintained by Kathy.

WL 3896095 (S.D.N.Y. Aug. 31, 2011); *de Abreu v. Bank of Am. Corp.*, 812 F. Supp. 2d 316 (S.D.N.Y. 2011); *Burns v. Del. Charter Guarantee & Trust Co.*, 805 F. Supp. 2d 12 (S.D.N.Y. 2011); *In re Agape Litig.*, 773 F. Supp. 2d 298 (E.D.N.Y. 2011); *Berman v. Morgan Keegan & Co., Inc.*, 2011 WL 1002683 (S.D.N.Y. Mar. 14, 2011).

2. **Constructive knowledge of the fraud is insufficient to establish the actual knowledge element.**

Platinum Estates, Inc. v. TD Bank, N.A., 2012 WL 760791 (S.D. Fla. Mar. 8, 2012); *In re Refco Inc. Sec. Litig.*, 2012 WL 996910 (S.D.N.Y. Jan. 17, 2012); *Groom v. Bank of Am.*, 2012 WL 50250 (M.D. Fla. Jan. 9, 2012); *In re Optimal U.S. Litig.*, 837 F. Supp. 2d 244 (S.D.N.Y. 2011); *de Abreu v. Bank of Am. Corp.*, 812 F. Supp. 2d 316 (S.D.N.Y. 2011); *Berman v. Morgan Keegan & Co., Inc.*, 2011 WL 1002683 (S.D.N.Y. Mar. 14, 2011).

3. **Recklessness or willful blindness is also insufficient to establish the actual knowledge element.**

In re Agape Litig., 773 F. Supp. 2d 298 (E.D.N.Y. 2011); *Pension Comm. of Univ. of Montreal Pension Plan v. Banc of Am. Sec., LLC*, 446 F. Supp. 2d 163, 202 n.279 (S.D.N.Y. 2006).

4. **Actual knowledge may be proven by circumstantial evidence.**

Aetna Cas. & Sur. Co. v. Leahey Constr. Co., 219 F.3d 519, 536-37 (6th Cir. 2000); *In re Nat'l Century Fin. Enters., Inc., Inv. Litig.*, 580 F. Supp. 2d 630 (S.D. Ohio 2008); *In re Enron Corp. Sec., Derivative & "ERISA" Litig.*, 540 F. Supp. 2d 800 (S.D. Tex. 2007); *Gonzales v. Lloyds TSB Bank, PLC*, 532 F. Supp. 2d 1200 (C.D. Cal. 2006).

5. **Substantial assistance may only be found where the alleged aider and abettor affirmatively assists, helps conceal or fails to act when required to do so, thereby enabling the fraud to occur.**

Sharp Int'l Corp. v. State St. Bank & Trust Co. (*In re Sharp Int'l Corp.*), 403 F.3d 43, 50 (2d Cir. 2005); *In re Optimal U.S. Litig.*, 837 F. Supp. 2d 244 (S.D.N.Y. 2011); *In re Agape Litig.*, 773 F. Supp. 2d 298 (E.D.N.Y. 2011); *Berman v. Morgan Keegan & Co., Inc.*, 2011 WL 1002683 (S.D.N.Y. Mar. 14, 2011).

6. **The plaintiffs must also prove that the actions of the defendant proximately caused their harm; "but for" causation is insufficient.**

Aetna Cas. & Sur. Co. v. Leahey Constr. Co., 219 F.3d 519, 536-37 (6th Cir. 2000); *In re Optimal U.S. Litig.*, 837 F. Supp. 2d 244 (S.D.N.Y. 2011); *Cromer Fin. Ltd. v. Berger*, 137 F. Supp. 2d 452, 471 (S.D.N.Y. 2001).

B. NEGLIGENCE

1. **<u>Elements:</u>**

   a. A duty recognized by law, requiring the actor to conform to a certain standard of conduct for protection of others against unreasonable risks;

   b. Failure to conform to the standard required;

   c. A causal connection between the conduct and resulting injury; and

   d. Actual loss or damage resulting to interests of another.

Chaney v. Dreyfus Serv. Corp., 595 F.3d 219, 229-30 (5th Cir. 2010); *Bouriez v. Carnegie Mellon Univ.*, 585 F.3d 765, 771 (3d Cir. 2009); *Lerner v. Fleet Bank, N.A.*, 459 F.3d 273, 286-87 (2d Cir. 2006); *Short v. Conn. Comm. Bank, N.A.*, 2012 WL 1057302 (D. Conn. Mar. 28, 2012); *Picard v. Madoff* (*In re Bernard L. Madoff Inv. Sec. LLC*), 458 B.R. 87 (Bankr. S.D.N.Y. 2011); *Burns v. Del. Charter Guarantee & Trust Co.*, 805 F. Supp. 2d 12 (S.D.N.Y. 2011); *Agile Safety Variable Fund, L.P. v. RBS Citizens, N.A.*, 793 F. Supp. 2d 1248 (D. Colo. 2011); *Grund v. Del. Charter Guarantee & Trust Co.*, 788 F. Supp. 2d 226 (S.D.N.Y. 2011); *Mandelbaum v. Fiserv, Inc.*, 787 F. Supp. 2d 1226 (D. Colo. 2011); *Haase v. GunnAllen Fin., Inc.*, 2011 WL 768045 (E.D. Mich. Feb. 28, 2011).

C. LEGAL ISSUES

1. **<u>Can ordinary banking services constitute "substantial assistance" on a claim of aiding and abetting fraud?</u>**

Yes: Henry v. Lehman Commercial Paper, Inc. (*In re First Alliance Mortg. Co.*), 471 F.3d 977, 994-95 (9th Cir. 2006); *El Camino Resources, LTD. v. Huntington Nat'l Bank*, 722 F. Supp. 2d 875 (W.D. Mich. 2010); *Benson v. JPMorgan Chase Bank, N.A.*, 2010 WL 1526394 (N.D. Cal. Apr. 15, 2010); *Neilson v. Union Bank of Cal., N.A.*, 290 F. Supp. 2d 1101, 1109, 1129-32 (C.D. Cal. 2003); *Lawyers Title Ins. Corp. v. United Am. Bank of Memphis*, 21 F. Supp. 2d 785, 798-800 (W.D. Tenn. 1998).

No: de Abreu v. Bank of Am. Corp., 525 F. Supp. 2d 381, 390 (S.D.N.Y. 2007).

2. **<u>Do the circumstances warrant an award of punitive damages?</u>**

Yes: [No case law found]

No: [No case law found]

3. **<u>Did The Bank Owe Duties to the Members of the Investor Class?</u>**

Yes: McLemore v. Regions Bank, 682 F.3d 414, 425 (6th Cir. 2012)*; Neilson v. Union Bank of Cal., N.A.*, 290 F. Supp. 2d 1101, 1143 (C.D. Cal. 2003); *Short v. Conn. Community Bank, N.A.*, 2012 WL 1057302 (D. Conn. Mar. 28, 2012); *Levinson v. PSCC Services, Inc.*, 2010 WL 5477250 (D. Conn. Dec. 29, 2010).

No: Lerner v. Fleet Bank, N.A., 459 F.3d 273, 286 (2d Cir. 2006); *Conder v. Union Planters Bank, N.A.*, 384 F.3d 397 (7th Cir. 2004); *Eisenberg v. Wachovia, N.A.*, 301 F.3d 220, 226 (4th Cir. 2002); *MSMLK Inv. Co. v. JPMorgan Chase & Co.*, 431 Fed. App'x 17, 20 (2d Cir. 2011); *Ballard v. Royal Trust Bank*, 202 F.3d 277 (9th Cir. 1999); *Brooks v. Bank of Boulder*, 891 F. Supp. 1469 (D. Colo. 1995).

4. **Did The Bank Owe Duties to the Debtor?**

Yes: Wells v. Stone City Bank, 691 N.E.2d 1246 (Ind. App. 1998).

No: O'Halloran v. First Union Nat. Bank of Fla., 322 Fed. App'x 900 (11th Cir. 2009); *SIPC v. Capital City Bank* (*In re Meridian Asset Mgmt. Inc.*), 296 B.R. 243 (Bankr. N. D. Fla. 2003)

5. **Are the Trustee's Claims Subject to *In Pari Delicto*?**

See generally Phelps and Rhodes, *The Ponzi Book: A Legal Resource for Unraveling Ponzi Schemes* § 14.04 (LexisNexis 2012); *see also* Phelps and Williams, *The Depths of Deepening Insolvency: Damage Exposure for Officers, Directors and Others* § 10.03 (American Bankruptcy Institute 2013).

Yes: Peterson v. McGladrey & Pullen, LLP, 676 F.3d 594 (7th Cir. 2012); *Mosier v. Callister, Nebeker & McCullogh*, 546 F.3d 1271, 1276 (10th Cir. 2008); *Official Committee of Unsecured Creditors of PSA, Inc. v. Edwards*, 437 F.3d 1145, 1152 (11th Cir. 2006); *Official Committee of Unsecured Creditors v. R.F. Lafferty & Co.*, 267 F.3d 340, 357 (3d Cir. 2001); *In re Hedged–Invs. Assocs., Inc.*, 84 F.3d 1281, 1285 (10th Cir. 1996).

No: Goldstein v. FDIC, 2012 U.S. Dist. LEXIS 68491 (D. Md. May 16, 2012); *Anderson v. Cordell* (*In re Infinity Bus. Grp., Inc.*), 497 B.R. 794 (D.S.C. 2013); Jeffrey Davis, *Ending the Nonsense: The In Pari Delicto Doctrine Has Nothing to Do with What is § 541 Property of the Bankruptcy Estate*, 21 Emory Bankr. Dev. J. 519 (2005); Risa Lynn Wolf-Smith, *Innocent Trustee/Creditors Barred by Debtors' Past Wrongs: It Just Ain't Right*, 26 Am. Bankr. Inst. J., No. 2, at 42 (Apr. 2007); William McGrane, *The Erroneous Application of the Defense of In Pari Delicto to Bankruptcy Trustees*, 29 Cal. Bankr. J. 275 (2007); Gerald L. Baldwin, *In pari delicto Should Not Bar a Trustee's Recovery*, 23 Am. Bankr. Inst. J. 8 (Oct. 2004); Tanvir Alam, *Fraudulent Advisors Exploit Confusion in the Bankruptcy Code: How In Pari Delicto Has Been Perverted to Prevent Recovery for Innocent Creditors*, 77 Am. Bankr. L.J. 305 (Summer 2003).

6. **Does the adverse interest exception apply to bar the *in pari delicto* defense and thereby allow the trustee's claim?**

See Phelps and Rhodes, *The Ponzi Book: A Legal Resource for Unraveling Ponzi Schemes* § 14.07[3] (LexisNexis 2012); *see also* Phelps and Williams, *The Depths of Deepening Insolvency: Damage Exposure for Officers, Directors and Others* § 10.04[2] (American Bankruptcy Institute 2013).

Yes: Bankr. Servs., Inc. v. Ernst & Young (*In re CBI Holding Co.*), 529 F.3d 432, 448 (2d Cir. 2008); *Thabault v. Chait*, 541 F.3d 512, 528-29 (3d Cir. 2008); *Liquidation Comm'n of Banco Intercontinental, S.A. v. Renta*, 530 F.3d 1339, 1354-55 (11th Cir. 2008); *Bechtle v. Master, Sidlow & Associates, P.A.*, 766 F. Supp. 2d 547, 554-55 (E.D. Pa. 2011); *Anderson v. Cordell* (*In re Infinity Bus. Grp., Inc.*), 497 B.R. 794 (D.S.C. 2013).

No: Mosier v. Callister, Nebeker & McCullough, 546 F.3d 1271 (10th Cir. 2008); *Cobalt Multifamily Investors I, LLC v. Shapiro*, 2012 WL 762129 (S.D.N.Y. Mar. 7, 2012); *Kirschner v. Grant Thornton LLP*, 15 N.Y.3d 446, 912 N.Y.S.2d 508, 938 N.E.2d 941 (2010); *Silverman v. Meister Seelig & Fein, LLP* (*In re Agape World, Inc.*), 467 B.R. 556 (Bankr. E.D.N.Y. 2012); *In re Nat'l Century Fin. Enters., Inc.*, 783 F. Supp. 2d 1003 (S.D. Ohio 2011).

7. **Does the adverse interest exception require**

The agent's total abandonment of the entity's interests, such that any benefit to the entity defeats the adverse interest exception?

Or

The agent's subjective intent to benefit only himself, such that any intent to benefit the entity defeats the adverse interest exception?

Or

No short term benefit to the entity, so that any short term benefit defeats the adverse interest exception?

See Phelps and Rhodes, *The Ponzi Book: A Legal Resource for Unraveling Ponzi Schemes* § 14.07[3] (LexisNexis 2012); *see also* Phelps and Williams, *The Depths of Deepening Insolvency: Damage Exposure for Officers, Directors and Others* § 10.03 (American Bankruptcy Institute 2013).

Total abandonment is required:

Kirschner v. KPMG LLP, 938 N.E.2d 941, 952 (N.Y. 2010); *Breeden v. Kirkpatrick & Lockhart LLP* (*In re Bennett Funding Grp., Inc.*), 336 F.3d 94, 100 (2d Cir. 2003); *Thabault v. Chait*, 541 F.3d 512, 527 (3d Cir. 2008); *Cobalt Multifamily Investors I, LLC v. Arden*, 2011 U.S. Dist. LEXIS 117097, at *32 (S.D.N.Y. Sept. 9, 2011), *Mag. report and recommendation adopted*, 2011 U.S. Dist. LEXIS 112296 (S.D.N.Y. Sept. 30, 2011); *Cobalt Multifamily Investors I, LLC v. Shapiro*, 2011 U.S. Dist. LEXIS 119346, at *37-38 (S.D.N.Y. Sept. 9, 2011); *USACM Liquidating Trust v. Deloitte & Touche LLP*, 764 F. Supp. 2d 1210, 1218-19 (D. Nev. 2011); *Allard v. Arthur Andersen & Co.*, 924 F. Supp. 488, 495 (S.D.N.Y. 1996); *Official Comm. of Unsecured Creditors of Grumman Olson Indus., Inc. v. McConnell* (*In re Grumman Olson Indus., Inc.*), 329 B.R. 411, 426 (Bankr. S.D.N.Y. 2005); *NCP Litig. Trust v. KPMG*, 945 A.2d 132, 147 (N.J. Super. Ct. Law Div. 2007); *Bondi v. Bank of Am. Corp.* (*In re Parlamat Sec. Litig.*), 383 F. Supp. 2d 587, 599 (S.D.N.Y. 2005); *Beck v. Deloitte & Touche*, 144 F.3d 732,

737 (11th Cir. 1998).

<u>Agent's subjective intent to benefit only himself is required</u>:

In re CBI Holding Co., 529 F.3d 432, 448 (2d Cir. 2008); *Cobalt Multifamily Investors I, LLC v. Shapiro*, 2009 U.S. Dist. LEXIS 60481, at *16 (S.D.N.Y. July 15, 2009); *Grede v. McGladrey & Pullen*, 421 B.R. 879, 886 (N.D. Ill. 2009).

<u>Short term benefit defeats the adverse interest exception</u>:

Cobalt Multifamily Investors I, LLC v. Shapiro, 2011 U.S. Dist. LEXIS 119346, at *343 (S.D.N.Y. Sept. 9, 2011); *Beck v. Deloitte & Touche*, 144 F.3d 732, 736 (11th Cir. 1998); *Kirschner v. Grant Thornton, LLP*, 2009 U.S. Dist. LEXIS 32581, at *21 (S.D.N.Y. Apr. 14, 2009).

<u>Short term benefit does not defeat the adverse interest exception</u>:

CBI Holding Co., 529 F.3d 432, 453 (2d Cir. 2008); *Christians v. Grant Thornton, LLP*, 733 N.W.2d 803, 810 (Minn. Ct. App. 2007); *Grede v. McGladrey & Pullen LLP*, 421 B.R. 879, 888 (N.D. Ill. 2009); *Oppenheimer-Palmieri Fund, L.P. v. Peat Marwick Main & Co.* (*In re Crazy Eddie Sec. Litig.*), 802 F. Supp. 804, 817-18 (E.D.N.Y. 1992).

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ABI Health Care Insolvency Manual Ch. 10

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Current through Third Edition 2012
Ch. 10 The Interplay between Medicare and Medicaid and Bankruptcy

***191** Ch. 10 The Interplay between Medicare and Medicaid and Bankruptcy

1. Introduction

Extensive regulations govern the Medicare and Medicaid programs.[446] Given these regulations' pervasive nature, they invariably collide with bankruptcy law when health care providers enter bankruptcy.[447] Since a substantial proportion of health care providers' revenues derive from Medicare and Medicaid,[448] the resolution of conflicts between Medicare, Medicaid and bankruptcy is of particular importance to health care providers in bankruptcy.

2. Recoupment and Setoff

As described in Chapter 9 of this *Manual*, the Center for Medicare and Medicaid Services (hereinafter "CMS") is the division of the Department for Health and Human Services (hereinafter "HHS") charged with Medicare and Medicaid administration.[449] Medicare, CMS and health care providers enter into provider agreements, which govern the provider's participation in the program. CMS contracts with private insurance companies, known as fiscal intermediaries, to facilitate reimbursements to health care providers.[450] The fiscal intermediaries distribute reimbursements to providers in interim ***192** amounts each year that are based on the estimated cost of providing care for Medicare beneficiaries.[451] At the conclusion of each fiscal year, providers submit a cost report to the fiscal intermediary,[452] and the intermediary reconciles the actual costs incurred by the provider against the estimated costs already paid.[453] When the estimated cost payments are less than the costs actually incurred, the government pays the provider the difference.[454] However, if the payments exceed actual costs, the fiscal intermediary has the right to withhold reimbursements from future estimated payments to offset the past overpayments.[455] Medicaid reimbursements are often similarly governed under state law through provider agreements that provide for estimated payments followed by an annual reconciliation.[456]

The government's right to recover overpayments is an important concern for most health care providers that enter bankruptcy. An unrestricted right to recover overpayments could have a devastating effect on the provider's ongoing operations and its feasibility of reorganizing, as providers' revenues are often dependent on continuing reimbursements.[457]

The government has two distinct means to recover overpayments made to providers in bankruptcy: setoff and recoupment. Setoff is a right to offset debt owed to another party by claims against that party.[458] Subject to some limitations established by § 553 of the Bankruptcy Code, a creditor may assert a right to setoff when both the claim and the debt arose before the commencement of the bankruptcy case, and the claim and the debt are mutual obligations that are valid and enforceable.[459] Under ***193** § 506(a) of the Bankruptcy Code, a creditor with a setoff right is treated as a secured creditor to the extent of the

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offset.[460] However, under § 362(a)(7) of the Bankruptcy Code, a creditor exercising its setoff rights in bankruptcy violates the automatic stay, unless the court first grants the creditor relief from the stay.[461]

In contrast to setoff, recoupment does not rely on the existence of two independent obligations. Instead, it is the equitable right to reduce the amount of a claim or debt.[462] By definition, recoupment may arise only out of the "same transaction or occurrence that gives rise to the liability sought to be reduced."[463] Although the courts are split, the majority view is that the automatic stay does not prevent a party from exercising a right to recoupment because recoupment merely calculates the amount of the obligation rather than enforcing a separate debt.[464] The majority view reasons that funds subject to recoupment are not property of the debtor's estate since the debtor was not entitled to them originally; consequently, the automatic stay does not prevent the recovery of these funds through recoupment.[465] Additionally, unlike setoff, the initial obligation and the later right to reduce that obligation need not both arise before the commencement of the bankruptcy case.[466]

Given that the Bankruptcy Code statutorily restrains setoff, the government favors recoupment when attempting to recover Medicare or Medicaid overpayments from providers.[467] However, in order for recoupment to apply, the initial reimbursement based on estimated costs must be part of the ***194** "same transaction or occurrence" as the later offset based on the actual costs incurred by the provider. Courts have been inconsistent in this determination.

Three lines of cases have emerged regarding the scope and validity of the government's right to recoup overpayments of Medicare and Medicaid from a provider in bankruptcy. The divergence among the courts largely stems from how narrowly "same transaction or occurrence" is interpreted.

In *University Medical Center v. Sullivan*, the Third Circuit concluded that under the provider agreement, each cost year is a separate transaction or occurrence.[468] The court reasoned that for recoupment purposes, whether two claims arise from the same transaction requires more than a "mere logical relation." "Rather, both debts must arise out of a *single integrated transaction* so that it would be inequitable for the debtor to enjoy the benefits of that transaction without also meeting its obligations."[469] Upon examining the provider agreement, the court found that each cost year was an independent transaction, as each "transaction begins with services rendered by the provider..., includes payment to the provider, and concludes with HHS's recovery of any overpayment."[470] Under this rule, the government can only recoup by denying payment for post-petition services up to the end of the cost year that the bankruptcy petition was filed and only for overpayments occurring within that cost year.[471] Recovery of overpayments from previous cost years is treated as an exercise of setoff rather than recoupment, and therefore, as a violation of the automatic stay.[472] Several courts have followed the *University Medical Center* approach by defining the "same transaction" narrowly as a "single integrated transaction" and limiting Medicare or Medicaid recoupment to single cost years.[473]

***195** A minority of courts have defined "same transaction" even more narrowly than the *University Medical. Center* approach by ruling that each time services are provided, invoiced and reimbursed, it is considered a separate transaction for recoupment purposes. In *Medicar Ambulance Co. Inc. v. Shalala,* the court reasoned that the "same transaction and occurrence requirement is not met simply because both claims arise under a single contract or relationship involving a series of distinct transactions. The same transaction requirement is met only if both claims are based on exactly the same deal between parties."[474] While several courts have agreed with this narrow interpretation, these decisions have little precedential value because they were abrogated when the Ninth Circuit Court of Appeals adopted the "logical relation" test in *Sims v. U.S. Department of Health and Human Services (In re TLC Hospital Inc.)*,[475] which is the dominant trend as described below.

Instead, the predominant view among federal circuit courts is to reject the *University Medical Center* holding and to allow the government to recoup overpayments from previous cost years by withholding the current year's reimbursements. In *United States v. Consumer Health Services of America Inc.*, the District of Columbia Court of Appeals held that the frequency of the

audit does not appropriately define the scope of the transaction.[476] A provider's "stream of services [is] to be considered one transaction for the purposes of any claim that the government would have against the provider."[477] Although the court purported to apply the stricter "single integrated transaction" test for ***196** determining whether the claims were part of the "same transaction," commentators interpret this decision as a more liberal application of the "same transaction" requirement compared to *University Medical Center*.[478] A substantial number of other courts have adopted the *Consumer Health* approach,[479] including the First and Ninth Circuit Courts of Appeals.[480] For example, in *In re TLC Hospital Inc*., the Ninth Circuit concurred with *Consumer Health*'s holding, reasoning that the estimated payments and later adjustments were part of the "same transaction" for recoupment purposes under the more liberal "logical relation" test.[481] The logical relationship test defines "same transaction" in a more flexible manner compared to the "single integrated transaction" approach. The "same transaction" under the logical relationship test "may comprehend a series of many occurrences, depending not so much upon the immediateness of their connection as upon their *logical relationship*."[482] Following this approach, the government may recoup Medicare or Medicaid overpayments to providers from any cost year against any and all subsequent payments, including reimbursements for future services. *Consumer Health*'s approach now appears to be the majority view.[483]

197** ***3. Attempts to Limit the Government's Right of Recoupment

Under the majority approach, the government has unparalleled power to recoup overpayments of past Medicare and Medicaid reimbursements from health care providers in bankruptcy. When the government exercises its right to recoupment, it reduces the provider's current revenues to offset previous overpayments.[484] Given that Medicare and Medicaid reimbursements represent a material portion of most health care providers' revenues,[485] health care providers in Chapter 11 depend on continued reimbursements during the proceedings in order to continue operating in the ordinary course of business and to successfully reorganize. Thus, while the government's right to recoup overpayments may be well settled in the majority of courts, health care providers in bankruptcy have a significant incentive to prevent the government from actually exercising that right.

a. Equitable Balancing

One possible strategy to limit HHS's right to recoupment is for the provider to argue that, under the circumstances, recoupment is inequitable under § 105 of the Bankruptcy Code. Section 105(a) of the Bankruptcy Code vests the bankruptcy court with the power to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" that govern bankruptcy law.[486] Since recoupment is an equitable common law doctrine rather than a statutory right, it is arguably subject to the bankruptcy court's equitable powers.[487]

Several courts have balanced the right to recoupment against the resulting harm to the debtor in the context of the government attempting to recoup unemployment benefit overpayments.[488] For example, the court in *In re* ***198** *Malinowski* prohibited the state unemployment agency from recouping past overpayments against the debtors because unemployment acted as a "safety net" for the debtor and the concern for the debtor's welfare outweighed the government's right to recoup.[489]

Similarly, a health care provider in bankruptcy could argue that the court should consider the resulting harm before permitting the government to recoup Medicare or Medicaid overpayments. The preferential nature of recoupment is already contrary to the bankruptcy law's policies favoring debtor rehabilitation and equal treatment among creditors.[490] The government's ability to recoup the entire value of its claim against the debtor without having to first seek relief from the automatic stay operates to prefer one creditor over every other creditor. Moreover, as suggested previously, recoupment may also endanger a health care provider's reorganization. If the court followed an equitable balancing approach, as seen in the unemployment benefit overpayment cases,[491] the court could deny recoupment where it would devastate the debtor's ability to rehabilitate and the provider continues to service Medicare and Medicaid patients.

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In *In re Holyoke Nursing Home Inc*. and *In re Slater Health Center Inc*., the First Circuit Court of Appeals explicitly rejected equitable balancing in the context of recoupment for Medicare and Medicaid overpayments.[492] These courts reasoned that "Congress intended...for the payment adjustment system to operate as one continuous stream including adjustments for 'overpayments"' and that "[e]quitable powers should not be used to interfere with this congressional policy choice."[493] However, whether the right to recoup should be balanced against the resulting harm upon the health care debtor and its estate is uncertain in other circuits.

***199 b. Are Overpayments Dischargeable in Bankruptcy?**

Another possible method to prevent the government from recouping Medicare and Medicaid overpayments is through the bankruptcy discharge. Upon confirmation of a Chapter 11 plan of reorganization, the court issues an order that releases all dischargeable debts.[494] Section 524 of the Bankruptcy Code enjoins creditors from pursuing discharged pre-petition debts.[495] In order to be enjoined, the creditor must hold a "debt," which is defined by the Bankruptcy Code as "liability on a claim."[496] "Claim," in turn, is broadly defined under § 101(5) of the Bankruptcy Code as a "right to payment" or "right to equitable remedy for breach of performance if such breach gives rise to a right to payment."[497] Thus, the government may be prevented from recovering Medicare and Medicaid overpayments if the right to recoupment is defined as a claim and the government fails to file a proof of claim after receiving adequate notice of the bankruptcy proceedings.

The bankruptcy courts have jurisdiction to determine whether overpayments of Medicare and Medicaid are dischargeable in bankruptcy.[498] Several courts have found that the right to recoupment is a claim, and is therefore dischargeable in bankruptcy.[499] For example, in finding that overpayments of Medicaid reimbursements were claims, the Southern District of New York emphasized that recoupment represented an underlying right to payment, which fits squarely within the broad definition of claim.[500] In jurisdictions that recognize recoupment as a claim, a health care provider could shield itself from post-discharge recoupment of Medicare or Medicaid overpayments if the government received adequate notice of the bankruptcy but failed to file a proof of claim.

***200** However, other courts have characterized recoupment as an equitable defense rather than an affirmative right to payment. Consequently, these courts find that the right to recoupment is nondischargeable because it is not a claim within the definition of § 101(5) of the Bankruptcy Code.[501]

Furthermore, this tactic is limited even in courts that permit discharge of overpayments. Only health care providers that confirm a Chapter 11 plan of reorganization receive a discharge.[502] Health care providers in Chapter 7 do not receive a discharge because only individual debtors are entitled to one.[503] Additionally, the discharge will only affect the government's right to recoup if it fails to file a timely proof of claim for the overpayments or exercise its right to recoup the overpayments prior to confirmation.

c. Anti-Discrimination under § 525 of the Bankruptcy Code

Health care providers have argued that the government withholding post-petition reimbursements to recoup pre-petition overpayments violates § 525 of the Bankruptcy Code,[504] which prohibits government discrimination against debtors. Specifically, § 525(a) mandates that:

a governmental unit may not deny, revoke, suspend, or refuse to renew a license, permit, charter, franchise, or other similar grant, condition such a grant to, discriminate with respect to such a grant against...[a debtor] solely because such...debtor is or has been a debtor under this title..., has been insolvent before the commencement of the case under this title, or during the

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case but before the debtor is granted or denied a discharge, ***201** or has not paid a debt that is dischargeable in the case under this title.[505]

In order to prove that the government's recoupment violates this anti-discrimination provision, the provider must show that Medicare and Medicaid reimbursements, and the underlying Provider Agreements, are government licenses or grants, and that the government's exercise of recoupment is done "solely because" of the provider's bankruptcy, insolvency or failure to pay discharged debt.

Some courts have found that Medicare and Medicaid recoupment falls within the purview of § 525 of the Bankruptcy Code.[506] For example, the court in *In re St. Mary Hospital* reasoned that while provider agreements may be characterized as executory contracts, the assumption of which requires payment or "cure" of pre-petition arrears and defaults, "the public policy of § 525(a) of the Bankruptcy Code overrides" the policy considerations of executory contracts.[507] Section 525 of the Bankruptcy Code prohibits governmental units from collecting pre-petition debts to ensure the debtor a fresh start.[508] Similarly, other courts have found that provider agreements are licenses or "other such grants" rather than executory contracts, given that their primary purpose is to ensure government-provided health care.[509] However, some courts refuse to characterize provider agreements as grants or licenses, and therefore find that adverse government actions under provider agreements do not constitute discrimination under § 525(a) of the Bankruptcy Code.[510]

***202** Where provider agreements are found to be within the scope of § 525(a) of the Bankruptcy Code, the government conditioning its continued performance under the agreement upon recoupment of pre-petition overpayments could violate the anti-discrimination provision. But the health care provider must still prove that the government's actions are done "solely because" of the bankruptcy or failure to pay dischargeable debt. When courts have found that the government's exercise of recoupment violates § 525(a) of the Bankruptcy Code, they generally reason that Medicare and Medicaid overpayments are dischargeable debts and that the government's demand for the overpayment is done on account of the provider's failure to pay those dischargeable debts.[511]

Additionally, § 525(a) of the Bankruptcy Code has been utilized to prevent the government from barring a provider who is or was in bankruptcy from Medicare or Medicaid participation.[512] For example, the government's attempts to exclude a provider have been held to violate § 525(a) of the Bankruptcy Code when done because of the provider's failure to pay pre-petition debt.[513] However, whether the government's decision to exclude a provider violates the anti-discrimination provision must be considered in light of the enactment of § 362(b)(28) of the Bankruptcy Code in 2005, which explicitly recognizes that HHS may exclude a debtor from participation in a federal health care program without having to seek relief from the automatic stay.[514] While § 362(b)(28) of the Bankruptcy Code did little to change prior existing law, as earlier case law allowed HHS to bar providers without violating the automatic stay in most situations based on an assertion of "police or regulatory powers,"[515] the provision suggests congressional intent to vest HHS with ***203** significant discretion over whether a provider should be excluded from the programs. Courts may be reluctant to find that HHS violated § 525(a) of the Bankruptcy Code when Congress has authorized HHS to wield significant power and discretion over eligibility to participate in Medicare or Medicaid.[516]

4. Jurisdiction of Bankruptcy Court versus Exhaustion of Administrative Remedies

The expeditious resolution of disputes is a primary goal in bankruptcy.[517] Since Medicare and Medicaid reimbursements comprise a material portion of many health care providers' revenues,[518] swift resolution of conflicts between the government and debtors is often essential to a debtor's survival and thus successful reorganization. The speed at which these conflicts are resolved largely depends on what forum has jurisdiction over the dispute. While vesting the bankruptcy court with the authority

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to decide these issues would ensure the quickest resolution, a number of courts have ruled that health care providers must exhaust administrative remedies for issues arising under Medicare law before the bankruptcy court has jurisdiction.[519]

Medicare has an extensive administrative process. First, at the close of each cost year, the provider must submit a cost report to the fiscal intermediary that details costs incurred that are attributable to Medicare.[520] The fiscal intermediary reviews and issues a Notice of Program Reimbursement (NPR) that determines the actual costs reimbursable to the provider, which is ***204** reconciled with the payments made based on estimated costs.[521] Next, the provider is entitled to an appeal and hearing before the Provider Reimbursement Review Board (PRRB).[522] After the PRRB issues a decision, the Secretary of HHS may reverse, affirm or modify the decision.[523] A federal district court may assert subject-matter jurisdiction over Medicare reimbursement disputes only after the provider has gone through these administrative steps.[524]

Given the need for prompt resolution of disputes within bankruptcy, a health care provider in bankruptcy presumably wants to avoid this extensive administrative process. Additionally, a debtor may prefer an impartial bankruptcy judge making determinations rather than the administrative process, since the fiscal intermediary represents the Medicare system, the Secretary of HHS appoints the members of the PRRB,[525] and the Secretary of HHS can overrule the PRRB decisions on its own motion.[526] Furthermore, a federal court reviewing a decision of the PRRB or the Secretary of HHS must accord the administrative decision substantial deference.[527] Federal courts apply an "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" standard of review to administrative decisions regarding Medicare.[528]

Whether a bankruptcy court may assert jurisdiction over a Medicare dispute before the provider first exhausts administrative remedies is a contentious issue. Section 405(h) of Title 28 of the U.S. Code, which is made applicable to Medicare via 42 U.S.C. § 1395ii, mandates that "[n]o action against the United States, the Commissioner of Social Security, or any officer or employee thereof shall be brought under section *1331* or *1346 of Title 28* to recover on any claim arising under this subchapter."[529] This provision bars providers from bringing civil suits in federal court against Medicare under these specific grants of subject-matter jurisdiction without first exhausting ***205** administrative remedies. Section 1334 of Title 28 of the U.S. Code, rather than §§ 1331 (federal question jurisdiction) or 1346 (actions against the U.S.), confers the district court with original and exclusive subject-matter jurisdiction over a bankruptcy case.[530]

Despite the fact that the plain language of Section 405(h) of Title 42 of the U.S. Code fails to include 28 U.S.C. § 1334 in the list of jurisdictional statutes barred from use without exhaustion of remedies, the majority view is that providers must still exhaust administrative remedies before a bankruptcy court can exert jurisdiction over a dispute arising under Medicare.[531] These courts reason that based on legislative history, Congress intended Section 405(h) of Title 42 of the U.S. Code to require exhaustion of remedies under Medicare for all types of jurisdictions and that the exclusion of § 1334 is the result of a "scrivener's error."[532] Specifically, prior to an amendment, § 405(h) of Title 42 of the U.S. Code barred all actions pursuant to "28 U.S.C. § 41," which conferred subject-matter jurisdiction on all types of actions in federal court, including bankruptcy jurisdiction under § 41(19).[533] In 1984, Congress amended the jurisdiction statutes; Congress altered § 405(h) by deleting "28 U.S.C. § 41" and replacing it with "section 1331 or 1346 of Title 28." However, Congress cautioned courts not to interpret these amendments as substantive changes: "[N]one of such amendments shall be construed as or affecting any right, liability, status, or interpretation which existed (under the provisions of law involved) before."[534] These courts conclude that since Congress intended to keep jurisdiction substantively the same, § 1334' s omission in § 405(h) was an error.[535] Furthermore, broadly interpreting § 405(h) as ***206** requiring exhaustion of remedies acknowledges congressional intent to defer to HHS's expertise in Medicare.[536] Courts have used the same reasoning to find that parties must exhaust administrative remedies before bringing a diversity action under § 1332 of Title 28, which is also not explicitly mentioned in § 405(h).[537] The U.S. Supreme Court's decision in *Stern*

v. Marshall may add further support to a bankruptcy court's limited jurisdiction to determine issues relating to Medicare and Medicaid reimbursement.[538]

However, several other courts have ruled that a provider need not exhaust administrative remedies when asserting Medicare related claims in bankruptcy.[539] Foremost, these decisions interpret § 405(h) of Title 42 of the U.S. Code according to its plain language. "[T]he specific language of 28 U.S.C. § 405 does not state that jurisdiction under 28 U.S.C. § 1334 is subordinate to 42 U.S.C. § 405."[540] Accordingly, "using a plain reading of the statute, it is evident that the bankruptcy courts are not prohibited from exercising jurisdiction over matters which concern Medicare."[541]

These courts question whether the legislative history suggests congressional intent to mandate exhaustion of remedies in bankruptcy. The legislative record shows that Congress intended to make no change to "substantive law," but jurisdiction is procedural rather than substantive.[542] Also, timing ***207** indicates that Congress's omission of § 1334 in § 405(h) was intentional; Congress amended § 405(h) only eight days after enacting § 1334.[543]

Finally, courts finding no obligation to exhaust administrative remedies note policy concerns over delay that are inherent in the administrative process, and their impact upon the bankruptcy proceedings. One court has suggested that requiring exhaustion would cause as much as a year-long delay: "[I]f the bankruptcy court were to suspend the proceedings before it and permit the Department of Health and Human Services to exercise its administrative proceedings...then the entire bankruptcy scheme would be disrupted."[544]

Several courts have avoided ruling whether § 405(h) of Title 42 of the U.S. Code requires exhaustion of remedies by finding that the dispute in question arose under the Bankruptcy Code rather than Medicare law.[545] For example, in *University Medical Center*, the issue was not the amount that Medicare overpaid the provider, but whether the government could recover pre-petition overpayments in bankruptcy without violating the automatic stay.[546]

5. Interplay between Post-Sale Bankruptcy Costs and Medicare's Cost-Reimbursement System

a. Summary of Medicare Cost Reimbursement

Medicare does not reimburse providers based on the amount charged for services. Instead, Medicare reimburses providers through a complex system based on the "reasonable and necessary" costs incurred in providing ***208** services to Medicare beneficiaries.[547] Under the cost-reimbursement system, Medicare must reimburse providers for the fraction of the total allowable costs that are allocable to providing services to Medicare patients.[548] The Secretary of HHS has the authority to issue administrative regulations governing Medicare.[549] Since "reasonable and necessary" is not explicitly defined by statute, the Secretary has the authority to determine what costs are reasonable and necessary.[550] This determination and the means of implementing the decision (administrative regulation or administrative opinion) are within the discretion of the Secretary.[551]

Under the regulations promulgated by the Secretary, "[r]easonable cost includes all necessary and proper costs incurred in furnishing the services."[552] Reasonable cost takes "into account both direct and indirect costs of providers of services."[553] Necessary and proper costs are "costs that are appropriate and helpful in development and maintaining the operation of patient care facilities and activities."[554] Also, "reasonable cost includes all necessary and proper expenses incurred in furnishing services, such as administrative costs.... It includes both direct and indirect costs."[555]

Unless costs are "not related to patient care, specifically not reimbursable under the program, or flow...from the provision of luxury items or services,"[556] they are allowable under Medicare. In short, reimbursable expenses are not limited to "hands-on

care," but instead are defined in broad and flexible terms: all administrative and general overhead costs that are in some way "related to" the operation of patient care facilities and activities.[557] ***209** For example, the Medicare regulation that governs legal fees, the *Provider Reimbursement Manual* (hereinafter "PRM") § 2183, advises:

Legal fees and related costs incurred by a provider are allowable if related to the provider's furnishing of patient care, *e.g*., legal fees incurred in appeals to the Provider Reimbursement Review Board and, if applicable, further appeals subsequent to a Board decision. However, legal fees and related costs incurred by a provider related to alleged civil fraud or indictment for a criminal act by the provider or its owners, employees, directors, etc., or legal fees for certain anti-union activities (*see* § 2180), are not related to the furnishing of patient care, and therefore, are unallowable provider costs.[558]

Health care providers in bankruptcy that continue to treat Medicare patients are reimbursed in the same manner as prior to the bankruptcy. Therefore, costs that a health care provider incurs within bankruptcy that comply with the broad "related to" standard are reimbursable.[559]

b. Are Post-Sale Bankruptcy Expenses Reimbursable under Medicare?

Following the sale of a health care provider, whether under § 363 of the Bankruptcy Code or through a confirmed plan, the debtor's bankruptcy estate continues to incur costs. Post-sale expenses may include finalizing Medicare reimbursements and final cost reports, collecting other accounts receivables, pursuing and liquidating estate causes of action, reviewing claims for validity, employing wind-down staff, filing tax returns, conducting audits and complying with record retention and destruction laws.

Outside of the sales context, Medicare would likely reimburse many of these costs under the standard that general administrative costs are allowable ***210** if "related to" Medicare patient care.[560] For example, courts have found that professional fees, collection expenses and management costs are all reimbursable.[561] However, when a health care provider sells substantially all of its assets, its participation in Medicare terminates, as it no longer provides services to patients. Following a sale, the costs that Medicare will reimburse a provider are relatively uncertain.

Section 2176 of the PRM regulates which costs incurred after the provider terminates participation are reimbursable. In relevant part, it states:

When a provider terminates its participation in the program... administrative costs associated with the preparation and settlement of cost reports with an intermediary and other third parties will be incurred after the effective date of termination. *The direct administrative costs that are reasonable and related to the settlement of reimbursement for patient care rendered while the provider was participating in the program and bad debts resulting from coinsurance and deductibles billed to Medicare patients are allowable*. Examples of allowable direct administrative costs are salaries and those costs associated with such salaries, *i.e*., fringe benefits, workmen's compensation insurance, ***211** and Bankruptcy and payroll taxes; accounting and legal fees which are incurred for bill preparation, bill processing, and cost report preparation; and, where applicable, hearing fees and expenses incurred for settlement with an intermediary and other third parties.... *However, legal fees and related costs incurred in the sale of the facilities, costs incurred on or after the effective date of termination for the operation or maintenance of closing of the facility are not allowable*.[562]

By its plain language, Section 2176 adopts the general principle that direct expenses incurred after the provider's termination from Medicare are reimbursable if they are (1) reasonable and (2) related to the settlement of reimbursement for patient care. These allowable termination costs are reimbursable in the final cost year.[563]

Regulation 42 C.F.R. § 413.9 provides guidance to determine whether a post-sale cost is "reasonable."[564] For example, in *Orange County Medical Center v. BlueCross BlueShield Association/Blue Cross of California*, the PRRB found post-termination costs incurred to collect pre-termination receivables reasonable because they complied with the general "related to" standard, and "[t]he collection efforts...resulted in a substantial financial benefit to the Provider in excess of the costs incurred."[565]

Additionally, as noted, Section 2176 of the PRM requires that post-termination costs be specifically "related to the settlement of reimbursement." This element requires that incurred costs more narrowly relate to reimbursements as compared to the 42 C.F.R. § 413.9 "related to" patient care standard. For example, legal, accounting and collection costs related to pursuing Medicare reimbursement claims and appeals fulfill this requirement.[566] On the other hand, unemployment benefit payments due post-termination are generally ***212** not reimbursable under Section 2176 of the PRM because they are unrelated to the settlement of reimbursement.[567]

Section 2176 of the PRM expressly disallows reimbursement for the costs incurred in the actual sale, which would likely include, among other things, costs related to finding a buyer, negotiating the transaction and closing expenses. Costs incurred for the operation or maintenance of the facilities post-sale are also not reimbursable.[568]

A straightforward application of Section 2176 would seem to limit reimbursable post-sale costs to those incurred in finalizing Medicare reimbursements. This would likely include, as suggested by the examples in Section 2176, the cost of employing wind-down staff to prepare final cost reports, the accounting fees to prepare Medicare billing and the legal costs incurred in pursuing reimbursement appeals.[569]

The strict limitation that the cost must "relate to the settlement of reimbursements" seems to exclude many other costs that health care providers face post-sale. Foremost, the general costs of administering the bankruptcy estate that do not directly relate to Medicare reimbursements are generally disallowed. For example, the government has challenged reimbursement requests of post-sale expenses for the fees of an Official Creditors' Committee and U.S. Trustee fees as unrelated to the settlement of reimbursements.[570] Another major cost that providers face post-sale is compliance with various medical and business record-retention laws.[571] Health care providers post-sale frequently incur a substantial cost in storing and retaining records in compliance with these laws.[572] Arguably, these costs are excluded under ***213** Section 2176 as "costs incurred on or after the effective date of termination for...maintenance of closing the facility."[573] Accordingly, providers in bankruptcy are often required to find a way to pay for the cost of record retention from their bankruptcy estate.[574]

While the language of Section 2176 of the PRM restricts reimbursable post-sale costs, it only applies to costs that arise out of the provider's termination from participation in Medicare.[575] "The [allowable] costs referred to in the language of § 2176 do not include those that are totally independent of a provider's termination."[576] Several decisions have found post-termination costs to be reimbursable under 42 C.F.R. § 413.9, the regulation that controls reimbursements while the provider is a participant in the program. Specifically, costs that the provider would incur regardless of whether it terminated participation in Medicare and that meet the general "related to"-providing-patient-care standard may be reimbursable.[577] For example, in *Gateway Community Hospital v. BlueCross BlueShield*, the PRRB allowed reimbursement for malpractice tail insurance following a provider's liquidation. It reasoned that the provider retained liability for malpractice claims that arose during the provider's participation in Medicare regardless of whether it continued to participate in the program. Consequently, the tail insurance was a necessary ***214** cost related to patient care that was incurred in the provider's final fiscal year under 42 C.F.R. § 413.9.[578] Similarly, the post-sale costs of maintaining vested pensions are generally reimbursable because they are a function of employment when the provider was a participant in Medicare.[579] A provider in bankruptcy may consider arguing that post-sale costs, which do

not relate to the "settlement of reimbursements," should be reimbursable under 42 C.F.R. § 413.9 if those costs relate to patient care and if the provider would bear them regardless of its participation in Medicare.

6. Medicare's Requirement that It Will Only Reimburse Costs that Are Actually Paid in Fact versus the Bankruptcy Code Permitting Discharge of Debts at a Payment of Less than Face Value of a Claim

Medicare regulations require that providers use accrual accounting for reimbursement purposes, which means that liabilities are reflected in the period that they are incurred rather than when they were paid.[580] However, the regulations veer away from accrual accounting in some instances. Regulation 42 C.F.R. § 413.100(c)(2)(i) disallows, as a general rule, short-term liabilities that the provider fails to liquidate (*i.e.*, pay) within one year after the conclusion of the cost year that Medicare reimbursed the provider for that liability.[581] This regulation contains several exceptions to the general rule, as it specifies different time limits for certain types of liabilities.[582] Additionally, the provider may request from HHS an extension of up to three years if the request is submitted within a year after the conclusion of the cost-year.[583] A provider's failure to comply with the liquidation requirements results in disallowance of the reimbursement in the cost-year for which the liability was accrued. Instead, the cost is "allowable in the cost reporting period when the liquidation of the liability occurs."[584] The rationale for the liquidation requirement is ***215** to prevent Medicare from reimbursing providers for costs that for whatever reason are never actually paid. "If costs are not liquidated within a certain period of time, then Medicare justifiably assumes that they will not be paid at all and therefore that providers are sitting on windfall profits. A different rule...would create incentives for health care providers not to pay third-party providers on a timely basis."[585]

Fiscal intermediaries, the PRRB and the Secretary of HHS have vigorously enforced the liquidation requirements for short-term liabilities against providers.[586] In fact, they have even enforced the liquidation requirements against debtors in bankruptcy.[587] For example, in *In re Slater Health Center Inc*., the provider incurred liabilities to third parties for services provided to Medicare patients. The provider included the costs in the fiscal years incurred, but failed to actually pay the third parties as a result of the provider's Chapter 11 bankruptcy. The fiscal intermediary objected to the unliquidated amounts and claimed that the provider had been overpaid for those cost-years. It moved to recoup reimbursements for costs that the provider supplied to patients but never paid out to third-party providers. The First Circuit Court of Appeals concluded that HHS was within its regulatory power to disallow reimbursement for unliquidated liabilities.[588] Therefore, under First Circuit ***216** precedent, the government may recoup costs from providers for services that were actually provided to Medicare beneficiaries but never paid to third-party vendors.[589] The court reasoned that the liquidation requirement was within the regulatory discretion of HHS and that disallowing the unliquidated amounts does not unfairly prejudice the unpaid third parties:

In the context of bankruptcy, where the funds in the estate will be used to pay off a wide variety of creditors and other expenses, there is no guarantee that all or most of the funds will be used to pay third-party providers if the overpayment were returned to the bankruptcy estate. The overpayment claim under § 413.100(c), far from being wholly extrinsic to the relationship between Medicare and Slater, is in fact integral to it.[590]

The First Circuit's allowance of recoupment based on a provider's failure to liquidate short-term liabilities could be interpreted as permitting disallowance of reimbursements for all pre-petition unpaid debts. Such a broad interpretation runs counter to the nature of bankruptcy as an adjustment of debts.

The Bankruptcy Code permits a Chapter 11 debtor to confirm a plan of reorganization and emerge from bankruptcy without paying its pre-petition unsecured debts in full, so long as certain requirements are satisfied.[591] Since plans of reorganization that offer a 100 percent recovery to unsecured creditors are rare, if the First Circuit's view was extended, Medicare would be able to reduce the amount of reimbursement it owes bankruptcy providers in virtually every bankruptcy. The government could

reduce reimbursements by the amount of debts that the provider failed to pay to third parties, even though the government received the benefits of goods and services provided for patient care.

Allowing Medicare to recover reimbursements from the provider for debts that the Bankruptcy Code discharges frustrates the discharge provisions, ***217** as well as the fresh-start policy of the Bankruptcy Code.[592] It has been held that a discharge in bankruptcy is an involuntary "release" of the debt,[593] and by common usage, the words "payment," "release" and "discharge" are somewhat interchangeable.[594] Moreover, a discharge operates as a full satisfaction of a debt because the creditors are legally required to take partial payment in full satisfaction and to give a "release" of the full amount of the debt.[595] Thus, arguably "discharge" should equal "payment" for purposes of Medicare reimbursement.

Additionally, the policy reason for conditioning Medicare reimbursement on actual payment of costs is to avoid reimbursement of fictional or unwarranted costs.[596] This concern diminishes in the bankruptcy context, because the bankruptcy court reviews each claim and determines whether it is valid and allowable.[597]

Finally, Medicare's *Provider Reimbursement Manual* recognizes that strict adherence to the payment requirement is inappropriate in bankruptcy proceedings: "In the event that a provider undergoes bankruptcy proceedings, the program makes payment to the provider based on the reasonable or actual costs of services rendered to Medicare beneficiaries and not on the basis of costs adjusted by bankruptcy arrangements."[598]

It is difficult to reconcile these considerations against the holding in *In re Slater Health Center Inc*. Functionally, the case "can be read for the ***218** proposition that although debts discharged in bankruptcy will not result in a reduction of federal payments, that only applies to short term debts to the extent they were incurred within a year of the petition date."[599]

Footnotes

446 . As of 2001, one estimate suggested that 125,000 pages of regulations existed for Medicare and Medicaid. *See* Medicare Payment Advisory Commission, Report to the Congress: Reducing Medicare Complexity and Regulatory Burden xi (Dec. 2001).

447 . *See* Robert G. Richardson, *Accident Scene -- Medicare and the Bankruptcy Code Collide*, 14-3 APR AM. BANKR. INST. J. 10 (April 1995) ("With increasing frequency, the federal regulatory scheme associated with health care is running head-on into the reorganization process of Chapter 11 of the Bankruptcy Code.").

448 . As of 2011, Medicare and Medicaid reimbursements account for approximately 55 percent of hospital revenues nationally. *See* Robert Pear, *Administration Offers Health Care Cuts as Part of Budget Negotiations*, N.Y. TIMES, July 4, 2011, at A14 [hereinafter *Admin. Offers Health Care Cuts*].

449 . *John L Doyne Hosp. v. BlueCross BlueShield Assoc./Nat'l Gov't Services*, PRRB Dec. No. 2011-D25, 2011 WL 2574328, at *11 (PRRB Apr. 13, 2011).

450 . 42 U.S.C. § 1395h; 42 C.F.R. § 413.64.

451 . 42 U.S.C. § 1395g(e); 42 C.F.R. §§ 413.60, 413.64.

452 . 42 C.F.R. § 413.20.

453 . 42 C.F.R. § 413.64(f).

454 . *Id*.

455 . 42 C.F.R. § 405.1803(c).

456 . *See, e.g.*, *In re Dist. Memorial Hosp. of Southwestern North Carolina*, 297 B.R. 451, 453 (Bankr. W.D.N.C. 2002) (describing North Carolina's estimated payment and reconciliation process).

457 . *See id*. at 456 (noting that Medicare and Medicaid reimbursement is often the "life blood" of health care providers).

458 . *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 18 (1995) ("The right of setoff (also called "offset") allows entities that owe each other money to apply their mutual debts against each other, thereby avoiding 'the absurdity of making A pay B when B owes A.'") (quoting *Studley v. Boylston Nat. Bank*, 229 U.S. 523, 528 (1913)).

459 . 11 U.S.C. § 553(a); *see* *Strumpf*, 516 U.S. at 18-19 ("Although no federal right of setoff is created by the Bankruptcy Code, 11 U.S.C. § 553(a) provides that, with certain exceptions, whatever right of setoff otherwise exists is preserved in bankruptcy.").

460 . 11 U.S.C. § 506(a).

461 . 11 U.S.C. § 362(a)(7).

462 . *See* 5 COLLIER ON BANKRUPTCY ¶ 553.10 (16th ed. rev. 2010) [hereinafter COLLIER] (internal quotation omitted).

463 . *Id*.; *see also* *Reiter v. Cooper*, 507 U.S. 258, 265 n.2 (1993) (suggesting that recoupment is appropriate in bankruptcy cases as counterclaim arising from same transaction between debtor and nondebtor).

464 . *See* *In re Malinowski*, 156 F.3d 131, 133 (2d Cir. 1998); *In re McMahon*, 129 F.3d 93, 96 (2d Cir. 1997); *In re Flagstaff Assocs*., 60 F.3d 1031, 1035 (3d Cir. 1995); *In re Holford*, 896 F.2d 176, 179 (5th Cir. 1990); *In re American Fabricators*, 186 B.R. 526, 529 (Bankr. M.D. Fla. 1995); *In re Lease Purchase Corp*., No. 87-1117, 1993 WL 13004567, at *2 (Bankr. S.D. Ga. Sept. 29, 1993). *But see* *In re Klingberg Schools*, 68 B.R. 173, 178 n.8 (N.D. Ill. 1986), *aff'd*,837 F.2d 763 (7th Cir. 1988) (suggesting that automatic stay applies to recoupment); *In re Heaftiz*, 85 B.R. 274, 280 (Bankr. S.D.N.Y. 1988) (holding that a party must seek relief from court to exercise right to recoupment).

465 . *In re Malinowski*, 156 F.3d at 133.

466 . *In re B & L Oil Co*., 782 F.2d 155 (10th Cir. 1986).

467 . *See* *In re Holyoke Nursing Home Inc*., 372 F.3d 1, 3-4 (1st Cir. 2005) (describing advantages the government gains from recoupment in bankruptcy compared to setoff).

468 . *Univ. Med. Ctr. v. Sullivan*, 973 F.2d 1065, 1081 (3d Cir. 1992).

469 . *Id*. (emphasis added).

470 . *Id*. at 1081-82 ("Recovery of...[a year's] overpayment, therefore, is the final act of the transactions that began in...[that year].").

471 . *Id*. at 1081.

472 . *Id*. at 1084.

473 . *See* *Malinowsk*, 156 F.3d at 134-35 (agreeing with the logic of *Univ. Med. Ctr*. in the context of adjustments to state unemployment insurance overpayments); *In re Thompson*, 182 B.R. 140, 148-49 (Bankr. E.D. Va. 1995), *aff'd*, 182 B.R. 140 (4th Cir. 1996) (applying *Univ. Med. Ctr*. standard to retirement benefits); *In re Sun Healthcare Group Inc*., 245 B.R. 779 (D. Del. 2000) (holding that recoupment was limited to overpayments within the same fiscal year); *In re Bayonne Medical Center Inc*., No. 07-15195 (MS), 2009 WL 1025123, at *13 (Bankr. D. N.J. Feb. 3, 2009) (explaining Medicare overpayments can be recouped only from same cost year); *In re Quality Link-Bertie LP*, No. 00-51125, 2001 WL 34388128, at *4-5 (Bankr. W.D.N.C. Oct. 16, 2001) (ruling the Third Circuit approach more appropriate for overpayments under Medicaid agreements); *In re Colonial Health Investors LLP*, No. 00-51125, 2001 WL 34388127, at *4-5 (Bankr. W.D.N.C. Oct. 16, 2001) (same); *In re Gaither*, 200 B.R. 847, 851 n.4 (Bankr. S.D. Ohio 1996) (allowing recoupment for overpayment of unemployment over three-year period because statute specified accounting and recovery over three years instead of one); *In re Kings Terrace Nursing Home and Health Related Facility*, No. 91 B11478, 1995 WL 65531 (Bankr. S.D.N.Y. Jan. 27, 1996) (barring post-petition recoupment for pre-petition Medicare and Medicaid overpayments because each cost year is a separate transaction).

474 . *Medicar Ambulance Co. Inc. v. Shalala*, 166 B.R. 918, 922 n.6 (Bankr. N.D. Cal. 1994), *see also* *In re Healthback LLC*, 226 B.R. 464, 477 (Bankr. W.D. Okla. 1998), *vacated*,No. 97-22616-BH, 1999 WL 35012949 (Bankr. W.D. Okla. May 28, 1999) ("[A]s a matter of logic, each provision of services by the debtor to a patient is a separate transaction and contract.").

475 . 224 F.3d 1008, 1012 (9th Cir. 2000) ("[W]e conclude that the distinctive Medicare system of estimated payments and later adjustments does qualify as a single transaction for purposes of recoupment.").

476 . *United States v. Consumer Health Services of America Inc*., 108 F.3d. 390, 395 (D.C. Cir. 1997).

477 . *Id*.

478 . *See* 5 COLLIER ¶ 553.10[1].

479 . *See, e.g.*, *Ravenwood Healthcare Inc. v. Maryland Dep't of Health & Mental Hygiene*, No. MJG-06-3059, 2007 WL 1657421, at *6-7 (D. Md. June 5, 2007) (allowing recoupment of pre-petition Medicaid overpayments post-petition because would be inequitable to deny the state recoupment while the provider continues to receive benefits of program); *In re Samaritan Alliance*, No. 07-50735, 2009 WL 939578, at *3 (Bankr. E.D. Ky. Mar. 16, 2009) (finding pre-petition Medicaid payments from different cost year could be recouped post-petition); *In re Memorial Hosp. of Southwestern North Carolina Inc*., 297 B.R. 451, 454 (Bankr. W.D.N.C. 2002) (finding Medicare and Medicaid estimates and later adjustments qualify as a single transaction); *In re Southern Inst. for Treatment*, 217 B.R. 962, 965-66 (Bankr. S.D. Fla. 1998) (allowing government to recoup Medicare overpayments from previous cost years).

480 . *Holyoke Nursing Home*, 372 F.3d at 4;*In re TLC Hosp. Inc*., 224 F.3d 1008, 1013-14 (9th Cir. 2000); *see* *In re Slater Health Ctr. Inc*., 398 F.3d 98, 103 (1st Cir. 2005) (reaffirming holding in *Holyoke Nursing Home*).

481 . *TLC Hosp*., 224 F.3d at 1013-14.

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482 . *Moore v. New York Cotton Exchange*, 270 U.S. 593, 610 (1926).

483 . *Holyoke Nursing Home*, 372 F.3d at 4 (stating that "the interpretation favored by the District of Columbia Circuit and Ninth Circuit has been embraced by the overwhelming majority of district and bankruptcy courts nationwide which have ruled to date."); *In re Health Mgmt. L.P.*, 336 B.R. 392, 396 (Bankr. C.D. Ill. 2005) ("Most district and bankruptcy courts have... rejected the Third Circuit's analysis in *University Medical Center*").

484 . 42 C.F.R. § 413.64.

485 . *See* Pear, *Admin. Offers Health Care Cuts*, at A14; *see also Dist. Memorial Hospital*, 297 B.R. at 453.

486 . 11 U.S.C. § 105(a).

487 . *See In re Mewborn*, 367 B.R. 529, 541 (Bankr. D. N.J. 2006) ("[C]onsidering that recoupment is an equitable remedy, the Court must examine the facts of each case with particularity.").

488 . *See Malinowski*, 156 F.3d at 135;*Mewborn*, 367 B.R. at 537 (denying recoupment given the "income security" nature of unemployment and that debtor's misconduct occurred years before); *In re Ross*, 104 B.R. 171, 174 (E.D. Mo. 1989) (preventing state unemployment agency from pursuing past overpayments against the debtor because of "the hardship that could occur when an unemployed bankrupt would have to forgo his sole subsistence").

489 . *Malinowski*, 156 F.3d. at 541.

490 . *See Colonial Health Investors*, 2001 WL 34388127, at *4 ("The doctrine of recoupment... protects the interest of only one creditor of a debtor at the expense of the other interests in the bankruptcy case."); *In re Masterwear Corp.*, 229 B.R. 301, 311 (Bankr. S.D.N.Y. 1999) ("Recoupment, like setoff, operates to prefer one creditor over every other."); *see also* Daniel C. Burton & Thomas W. Waldrep, *Medicare and Medicaid Receivables: Recoupment or Setoff?,* 21-5 AM. BANKR. INST. J. 18 (June 2002).

491 . *See Malinowski*, 156 F.3d at 131.

492 . *Slater Health Ctr.*, 398 F.3d at 104-05;*Holyoke Nursing Home*, 372 F.3d at 5.

493 . *Slater Health Ctr.*, 398 F.3d at 104-05 (summarizing *Holyoke Nursing Home*).

494 . 11 U.S.C. § 1141(d)(1)(A).

495 . 11 U.S.C. § 524(a).

496 . 11 U.S.C. § 101(12).

497 . 11 U.S.C. § 101(5).

498 . The Provider Reimbursement Review Board, the administrative body that hears appeals regarding Medicare and Medicaid reimbursement disputes, refuses to exert jurisdiction over whether an overpayment has been discharged in bankruptcy. *See Triad 2007 v. BlueCross BlueShield Assoc.*, PRRB Dec. No. 2009-D21, 2009 WL 1973493 (PRRB June 30, 2007); *Heritage Health Care Inc. v. Mut. of Omaha Ins. Co.*, PRRB Dec. No. 200-D8, 1999 WL 33749316 (PRRB June 30, 1999).

499 . *Kings Terrace Nursing Home & Health Related Facility*, 184 B.R. 200 -- v. - 203 (S.D.N.Y. 1995); *In re Izaguirre*, 166 B.R. 484, 492 (Bankr. N.D. Ga. 1994) (finding right to recoup overpayments of disability insurance benefits dischargeable).

500 . *Kings Terrace*, 184 B.R. at 203 ("[W]hatever its underlying foundations, there can be no recoupment unless there is an underlying right.").

501 . *See In re Al-Jiboury*, 344 B.R. 218, 227-28 (Bankr. D. Mass. 2006) (finding that state agency's right to recoup overpayments of food stamps is not a claim); *In re Jones*, 289 B.R. 188, 192 (Bankr. M.D. Fla. 2002) (holding that government's right to recoup overpayment of disability benefits is not a claim); *In re A and C Elec. Co. Inc.*, 211 B.R. 268, 273 (Bankr. N.D. Ill. 1997) (finding that recoupment of overpayment under contract is not a claim).

502 . 11 U.S.C. § 1141(d)(3).

503 . 11 U.S.C. § 727(a)(1).

504 . *In re S. Inst. for Treatment & Evaluation Inc.*, 217 B.R. 962 (S.D. Fla. 1998); *Kings Terrace Nursing Home & Related Health Facility*, No. 91 B 11478 (FGC), 1995 WL 65531 (Bankr. S.D.N.Y. Jan. 27, 1995), *aff'd*,184 B.R. 200 (S.D.N.Y. 1995); *St. Mary Hosp.*, 89 B.R. 503 (Bankr. E.D. Pa. 1988).

505 . 11 U.S.C. § 525(a).

506 . *Kings Terrace Nursing Home*, 1995 WL 65531, at *14-*15;*In re St. Mary Hosp.*, 89 B.R. at 512-13.

507 . *St. Mary Hosp.*, 89 B.R. at 512;*see also* Frank A. Oswald and Howard P. Magaliff, *Transfer of Medicare Provider Numbers in Bankruptcy: Executory Contract or Saleable Asset?*, 28-4 AM. BANKR. INST. J. 18, (May 2009) (discussing whether a provider agreement is an executory contract or a saleable asset of the debtor's estate).

508 . *St. Mary's Hosp.*, 89 B.R. at 510.

509 . *See In re Sun Healthcare Group Inc.*, Bankr. Nos. 99-3657 through 99-3841, Civil No. 00-986-GMS, 2002 WL 2018868 (D. Del. Sept. 4, 2002) ("[I]t's clear that...[the provider agreement] is a license being issued by the government to permit the debtor to

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participate in a program, and although it has [a] financial aspect to it, I think those are clearly ancillary to the primary purpose of the program[,] which is to license or authorize qualified parties to participate in the program.").

510 . *S. Inst. for Treatment & Evaluation*, 217 B.R. at 965 ("[T]he Debtor has not been denied a license, permit or any such similar grant.").

511 . *See Kings Terrace Nursing Home*, 1995 WL 65531, at *14-*15;*In re St. Mary Hosp.*, 89 B.R. at 512-13.

512 . *See Sun Healthcare Group Inc.*, 2002 WL 2018868.

513 . *See In re Psychotherapy and Counseling Ctr. Inc.*, 195 B.R. 522 (Bankr. D. D.C. 1996).

514 . 11 U.S.C. § 362(b)(28).

515 . Prior to 2005, many courts held that HHS could exclude providers without violating the automatic stay pursuant to § 362(b)(4) of the Bankruptcy Code, which exempts police and regulatory acts by government entities from the automatic stay. *See Psychotherapy and Counseling Ctr.*, 195 B.R. at 529-30. However, several courts held that exclusion based solely on the government's pecuniary interests, rather than protecting the public, did not fall within the police and regulatory exception. *See, e.g., In re Ruskak*, 184 B.R. 459 (Bankr. E.D. Pa. 1995). The only effect of § 362(b)(28) of the Bankruptcy Code is in abrogating decisions ruling that HHS's exclusion does not fit into the police and regulatory power exception to the automatic stay. *See* Samuel R. Maizel and Rachel Caplan, *Chicken Little Comes to Roost in Bankruptcy: Why § 362(b)(28) Doesn't Mean the Sky Is Falling*, 25-6 AM. BANKR. INST. J. 22 (July/Aug. 2006) ("[T]his amendment will make little, if any, change in how health care restructuring cases are resolved.").

516 . The full implications of § 362(b)(28) of the Bankruptcy Code are uncertain, as no published case has addressed it as of the date of this publication.

517 . *See, e.g.,*11 U.S.C. § 704(a)(1) ("The [Chapter 7] trustee shall...close such estate as expeditiously as is compatible with the best interests of parties in interest."); *In re Kemp*, 134 B.R. 413, 415 (Bankr. E.D. Cal. 1991) ("Two of the primary objectives of Chapter 11 are the expeditious resolution of disputes and speedy payment to creditors.") (internal quotation omitted).

518 . *See* Pear, *Admin. Offers Health Care Cuts*, at A14; *see also Dist. Memorial Hosp.*, 297 B.R. at 453.

519 . This section only addresses jurisdiction over issues arising under the Medicare Act. Medicaid is not governed by 28 U.S.C. § 405(h) or a similar statute that requires exhaustion of remedies. Bankruptcy courts generally find jurisdiction over Medicaid disputes. *See, e.g., Colonial Health Investors*, 2001 WL 34388127;*In re Quality Link-Bertie LP*, No. 00-51125, 2001 WL 34388128 (Bankr. W.D.N.C. Oct. 16, 2001).

520 . 42 C.F.R. § 413.20.

521 . *See*42 C.F.R. § 405.1803.

522 . *See*42 U.S.C. § 1395***oo***; 42 C.F.R. pt. 405, Subpt. R.

523 . *See*42 U.S.C. § 1395***oo***(f)(1); 42 C.F.R. § 405.1875.

524 . *See*42 U.S.C. § 1395***oo***(f); 42 C.F.R. § 405.1877.

525 . *See*42 U.S.C. § 1395***oo***(h).

526 . *See*42 U.S.C. § 1395***oo***(f)(1); 42 C.F.R. § 405.1875.

527 . *See Heckler v. Campbell*, 461 U.S. 458, 466 (1983) ("Congress has conferred on the Secretary exceptionally broad authority to prescribe standards for applying certain sections of the Social Security Act.") (internal quotation omitted).

528 . 5 U.S.C. § 706(2)(A).

529 . 42 U.S.C. § 405(h) (emphasis added).

530 . 28 U.S.C. § 1334.

531 . *See, e.g., In re Excel Home Care*, 316 B.R. 565, 573-74 (D. Mass. 2004); *In re St. Mary Hospital*, 123 B.R. 14, 16 (E.D. Pa. 1991); *In re Hodges*, 364 B.R. 304, 306 (Bankr. N.D. Ill. 2007); *In re House of Mercy Inc.*, 353 B.R. 867, 872 (Bankr. W.D. La. 2006); *In re Consol. Med. Transport Inc.*, 300 B.R. 435, 444 (Bankr. N.D. Ill. 2003); *In re Mid-Delta Health Sys. Inc.*, 251 B.R. 811, 815 (Bankr. N.D. Miss. 1999); *In re Hosp. Staffing Services Inc.*, 258 B.R. 53, 58 (S.D. Fla. 2000); *In re St. John's Home Health Agency Inc.*, 173 B.R. 238, 243 (Bank. S.D. Fla. 1994); *In re Upsher Laboratories Inc.*, 135 B.R. 117, 120 (Bank. W.D. Mo. 1991); *In re Visiting Nurse Association of Tampa Bay Inc.*, 121 B.R. 114, 118 (Bankr. M.D. Fla. 1990) (suggesting that overwhelming consensus is that federal courts do not have jurisdiction to hear challenges without provider first exhausting administrative remedies).

532 . *St. Mary Hosp.*, 123 B.R. at 17.

533 . *Id.*

534 . P.L. No. 98-369, 98 Stat. 1162, § 2663(b).

535 . *Healthback*, 226 B.R. at 472 (explaining that courts that find bankruptcy jurisdiction barred generally reason that "28 U.S.C. § 1334 was inadvertently omitted from the revision of 42 U.S.C. § 405(h)").

536 . *See In re Excel Home Care*, 316 B.R. at 571 ("Congress intended the Medicare Act to provide the 'exclusive means' to resolve claims that 'arise under' it.").

537 . *Midland Psychiatric Associates Inc. v. United States*, 145 F.3d 1000 (8th Cir. 1998); *Bodimetric Health Services Inc. v. Aetna Life & Cas.*, 903 F.2d 480 (7th Cir. 1990); *Allstar Care Inc. v. Blue Cross & Blue Shield of S. Carolina*, 184 F. Supp. 2d 1295 (S.D. Fla. 2002).

538 . *Stern v. Marshall*, 131 S.Ct. 2594 (2011) (holding that bankruptcy court lacked authority under Article III of the Constitution to enter a final judgment on widow/debtor's counterclaim for tortious interference with the gift she expected from her deceased husband).

539 . *See In re Town & Country Home Nursing Services Inc.*, 963 F.2d 1146, 1155 (9th Cir. 1992); *Healthback*, 226 B.R. at 472-75;*In re Slater Health Ctr. Inc.*, 294 B.R. 423, 428 (Bankr. D. R.I. 2003), *vacated in part*, 306 B.R. 20 (D. R.I. 2004), *aff'd*,398 F.3d 98 (1st Cir. 2005); *First American Health Care of Georgia Inc.*, 208 B.R. 985, 988-90 (Bankr. S.D. Ga. 1996), *vacated by consent order*, 1996 WL 282149 (Bankr. S.D. Ga. 1996); *In re Shelby County Healthcare Services of Ala. Inc.*, 80 B.R. 555, 562 (Bankr. N.D. Ga. 1987).

540 . *Healthback*, 226 B.R. at 469.

541 . *Id.* at 473;*see First American Health Care*, 208 B.R. at 988 ("When enacting Section 1334 [in 1984] Congress had the opportunity to exclude actions covered by 405(h), but instead omitted any reference to the Medicare jurisdictional preclusion provisions and, therefore, granted concurrent jurisdiction of Section 405(h) matters to bankruptcy courts.").

542 . *In re Healthback*, 226 B.R. at 472-79.

543 . *See First American Health Care*, 208 B.R. at 988:
Moreover, effective July 18, 1984, only eight days subsequent to the enacting of Section 1334, Congress revised Section 405(h) and substituted "Section 1331 or 1346 of Title 28, United States Code," for Section 24 of the Judicial Code of the United States.... Although the possibility exists that the exclusion was unintentional, when considering the proximity of the enactment of both statutes along with the significant changes in bankruptcy jurisdiction that Section 1334 established, I hold that the plain meaning of Section 405(h) should be enforced, and clearly, this court's jurisdiction under Section 1334 was not circumscribed.

544 . *Healthback*, 226 B.R. at 475.

545 . *Univ. Med. Ctr. v. Sullivan*, 973 F.2d 1065, 1073 (3d Cir. 1992) (finding recovery of Medicare overpayments arose under Bankruptcy Code as a violation of automatic stay rather than under Medicare statute); *In re AHN Homecare LLC*, 222 B.R. 804, 810 (Bankr. N.D. Tex. 1998) (same).

546 . *Univ. Med. Ctr.*, 973 F.2d at 1073.

547 . *See*42 U.S.C. § 1395x(v)(1)(A).

548 . *See id.*; *see also*42 C.F.R. §§ 413.24, 413.50.

549 . *See Campbell*, 461 U.S. at 466.

550 . *New York ex rel. Bodnar v. Sec'y of Health & Human Services*, 903 F.2d 122, 125 (2d Cir. 1990) ("The Medicare statute unambiguously vests final authority in the Secretary, and no one else, to determine whether a service is reasonable and necessary, and thus whether reimbursement should be made.").

551 . *Heckler v. Ringer*, 466 U.S. 602, 617 (1984) ("The Secretary's decision as to whether a particular medical service is 'reasonable and necessary' and the means by which she implements her decision...are clearly discretionary decisions" (citations omitted).).

552 . 42 C.F.R. § 413.9(a).

553 . 42 C.F.R. § 413.9(b)(1).

554 . 42 C.F.R. § 413.9(b)(2).

555 . 42 C.F.R. § 413.9(b)(3).

556 . 42 C.F.R. § 413.9(c)(3).

557 . *See, e.g., Doctor Hosp. Inc. v. Calitano*, 459 F. Supp. 201 (D. D.C. 1978) (holding that legal fees arising out of operation of a hospital, as opposed to disputes between shareholders, are allowed).

558 . *See*CENTERS FOR MEDICARE & MEDICAID SERVICES, MEDICARE PROVIDER REIMBURSEMENT MANUAL § 2183, www.cms.gov/manuals/pbm/itemdetail.asp? itemid=CMS021929 [hereinafter PRM].

559 . *See United States v. Bourseau*, No. 03-CV-907-BEN(WMC), 2006 WL 2961105, at *6 (S.D. Cal. 2006), *aff'd*, 531 F.3d 1159 (9th Cir. 2008) (suggesting bankruptcy legal expenses are reimbursable when related to Medicare patient care).

560 . 42 C.F.R. § 413.9.

561 . *See, e.g., Good Luck Nursing Home Inc. v. Harris*, 636 F.2d 572, 587 (D.C. Cir. 1980) (allowing attorney's fees spent in honest dispute with Medicare, as opposed to costs of defending criminal fraud charges); *Lawrenceville Nursing Home Inc. v. Schweiler*, 528 F. Supp. 1370, 1379 (D.N.J. 1982) (allowing attorney's fees in Medicare reimbursement litigation but not costs of defending fraud charges against individual owners); *Home Services of Greater Philadelphia Inc. v. Harris*, 530 F. Supp. 1236 (E.D. Pa. 1982) (overruling ADMR decision to disallow accountant's fees); *St. Luke's Hosp. v. Aetna Life Insurance Co.*, PRRB Dec. No. 1995-D17, 1995 WL 933956 (PRRB Jan. 12, 1995) (allowing survey fee, appraisal fee, broker's fee, legal fees, accountant's fees and lease termination payment); *St. Joseph Hospital v. BlueCross BlueShield*, PRRB Dec. No. 1984-D109 (PRRB April 26, 2984) (allowing collection agency fees for collecting non-Medicare charges); *Red Bank Community Hosp.*, PRRB Dec. No. 1983-0147 (PRRB 1983)

(allowing management fees); *Mercy Community Hosp. v. Heckler*, PRRB Dec. No. D133 (PRRB Jan. 04, 1982) (allowing legal and accounting fees); *Rhode Island Hosp.*, PRRB Dec. No. 81-D73 (PRRB 1981]) (allowing litigation fees incurred in challenging constitutionality of routine cost limits); *Reid Memorial Hosp.*, PRRB Dec. No. 1982-D86 (PRRB 1982) (allowing costs of collection agency); *Home Health Servc. of United States*, PRRB Dec. 1978-D54 (PRRB 1978) (allowing attorney's retainer).

562 . *See* PRM § 2176 (emphasis added).

563 . *Logos Healthcare Rehabilitation of Tenn. Inc. v. BlueCross BlueShield Assoc.*, PRRB Dec. No. 2007-D-77, 2007 WL 3341620, at *10 (PRRB June 10, 2005) ("[T]ermination costs are allowable in a terminating cost report.").

564 . *See Orange County Med. Ctr.*, 1994 WL 928195, at *9 (finding post-termination expenses reasonable under § 2176 because they complied with 42 C.F.R. § 413.9).

565 . *See id.* at *9.

566 . *Id.*

567 . *St. Joseph's Hosp. (San Francisco) v. BlueCross BlueShield*, PRRB Dec. No. 83-D104, CCH ¶ 33,096 (PRRB July 5, 1983).

568 . PRM § 2176.

569 . *Id.* ("Examples of allowable direct administrative costs are salaries and those costs associated with such salaries, *i.e.*, fringe benefits, workmen's compensation insurance, and payroll taxes; accounting and legal fees which are incurred for bill preparation, bill processing, and cost report preparation; and, where applicable, hearing fees and expenses incurred for settlement with an intermediary and other third parties.").

570 . *See* Complaint at 57, *Speltz Consulting LLC v. Thompson (In re Jackson Brook Inst.)*, Adv. Proc. No. 03-2075, Dkt. No. 1 (Bankr. D. Me. Mar. 28, 2003).

571 . *See, e.g.*, N.Y. Comp. Codes R. & Regs. tit. 10, § 405.10 (requiring medical records be retained for at least six years following the patient's last visit for adults or three years after the patient reaches the age of 18, whichever is longer).

572 . *See, e.g.*, Debtors' Motion for an Order (I) Authorizing the Debtors Entry into an Information Management Services and Trust Agreement With MetalQuest-SVCMC Trust, LLC d/b/a MetalQuest, (II) Approving the Document Retention and Destruction Plan Set Forth Therein; (III) Directing the Additional Storage Vendors to Cooperate in Transfer of Records; and (IV) Granting Related Relief Pursuant to 11 U.S.C. §§ 363 and 554 and Rule 6007 of the Federal Rules of Bankruptcy Procedure [hereinafter "Debtors' Motion for an Order"] at 9, *In re Saint Vincents Catholic Med. Centers of New York*, Adv. No. 10-11963, Dkt. No. 1782 (Bankr. S.D.N.Y. July 7, 2011) (allocating $3.1 million to store and retain medical and business records).

573 . PRM § 2176.

574 . *See, e.g.*, Debtors' Motion for an Order at 17-21, *Saint Vincents Catholic Med. Centers,* Adv. No. 10-11963, Dkt. No. 1782.

575 . *John L Doyne Hosp. v. BlueCross BlueShield Assoc./Nat'l Gov't Services*, PRRB Dec. No. 2011-D25, 2011 WL 2574328, at *11 (PRRB Apr. 13, 2011) (disallowing post-retirement health-benefit costs because the provider had the obligation of paying these costs regardless of whether it terminated participation in Medicare).

576 . *Id.*

577 . *See, e.g.*, *Dakota Midland Hosp. v. BlueCross BlueShield*, PRRB Dec. No. 1997-D72, 1997 WL 383652, at * 7 (PRRB June 25, 1997) (reasoning that four "selling expenses" are allowable: unemployment, severance pay, voluntary early retirement and tail malpractice insurance); *Gateway Community Hosp. v. BlueCross BlueShield*, PRRB Dec. No. 1992-D50 (PRRB Aug. 20, 1992) (holding that malpractice "tail insurance" necessitated by sale of hospital was reimbursable under general Medicare reimbursement principles embodied in § 413.9).

578 . *Gateway Community Hosp.*, PRRB Dec. No. 1992-D50.

579 . *Sisters of Saint Francis Health Services v. Schweiker*, 514 F. Supp. 607, 611 (D. D.C. 1981); *Wayne County Gen. Hosp. v. BlueCross BlueShield Assoc./United Gov't Services*, PRRB Dec. No. 2004-D44 (PRRB Sept. 24, 2004).

580 . 42 C.F.R. § 413.24(b)(2).

581 . 42 C.F.R. § 413.100(c)(2)(i)(A); *see* PRM § 2305.

582 . *See, e.g.*, 42 C.F.R. § 413.100(c)(2)(iv) (requiring owner and officer compensation to be paid within 75 days of being accrued).

583 . 42 C.F.R. § 413.100(c)(2)(i)(A); PRM § 2305(A).

584 . PRM § 2305(A).

585 . *Slater Health Ctr.*, 398 F.3d at 104.*See also Mid-City Home Health Los v. BlueCross BlueShield Assoc./United Gov't Services*, PRRB Dec. No. 2005-D35, 2005 WL 900177, at *3 (PRRB Apr. 12, 2005) ("Medicare is designed to reimburse providers for costs actually incurred and paid; it does not pay for costs incurred but not paid.").

586 . *See, e.g.*, *Prof'l Rehab. Outpatient Services v. Health Care Fin. Admin.*, No. CIV.A. H-00-2526, 2001 WL 1910296 (S.D. Tex. Dec. 7, 2001) (disallowing unliquidated owner's compensation); *Family Home Care Provider v. BlueCross BlueShield Assoc.*, PRRB Dec. No. 2005-D19, 2005 WL 3447735, at *3 CMS Admin. (Mar. 1, 2005) (overturning PRRB Dec. No. 05-D19 because provider

failed to liquidate owner compensation); *High County Home Health Care Inc. v. BlueCross BlueShield Assoc./Cahaba Gov't Benefit Administrators*, PRRB Dec. No. 2007-D37, 2007 WL 1978122, at *4 (PRRB May 22, 2007) (disallowing unliquidated employee benefit costs); *Comprehensive Home Care Inc. v. BlueCross BlueShield Assoc./Palmetto Gov't Benefits Administrators*, PRRB Dec. No. 2006-D41, 2006 WL 3050891, at *4 (PRRB July 28, 2006) (disallowing unliquidated compensation to owner); *Marion Gen. Hosp. v. BlueCross BlueShield Assoc./Trispan Health Services*, PRRB Dec. No. 2007-D8, 2006 WL 6557124, at *4-5 (PRRB May 9, 2006) (disallowing unliquidated settlement liability); *Mid-City Home Health*, 2005 WL 900177, at *3 (disallowing unliquidated legal and accounting fees); *Home Comp Care Inc. v. BlueCross BlueShield Assoc./Palmetto Gov't Benefits Administrators*, PRRB Dec. No. 2001-D47, 2001 WL 1122055, at * 6 (PRRB Sept. 14, 2001) (disallowing owner compensation).

587 . *See, e.g.*, *Slater Health Ctr.*, 398 F.3d 98; Complaint at 21, *Speltz Consulting*, Adv. Proc. No. 03-2075, Dkt. No. 1.

588 . *Slater Health Ctr.*, 398 F.3d at 104.

589 . *Id.* at 105.

590 . *Id.*

591 . *See, e.g.*, 11 U.S.C. § 1129(a)(7)(A)(ii) (requiring that to confirm plan of reorganization, a creditor, even over his objection, need only receive amount that is not less than creditor would receive if debtor were liquidated under Chapter 7).

592 . For example, the effect of a discharge under 11 U.S.C. § 524 "operates as an injunction against the commencement or continuation of an action, the employment of a process, [and] is an act, to collect, recover or offset any such debt." 11 U.S.C. § 524(a)(2).

593 . *In re Arrowmill Dev. Corp.*, 211 B.R. 497 (Bankr. D. N.J. 1997) (finding that discharge in bankruptcy is an involuntary release by operation of law of creditor's claim against debtor); *In re Dow Corning Corp.*, 255 B.R. 445 (Bankr. E.D. Mich. 2000).

594 . *See*BLACK'S LAW DICTIONARY (7th ed. 1999) (defining "discharge" as the payment of a debt or satisfaction of some other obligation, or the "release" of a debtor from monetary obligations under adjudication in bankruptcy); *see also*BLACK'S LAW DICTIONARY (7th ed. 1999) (defining "release" as liberation from an obligation, duty...also termed "discharge"); BLACK'S LAW DICTIONARY (7th ed. 1999) (defining "payment" as "[t]he money or other valuable thing so delivered in satisfaction of an obligation").

595 . *See*11 U.S.C. § 524(a)(2).

596 . *See Slater*, 398 F.3d at 104;*Midway*, 2005 WL900177, at *3.

597 . One of the main purposes of a bankruptcy proceeding is to determine the validity and allowability of claims (or, in this case, costs). *See*11 U.S.C. §§ 501-502, 1106(a)(1); Fed. R. Bankr. P. 3001-3008.

598 . PRM § 2102.1.

599 . James C. Dechene and Shalom L. Kohn, 3 HEALTH L. PRAC. GUIDE § 34:11 n.7 (2011).

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FIFTH AMENDMENT CONSIDERATIONS IN BANKRUPTCY

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The Fifth Amendment to the United States Constitution provides that "[n]o person. . . shall be compelled in any criminal case to be a witness against himself . . ." This privilege may be raised in any proceeding, civil or criminal, formal or informal, if the testimonial evidence that would be produced there might incriminate the speaker in a future criminal proceeding. *Lifkowitz v. Turley*, 414 U.S. 70, (1973). Although the Fifth Amendment does not generally prohibit the *asking* of incriminating questions or the *demanding* of certain incriminating documents, it nevertheless prohibits the courts from *compelling* a person to testify if he fears incrimination. *See*, *e.g*. *United States v. Monia*, 317 U.S. 424, 427 (1943). If a court determines that the privilege has been legitimately asserted, the government must permit the witness to stand on the privilege or to receive an immunity order that requires the witness to testify, but protects him at least as broadly as the constitutional privilege itself. *See* 18 U.S.C. 6002; *Kastigar v. United States*, 406 U.S. 441 (1972), *reh'g* denied 408 U.S. 931 (1972).

The Fifth Amendment privilege against self-incrimination does not apply to voluntarily given statements or voluntarily prepared business papers, even though the contents might be incriminating, because the element of compulsion is lacking. *See United States v. Doe*, 464 U.S. 605, 612 (1984) (business records of a sole proprietorship were not privileged, because they had not been prepared under compulsion). In a non-criminal proceeding a person's statement must be compelled, testimonial, and incriminating in a criminal proceeding. *See United States v. Hubbell*, 530 U.S. 27, 34-35(2000).

Professor Tarvin's recent article, *The Privilege Against Self-incrimination in Bankruptcy and the Plight of the Debtor*, 44 Seton Hall L. Rev. 47 (2014) is a must read for anyone with questions or issues regarding the Fifth Amendment privilege in the context of bankruptcy proceedings.

Documents in Bankruptcy

Generally, a debtor has no Fifth Amendment privilege to withhold documents that are property of the estate because release of estate property is not "testimonial." *In re Harris*, 221 U.S. 274,

279 (1911). In *Harris*, the debtor was required to turn over his "books of account" to the receiver of the bankruptcy estate. In deciding whether such requirement violated the Fifth Amendment, the Supreme Court stated: "The question is not of testimony but of surrender, not of compelling the bankrupt to be a witness against himself in a criminal case, present or future, but of compelling him to yield possession of property that he no longer is entitled to keep." *Id*. at 279. This distinction can become important in a proceeding where the debtor is claimed to have waived the privilege by turning over documents to the trustee.

As a rule, "…the surrender of property of the estate is not testimonial, and hence, does not implicate Fifth Amendment concerns." *In re Schick*, 215 B.R. 4, 10 (Bankr. S.D.N.Y. 1997). *See also In re Crabtree*, 39 B.R. 726 (Bankr. E.D. Tenn. 1984) (surrender of estate property to trustee has no testimonial aspects and does not implicate Fifth Amendment). Nor does the Fifth Amendment protect an involuntary debtor from an order requiring turnover of estate property. *In re Kaufman*, 35 B.R. 26 (Bankr. D. Haw. 1983). *See also In re Ross*, 156 B.R. 152 (Bankr. D. Idaho 1993) (cited with approval in *In re Renteria*, 2007 WL 7540974 (9th Cir. BAP 2007).

Schedules and Statements

Schedules and statements in bankruptcy have been characterized as testimonial in nature because they are signed by the debtor under oath. *See In re Jacques*, 115 B.R. 272 (D. Nev. 1990). Nevertheless, a debtor may not invoke the Fifth Amendment privilege to avoid filing schedules and statements and answering related questions under oath in a voluntary proceeding. *See In re Gregg*, 510 B.R. 614 (Bankr. W.D. Mo. (2014) (Chapter 7 debtor denied discharge following conversion from Chapter 11 for failure to file Chapter 7 schedules and statements per court order, notwithstanding debtor's invocation of the Fifth Amendment privilege). Of course, in a voluntary proceeding, the case will be dismissed if the schedules and statements are not filed in conformity with 11 U.S.C. 521(a)(1).

In an involuntary proceeding, at least one court has ruled that a debtor cannot be compelled to file schedules and statements in violation of his Fifth Amendment privilege. *See In re Kaufman*, 35 B.R. 26 (Bankr. D. Haw. (1983). More on this subject when we get to war stories.

Waiver of the Privilege

In *Rogers v. United States*, 340 U.S. 367, 373 (1951), the Supreme Court stated: "It is well established that a *witness*, in a single proceeding, may not testify voluntarily about a subject and then invoke the privilege against self-incrimination when questioned about the details." *Rogers* at 373. The scope of the waiver is determined by the scope of relevant cross-examination on the particular subject of initial testimony. *Mitchell v. United States*, 526 U.S. 314, 321 (1999). Some courts have adopted a two-pronged test for evaluating a testimonial waiver of an individual's Fifth Amendment privilege against self-incrimination, inferring waiver from prior statements if (1) the witness's prior statements have created a significant likelihood that the finder of fact will be left with and prone to rely on a distorted view of the truth, and (2) the witness had reason to know that his prior statements would be interpreted as a waiver of the Fifth Amendments privilege against self-incrimination. *See Klein v. Harris*, 667 F.2d 274, 287 (2d Cir. 2981). Testimonial waiver will not be lightly inferred, and courts will consider every reasonable presumption against finding a waiver of the Fifth Amendment privilege. *In re Hulon,* 92 B.R. 670, 673 (Bankr.N.D. Tex. 1988).

In *In re Yates*, 2008 WL 7889836 (Bankr. So. Cal. 2008), the bankruptcy court undertook an in-depth analysis as to whether a debtor upon being served interrogatories by the trustee had waived his Fifth Amendment privilege. At the heart of the trustee's inquiry was the possible unscheduled ownership by the debtor of off-shore accounts. Not surprisingly, the debtor did not schedule any off-shore bank accounts. The trustee urged that the unique goals of bankruptcy require special consideration in determining whether the Fifth Amendment privilege has been waived by information provided in the schedules and statements.[1] The bankruptcy court disagreed with the trustee and noted that immunity for information required in a bankruptcy proceeding is no longer automatic, as it was under the Bankruptcy Reform Act. *See* 11 U.S.C. §344 and former 11 U.S.C. §25 (a)(10). *See also* 18 U.S.C. 6001.

Discharge

A general and not specific assertion of the Fifth Amendment privilege will usually result in a denial of discharge in bankruptcy. *In re Martinez*, 2005 WL 648218 (Bankr. D. Idaho 2011). A

1 Professor Tarvin seems to suggest that the Fifth Amendment privilege is likely waived by filing schedules and statements (at least as to the information provided). Tarvin, p. 83.

targeted assertion of the Fifth Amendment privilege does not, per se, rule out obtaining a discharge. *In re Galan*, 455 B.R. 2145 (Bankr. D. Idaho 2011). More on this below.

Adverse Inference

In a civil proceeding, an adverse inference may be drawn from a party's invocation of the Fifth Amendment privilege. *See Baxter v. Palmigiano*, 425 U.S. 308, (1975) (it was not error for a parole board to draw a negative inference from inmate's silence). However, there must be more than just an adverse inference to establish a cause for objection to discharge. *In re Curtis*, 177 B.R. 717 (Bankr. S.D. Ala. 1995) (adverse inference alone to debtor's invocation of the Fifth Amendment in response to a particular question at trial was not sufficient to establish objection to discharge action based on false representations). *See* also *In re Powers*, 261 Fed. Appx. 719 (5th Cir. 2008); *In re Cunningham*, 365 B.R. 352 (Bankr. D. Mass. 2007).

An interesting question arises where a non-party witness invokes the Fifth Amendment privilege. In *Brink's Inc. v. City of New York*, 717 F. 2d 700 (2d Cir. 1983), the Second Circuit affirmed a judgment in a civil proceeding where the jurors were instructed they could draw an adverse inference from the invocation of the Fifth Amendment privilege by current and former employees of the defendant. For a detailed discussion of this subject see Heidt, *The Conjurer's Circle*: The Fifth Amendment Privilege in Civil Cases, 91 Yale L.J. 1062 (1982).

Practical Considerations

When bankruptcy is being considered by a client, it is usually predictable whether the Fifth Amendment will come into play. For instance, a client comes to you and wants to file bankruptcy for herself or her company because the FTC is reigning down hellfire and damnation on her and her company. The FTC has already threatened criminal implications. So you weigh the advantages and disadvantages of bankruptcy solutions knowing that some agency somewhere would like to criminally indict your client for something. If your client, pursuant to the advice of her criminal defense counsel, is going to make a blanket invocation of the Fifth Amendment privilege, then a discharge is unlikely.

In Re Hantges – one war story

Representing a debtor who makes a blanket invocation of the Fifth Amendment can be very uncomfortable. But it can be the difference between liberty and prison.