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Peter R. Roest

*Milbank, Tweed, Hadley & McCloy LLP*

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# Recovery of Medicare and Medicaid Overpayments in Bankruptcy\*

Peter R. Roest\*\*

## I. INTRODUCTION

Faced with ever-increasing pressure to reduce the costs of medical care from politicians and regulators who insist that Medicare and Medicaid expenditures must be controlled,<sup>1</sup> providers of medical services have increasingly sought the protection of the federal bankruptcy laws. Almost invariably, however, these providers are informed shortly after they initiate their bankruptcy cases that they received Medicare or Medicaid overpayments prior to their bankruptcy filings and that those overpayments will now be “recouped” by deducting the amounts of the alleged overpayments out of payments to be made for services rendered to beneficiaries after the filing of the bankruptcy case. This article examines the doctrine of recoupment as it has been applied in bankruptcy cases involving health care providers<sup>2</sup> and argues that the Third Circuit’s 1992 decision in *Univer-*

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\* The author deeply regrets being unable to come up with a clever or witty title for this article, but takes comfort in the fact that such titles are often misleading to the extent they suggest that the article’s contents are also either clever or witty. The author makes absolutely no such representations as to the contents of this article.

\*\* Mr. Roest is a Special Associate in the Financial Restructuring department of the New York office of Milbank, Tweed, Hadley & McCloy LLP. The opinions expressed in this article are solely those of the author and not necessarily those of Milbank, Tweed, Hadley & McCloy LLP.

1. For example, see Malia Rulon, *Medicare Cuts ‘Went Too Far,’ Critics Say*, HOUS. CHRON., Feb. 21, 2000, at A4 (quoting health care industry representatives and relatives of beneficiaries in West Virginia as arguing that the Medicare cuts contained in the Balanced Budget Act of 1997, Pub. L. No. 105-33, 111 Stat. 251 (Aug. 5, 1997), may have resulted in the denial of needed medical services to beneficiaries, the closing of many home health agencies in the state, and hospitals closing rural clinics and skilled nursing facilities and reducing services and staff “just to break even”).

2. Health care entities providing services to Medicare Part A beneficiaries are referred to as “providers” and deliver those services pursuant to a “provider agreement” between the entity and the United States Department of Health and Human Services (“HHS”). Technically, only those rendering services under Part A pursuant to a provider agreement are “providers.” For example, entities providing goods or services reimbursable under Medicare Part B are generally referred to as “suppliers” and do not enter into contracts with the government. For ease of reference, however, all persons and entities rendering services for which payment may be received under

sity Medical Center v. Sullivan (“University Medical Center”)<sup>3</sup> correctly balanced the competing interests of governmental units on the one hand and the provider debtor and its creditors on the other and properly held that the doctrine of recoupment should be applied narrowly in health care bankruptcy cases.

Part I of this article briefly outlines relevant provisions of the Social Security Act<sup>4</sup> and the Bankruptcy Code,<sup>5</sup> and summarizes the distinctions between recoupment and setoff. Part II discusses the *University Medical Center* decision. Part III analyzes the criticism of that decision by several cases and commentators, most notably health law attorney Samuel Maizel. Part IV discusses the D.C. Circuit’s thoroughly unconvincing interpretation of the applicable statutes and regulations in *United States v. Consumer Health Services of America*.<sup>6</sup> Finally, Part V discusses recoupment-related issues left open by *University Medical Center*.

### A. The Medicare Payment Process<sup>7</sup>

Healthcare persons and entities that provide services to Medicare and Medicaid patients are authorized to receive payments

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Medicare Part A, Medicare Part B, and Medicaid are referred to herein as “providers.”

3. *University Med. Ctr. v. Sullivan* (*In re University Med. Ctr.*), 973 F.2d 1065 (3d Cir. 1992) [hereinafter *University Med. Ctr. IV*].

4. 42 U.S.C.A. §§ 1301-1397jj (West 2000). All citations to federal and state statutes and regulations are to the versions thereof currently available online, which, as a rule, are more current than available print versions.

5. 11 U.S.C.A. §§ 101-1330 (West 2000).

6. *United States v. Consumer Health Servs. of Am.*, 108 F.3d 390 (D.C. Cir. 1997) [hereinafter *Consumer Health Servs. II*].

7. Because Medicaid payment practices vary from state to state, no attempt is made to describe them herein. In disputes with State Medicaid agencies, however, one must keep in mind a number of recent United States Supreme Court decisions construing the Eleventh Amendment and sharply limiting the relief that can be obtained in bankruptcy against the States. In *Seminole Tribe of Florida v. Florida*, 517 U.S. 44 (1996), the Court held that Congress may not use its legislative powers under Article I of the Constitution to override the Eleventh Amendment and can validly do so only when it is acting pursuant to clause five of the Fourteenth Amendment. See also *Kimel v. Florida Board of Regents*, 528 U.S. 62 (2000); *Alden v. Maine*, 527 U.S. 706 (1999). The vast majority of the courts have concluded that, to the extent section 106(a) attempts to abrogate the States’ sovereign immunity in bankruptcy and other federal courts, *Seminole Tribe* mandates the conclusion that the statute is unconstitutional because it exceeds Congress’ legislative authority under Article I. See *Texas v. Walker*, 142 F.3d 237 (5th Cir. 1998) (stating that the Eleventh Amendment bars commencement of suit seeking declaration that debt to state university had been discharged in bankruptcy) (dictum); *Sacred Heart Hosp. v. Pennsylvania Dept. of Public Welfare* (*In re Sacred Heart Hosp.*), 133 F.3d 237 (3d Cir. 1998) (holding the Eleventh Amendment bars adversary proceeding against state

agency to compel payment of bills for medical services); Louisiana Dept. of Transp. & Dev. v. PNL Asset Mgmt., LLC (*In re Fernandez*), 123 F.3d 241 (5th Cir. 1997), *opinion on denial of rehearing*, 130 F.3d 1138 (5th Cir. 1997) (concluding that Congress does not have the power to abrogate the States' sovereign immunity); Schlossberg v. Maryland Comptroller of the Treasury (*In re Creative Goldsmiths*), 119 F.3d 1140 (4th Cir. 1997) (holding that the Eleventh Amendment bars preference action against state for recovery of income taxes); Light v. State Bar of California (*In re Light*), 87 F.3d 1320 (table) (9th Cir. 1996) (stating the Eleventh Amendment prohibits debtor from pursuing damage claims against the California bar in his bankruptcy case); Kish v. Verniero (*In re Kish*), 212 B.R. 808 (D.N.J. 1997) (noting that action seeking declaration that surcharges were dischargeable in bankruptcy violated the Eleventh Amendment because the state Department of Motor Vehicles was the real party in interest); New Jersey v. Mocco, 206 B.R. 691 (D.N.J. 1997) (determining that the Eleventh Amendment bars suits seeking damages or injunctive relief from state or its instrumentalities or agencies); Grabscheid v. Michigan Employment Sec. Comm'n (*In re C.J. Rogers, Inc.*), 1997 WL 523299 (E.D. Mich. 1997) (concluding the section purporting to abrogate States' sovereign immunity as to preference actions was unconstitutional); *In re Martinez*, 196 B.R. 225 (D.P.R. 1996) (stating that section 106 could not authorize suit against State for violating the automatic stay by filing a tax lien against the debtor's property); California Franchise Tax Bd. v. Lapin (*In re Lapin*), 226 B.R. 637 (9th Cir. B.A.P. 1998) (deciding that the Eleventh Amendment bars suit against state for violating discharge injunction); Mitchell v. California Franchise Tax Bd. (*In re Mitchell*), 222 B.R. 877 (9th Cir. B.A.P. 1998) (stating that section 106 unconstitutionally abrogates States' Eleventh Amendment rights); Elias v. United States (*In re Elias*), 218 B.R. 80 (9th Cir. B.A.P. 1998) (deciding that the Eleventh Amendment bars suit against state for violating discharge injunction); French v. Georgia Dept. of Revenue (*In re ABEPP Acquisition Corp.*), 1997 WL 799584 (6th Cir. B.A.P. 1997) (determining the adversary proceeding against state asserting that state tax violated Commerce Clause was barred by Eleventh Amendment); Neary v. Pennsylvania Dept. of Revenue (*In re Neary*), 1998 Bankr. LEXIS 570 (Bankr. E.D. Pa. 1998) (concluding the bankruptcy court could not hear adversary proceeding against state to determine dischargeability of tax claim but would dismiss without prejudice to allow debtors the opportunity to sue an individual state officer under the Young doctrine); Morrell v. California Franchise Tax Bd. (*In re Morrell*), 218 B.R. 87 (Bankr. C.D. Cal. 1997) (determining that a complaint to determine dischargeability of tax claim was barred by Eleventh Amendment); Rose v. U.S. Dept. of Educ. (*In re Rose*), 214 B.R. 372 (Bankr. W.D. Mo. 1997) (concluding a complaint to determine dischargeability of student loans was barred by Eleventh Amendment); Louis, Harris v. Barall (*In re Louis, Harris*), 213 B.R. 796 (Bankr. D. Conn. 1997) (deciding that an action against state officials for violating automatic stay by seeking to enforce support order barred by Eleventh Amendment; section 106(a) is unconstitutional); Guiding Light Corp. v. Louisiana (*In re Guiding Light Corp.*), 213 B.R. 489 (Bankr. E.D. La. 1997) (holding an adversary proceeding seeking turnover of Medicaid payments from state was barred by Eleventh Amendment); Mueller v. Idaho (*In re Mueller*), 211 B.R. 737 (Bankr. D. Mont. 1997) (concluding an adversary proceeding to determine debtor's personal liability on tax claim barred by Eleventh Amendment); Horwitz v. Zywiczyński (*In re Zywiczyński*), 210 B.R. 924, 933 n. 18 (Bankr. W.D.N.Y. 1997) (stating the Eleventh Amendment "clearly prohibits" trustee's complaint against state seeking to extinguish its interest in a certificate of deposit); *In re NVR L.P.*, 206 B.R. 831 (Bankr. E.D. Va. 1997) (holding an action seeking declaratory judgment that confirmed plan required state taxing authorities to refund certain taxes was a "suit" and bankruptcy court could not hear the action because Congress' attempted abrogation of States' sovereign immunity in section 106 was unconstitutional); Koehler v. Iowa College

for those services pursuant to various provisions of the Medicare Act and applicable state law. Under Medicare Part A and many state Medicaid programs, a provider<sup>8</sup> enters into a provider agreement with HHS or its state-government equivalent. Although the specific payment procedures vary depending on the nature of the provider, the types of services provided, and the applicable program (Medicare Part A, Medicare Part B, or Medicaid), in the typical Medicare Part A reimbursement scenario that has most often led to litigation in a bankruptcy case in which the provider was a debtor, the Secretary of HHS (“Secretary”) makes these payments on a monthly basis by estimating the amount due to a provider and paying that amount. After the end of the year, there is an audit of the provider, at which time the Secretary determines whether the provider was properly paid, overpaid, or underpaid in the preceding year. In maintaining these relationships, the Secretary acts through a “fiscal intermediary” or “carrier”—usually a large, private insurance company—with which the Secretary contracts for those

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Student Aid Comm’n (*In re Koehler*), 204 B.R. 210 (Bankr. D. Minn. 1997) (stating that, to the extent it purports to abrogate States’ Eleventh Amendment rights, section 106 is unconstitutional); *Tri-City Turf Club, Inc. v. Kentucky Racing Comm’n* (*In re Tri-City Turf Club, Inc.*), 203 B.R. 617 (Bankr. E.D. Ky. 1996) (determining the bankruptcy court lacked jurisdiction to hear action against State for allegedly violating automatic stay); *Ossen v. Connecticut Dept. of Social Servs.* (*In re Charter Oaks Assocs.*), 203 B.R. 17 (Bankr. D. Conn. 1996) (holding that section 106(a) is an unconstitutional exercise of Congress’ powers under Article I of the Constitution); *Sparkman v. Florida Dept. of Revenue* (*In re York-Hannover Devs., Inc.*), 201 B.R. 137 (Bankr. E.D.N.C. 1996) (stating that Congress could not rely on Article I to abrogate States’ sovereign immunity so bankruptcy court could not hear fraudulent transfer action against State); *Ellenberg v. Bd. of Regents* (*In re Midland Mechanical Contractors, Inc.*), 200 B.R. 453 (Bankr. N.D. Ga. 1996) (holding the bankruptcy court lacked jurisdiction over debtor’s dispute with state university regarding a contract assumed in the bankruptcy case).

The Supreme Court left open one avenue by which health care debtors may be able to circumvent the Eleventh Amendment. It stated that the “Young doctrine” under which a person may obtain injunctive relief “to remedy a state officer’s ongoing violation of federal law” remains viable. *Seminole Tribe*, 517 U.S. at 73 n. 16 (citing *Ex parte Young*, 209 U.S. 123 (1908)). At least one court has used the Young doctrine to compel the payment of postpetition Medicaid reimbursements to the debtor notwithstanding the debtor’s inability, under *Seminole Tribe*, to sue the State of Louisiana and agencies directly. *Guiding Light Corp.*, 213 B.R. at 491-92.

8. Medicare Part A services are usually provided to beneficiaries through a Provider Agreement. Medicare Part B services are usually delivered pursuant to a Participation Agreement. Medicaid relationships between the state and the provider vary from state to state and may include long- or short-term provider agreements, or no provider agreements at all. See also *supra* note 2 (noting that for purposes of this article all persons and entities rendering services for which payment may be received under Medicare Part A, Medicare Part B, and Medicaid will be referred to herein as “providers”).

services and that actually deals with the provider on a day-to-day basis.<sup>9</sup>

The most important statute governing payments to providers is section 1395g(a), which states that:

The Secretary shall periodically determine the amount which should be paid under this part to each provider of services with respect to the services furnished by it, and the provider of services shall be paid, at such time or times as the Secretary believes appropriate (but not less often than monthly) and prior to audit or settlement by the General Accounting Office, from the Federal Hospital Insurance Trust Fund, the amounts so determined, with necessary adjustments on account of previously made overpayments or underpayments.<sup>10</sup>

The fiscal intermediary makes the initial determination of how much a provider should receive as its monthly payments and whether and how much a provider has been overpaid or underpaid during a particular year. As long as the provider is not in bankruptcy, there is no question that if the government determines, following an audit, that it has overpaid a provider, it can deduct the amount overpaid from future estimated payments until the overpayment has been fully recovered.<sup>11</sup>

### *B. The Impact of a Bankruptcy Filing on the Medicare and Medicaid Payment Process*

The problem that has divided the courts is what happens when a provider files a bankruptcy case under title 11 of the United States Code and the government determines that it

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9. For more detailed summaries of how the Medicare payment system works, see, for example, John T. Seybert, *Recoupment in the Health Care Industry – Is it Equitable?*, 6 AM. BANKR. INST. L. REV. 495, 496-500 (Winter 1998); *Bankruptcy Law and the Health Care Financing System*, 1995-AUG NAAG BANKR. BULL 2 (August 1995); George F. Magera, *The Bankruptcy Code, Medicare Regulations and the Medicare/Provider Relationship in Bankruptcy: When May the Government Recover Medicare Overpayments from Bankruptcy Health Care Providers?*, 54 U. PITT. L. REV. 1085, 1088-89 (Summer 1993).

10. 42 U.S.C.A. § 1395g(a) (West 2000).

11. See *University Med. Ctr. IV*, 973 F.2d 1065, 1073 (3d Cir. 1992):

If UMC had not filed for bankruptcy, there would be no dispute concerning the monies due to HHS or the method for recovering them. Neither party questions the amount of prepetition overpayments made to UMC nor any other determination of the fiscal intermediary that might be appealed to the Provider Reimbursement Review Board. Nor did either party take issue with the procedure by which the statute provided for making routine adjustments with a non-bankrupt provider for prior over or underpayments.

*Id.*

made prepetition overpayments<sup>12</sup> to the provider that it now wants to recover by reducing postpetition payments. Bankruptcy Code section 362(a) provides that the filing of a bankruptcy petition under title 11 acts as a stay of, *inter alia*, the following actions by a creditor:

- (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;
- (2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;
- (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;
- (4) any act to create, perfect, or enforce any lien against property of the estate;
- (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;
- (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title; [and]
- (7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor.<sup>13</sup>

At first blush, it would seem obvious from these statutory provisions that any action to recover prepetition Medicare or Medicaid overpayments should be prohibited by the automatic stay. Governmental units are unquestionably subject to the automatic stay.<sup>14</sup> To the extent the government has made overpayments

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12. As used herein, the term "prepetition overpayment" refers to a payment made with respect to services the debtor provided to Medicare or Medicaid beneficiaries prior to the filing of its bankruptcy petition, regardless of whether the payment is actually made before or after the petition date. *Cf. In re Morgan*, 77 B.R. 81 (Bankr. S.D. Miss. 1987) (refund obligation to the debtor that accrued prepetition but was not paid until after the petition was filed was a prepetition obligation).

13. 11 U.S.C.A. § 362(a)(1)-(7) (West 2000).

14. The introductory provision of section 362 states that the stay is "applicable to all entities." *Id.* § 362(a). The term "entity" includes a "governmental unit." 11 U.S.C.A. § 101(15) (West 2000). "Governmental unit" includes the United States and any State, Commonwealth, District, Territory, or municipality." *Id.* § 101(27); *see also*

and is entitled to recover them, the government has a “right of payment” against the debtor. Such a right, whether or not the government has already determined that overpayments have been made or the amount of the overpayments, should constitute a “claim” under the Bankruptcy Code.<sup>15</sup> Because the overpayments were made with respect to services provided prior to the bankruptcy filing, they should constitute prepetition claims. As noted above, the automatic stay prohibits any act to collect on a prepetition claim.

Furthermore, the funds owed to the debtor for postpetition services seem unquestionably to be “property of the estate.” Under Bankruptcy Code section 541, the commencement of a bankruptcy case creates an “estate.”<sup>16</sup> Section 541(a) provides that “property of the estate” includes “any interest in property that the estate acquires after the commencement of the case.”<sup>17</sup> If the debtor provides services to beneficiaries after the commencement of the case, it is entitled to be paid for those services and that right should, under section 541(a)(7), constitute property of the debtor’s estate. Bankruptcy Code section 362(a)(3) prohibits any attempt by a nondebtor to “obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate.”<sup>18</sup> Again, it seems as if it should be clear that any attempt by the government to recover prepetition overpayments violates the automatic stay.

### C. *Recoupment: An Exception to the Automatic Stay*

A number of courts, however, have permitted the government to recover prepetition overpayments out of payments due for postpetition services. The government has demanded recoupment or its functional equivalent<sup>19</sup> on three conceptually dis-

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Pearson v. United States (*In re Pearson*), 917 F.2d 1215 (9th Cir. 1990) (automatic stay binds all governmental units, including the United States); *In re Parr Meadows Racing Ass’n, Inc.*, 92 B.R. 30 (E.D.N.Y. 1988), *aff’d in part, rev’d in part on other grounds*, 880 F.2d 1540 (2d Cir. 1989) (governmental units are within the Bankruptcy Code’s definition of the term “entity,” and, therefore, are subject to the automatic stay).

15. 11 U.S.C.A. § 101(5)(A) (“[C]laim’ means – (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.”).

16. 11 U.S.C.A. § 541(a) (West 2000).

17. *Id.* § 541(a)(7).

18. 11 U.S.C.A. § 362(a)(3) (West 2000).

19. Although the government’s right to recover overpayments is usually referred to as recoupment (the authorities are not always consistent or precise in their choice of words), in this article, I generally refer to the right as a “recovery” right for consis-



tinct, but overlapping, bases. Thus, it has been argued that recovery of prepetition overpayments by deductions from postpetition payments<sup>20</sup> should be permitted because:

- Such deductions enforce the contractual right of recoupment contained or implied in the provider agreement, which binds a debtor who seeks payments for postpetition services whether or not the debtor assumes that agreement;<sup>21</sup>
- Such deductions are the exercise of an equitable right of recoupment that is available under the provider agreement and can be enforced against the debtor whether or not it is specifically set forth in the agreement and whether or not the agreement is assumed;<sup>22</sup> and
- Such deductions are either (i) the exercise of a statutorily-created right of recoupment that is enforceable without regard to the Bankruptcy Code, the provisions of the applicable, agreement, or equitable doctrines, or (ii) are authorized or mandated by statute, are neither recoupment nor setoff,

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tency of reference and to avoid giving the erroneous impression that I agree that the government's right, whatever it may be, is properly classified as recoupment when that right is asserted in bankruptcy.

20. The postpetition recovery of prepetition overpayments out of prepetition payments due to the provider but not paid prior to the initiation of the provider's bankruptcy case can be accomplished either through setoff or through one of the other recovery rights. In early cases (i.e., cases from the 1980s), the government attempted to argue that recovering prepetition overpayments out of postpetition payments was a valid exercise of the right of setoff notwithstanding Bankruptcy Code section 553 or that it was entitled to an equitable exception to the limitations section 553 places on setoff. See, e.g., *Ambulance Corp. of Am. v. Schweiker* (*In re Ambulance Corp. of Am.*), 27 B.R. 910, 911 (Bankr. E.D. Pa. 1983) (determining that the government had the right to "setoff past overpayments against reimbursements currently due under the Medicare program."). The government lost on this issue consistently and, in more recent disputes, has relied almost exclusively on its alleged recoupment rights.

21. Bankruptcy Code section 365 permits a trustee to "assume" or "reject" an executory contract or unexpired lease of the debtor. Generally, an executory contract or unexpired lease is one as to which future performance is due from both the debtor and the nondebtor and nonperformance by one party of its remaining duties would permit the other party to treat the nonperformance as a breach excusing it from further performance. See, e.g., *Gouveia v. Tazbir*, 37 F.3d 295 (7th Cir. 1994); *In re Crippin*, 877 F.2d 594 (7th Cir. 1989); *Terrell v. Albaugh* (*In re Terrell*), 892 F.2d 469 (6th Cir. 1989); *Northwest Airlines, Inc. v. Klinger* (*In re Knutson*), 563 F.2d 916 (8th Cir. 1977); *Leefers v. Anderson* (*In re Leefers*), 101 B.R. 24 (C.D. Ill. 1989); *In re Daugherty Constr., Inc.*, 188 B.R. 607 (Bankr. D. Neb. 1995); *In re Lewis*, 185 B.R. 66 (Bankr. N.D. Cal. 1995); *Summit Inv. and Dev. Corp. v. LeRoux* (*In re LeRoux*), 167 B.R. 318 (Bankr. D. Mass.), *aff'd*, 1995 WL447800 (D. Mass. Oct. 20, 1994), *aff'd*, 69 F.3d 608 (1st Cir. 1995); *In re Learning Publications, Inc.*, 94 B.R. 763 (Bankr. M.D. Fla. 1988); *Wilson v. TXO Prod. Corp.* (*In re Wilson*), 69 B.R. 960 (Bankr. N.D. Tex. 1987); *In re Charter Co.*, 52 B.R. 267 (Bankr. M.D. Fla. 1985); *In re Farrar McWill, Inc.*, 26 B.R. 313 (Bankr. W.D. Ky. 1982); *In re Fashion Two Twenty, Inc.*, 16 B.R. 784 (Bankr. N.D. Ohio 1982).

22. See Seybert, *supra* note 9, at 520-22.

and are unaffected by a bankruptcy filing because the government only owes payments to the provider to the extent of the amount unpaid after adjustments on account of previous overpayments have been made.<sup>23</sup>

In reviewing the principles of law developed by the courts and the commentators, one should keep in mind two underlying policy issues that are always present, if not always on the surface. First, although legislators, administrators, and commentators have repeatedly argued that the government should have a preferred position in bankruptcy, they have articulated few, if any, reasons why it is any more unfair than all of the other effects that a bankruptcy case has on the debtor's non-governmental creditors. Much of the policy discussions by the commentators and government spokespersons appears to take the erroneous perspective that the contest should be viewed as being between the innocent, overpaying government and the guilty debtor provider who fraudulently obtained prepetition overpayments, an analysis that always leads to one obvious result. These discussions generally neglect the fact that in the usual case, the contest is between the innocent, overpaying government and other, equally innocent creditors of the debtor provider, who necessarily will receive less on their claims if the government receives more on its claim.

Second, the term "overpayment," particularly when used by government spokespersons and sympathetic commentators, should be recognized for the euphemism it is. In most cases, when these people speak of "overpayments," they are usually alleging fraud on the part of providers.<sup>24</sup> In 1997, for example, Rep. Fortney Stark (D.-Cal.) introduced new legislation with the

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23. See, e.g., *Consumer Health Servs. II*, 108 F.3d 390, 394-95 (D.C. Cir. 1997); *In re St. Johns Home Health Agency*, 173 B.R. 238 (Bankr. S.D. Fla. 1994); *Visiting Nurse Ass'n of Tampa Bay v. Sullivan* (*In re Visiting Nurse Ass'n of Tampa Bay*), 121 B.R. 114 (Bankr. M.D. Fla. 1990).

24. See, e.g., Seybert, *supra* note 9, at 495 n. 1 (citing, among other sources, Robert Pear, *Cost of Rampant Mental Health Care Fraud Soars in Medicare*, N.Y. TIMES, Sept. 30, 1998, at All; and various statements of Rep. Stark, the health care industry's most vociferous congressional critic and author of the (in)famous Stark Amendments.) The Stark Amendments prohibit referrals, for the provision of eleven "designated health services," of patients by physicians to entities in which the physicians have a "financial interest." See 42 U.S.C.A. § 1395nn(a)(1) *et seq.* (West 2000). Rep. Stark and his supporters contend that the legislation was necessary to address rampant abuses in the health care industry in which doctors referred patients to laboratories and clinics in which they owned an interest for unnecessary services because they received a financial benefit from the referrals. The healthcare industry has responded with the argument that the Stark Amendments are sometimes so restrictive that they impede the creation of efficient businesses that could provide services at a lower cost

statement, “[u]nder current law, *providers and suppliers are using the Bankruptcy Code as a vehicle to defeat the Secretary’s efforts to battle fraud and abuse involving Medicare and Medicaid payments.*”<sup>25</sup> As is true with respect to the assertion that government’s claims should be accorded a preferred position in bankruptcy, there has been little explanation from these persons as to why Bankruptcy Code provisions that prohibit the discharge of claims resulting from the debtor’s fraud<sup>26</sup> are inadequate to address these concerns and must be supplemented with additional protections available only to the government-as-creditor.<sup>27</sup>

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and otherwise are so vague that it is impossible to determine exactly what kind of conduct is prohibited. As is usually the case, both sides are partially correct.

25. 143 Cong. Rec. E1739 (daily ed. Sept. 11, 1997) (statement of Rep. Stark) (emphasis added); see also 143 Cong. Rec. E1082-03 (daily ed. June 3, 1997) (statement of Rep. Stark), in which Rep. Stark supported his proposal to take the government’s Medicare- and Medicaid-based claims completely outside the bankruptcy process by stating that it would “prevent people like Vernon Will from filing for bankruptcy and discharging nearly \$20 million in debts, while his nursing home closed in San Jose, CA, notifying 27 elderly residents that they had one day to pack up and leave.” Rep. Stark introduced similar legislation in 1996 with the statement:

Providers and suppliers are using the Bankruptcy Code as a vehicle to defeat the Secretary’s effort to recoup overpayments from the Medicare trust funds. Specifically, providers and suppliers, who owe financial obligations to Medicare, are seeking relief from bankruptcy courts to have their outstanding overpayments, which are unsecured, discharge or greatly reduced.

142 Cong. Rec. E1731-01 (daily ed. Sept. 26, 1996) (statement of Rep. Stark).

26. See, e.g., 11 U.S.C.A. § 523(a)(2) (West 2000) (excepting from discharge claims “for money . . . to the extent obtained by . . . false pretenses, a false representation, or actual fraud”).

27. Several attempts were made in 1999 to heighten HHS’s protections. For example, the Medicare Waste Tax Reduction Act of 1999, S. 1451, 105th Cong. §§ 9-10, 145 Cong. Rec. S9529-03 (1999), would have amended the Medicare Act by (a) adding a new 42 U.S.C. § 1144 that would (i) exclude from the automatic stay “any action or proceeding to exclude or suspend the debtor from program participation, assess civil money penalties, recoup or setoff overpayments, or deny or suspend payment of claims” with respect to both Medicare and Medicaid; (ii) make debts to the government for Medicare or Medicaid overpayments and fines, penalties, and other assessments nondischargeable; and (iii) insulate prepetition payments to the government on account of overpayments, fines, penalties, or assessments under the Medicare Act from recovery as a preferential transfer under Bankruptcy Code section 547. 145 Cong. Rec. S9529-03, at S9536. (Bankruptcy Code section 547 permits the trustee or debtor in possession to recover, subject to certain exceptions, most payments made within ninety days prior to the filing of the bankruptcy petition by a debtor to a creditor on account of an antecedent debt.) Proposed new section 1987 of the Medicare would also, as a practical matter, have eliminated the ability (assuming it now exists) of a bankruptcy court to determine the amount due to a provider on its claims against the government and to compel payment of those claims under Bankruptcy Code section 542 (which provides for the turnover to the trustee of “property of the estate” as defined in Bankruptcy Code section 541). *Id.* at S9537. Note that the provisions of S. 1451 would have applied equally to both provider fraud and all other reasons for

Oddly enough, the patient concerns so frequently expressed as a basis for allowing the government to exercise its recovery rights against the debtor seem largely to fade away when it is the government's insistence on exercising those powers that is the single biggest threat to the debtor's patients. As one court stated:

[T]he Court should comment on the impact of these proceedings upon the ability of the hospital to reorganize. The debtor is not an average Chapter 11 debtor. It is the sole hospital serving a rural Virginia community. . . . Accordingly, the Court believes there is a public interest in the ability of the Hospital to successfully reorganize. It seems that the somewhat inflexible position taken by the United States in these proceedings has failed to account for this public interest.<sup>28</sup>

#### D. A Preliminary Issue: Recoupment and Setoff Distinguished

Judicial decisions often go to great lengths to separate recoupment from the morphologically and etiologically similar doctrine of setoff. Although it is important to be familiar with the arguments to some extent, the question of whether prepetition overpayments can be set off against postpetition payments seems now to have been resolved in favor of the debtor. In the early cases, HHS generally argued both theories.<sup>29</sup> In more recent cases, the setoff issue has faded into the background in light of the incontrovertible fact that Bankruptcy Code section 553(a) prohibits the setoff of prepetition overpayment claims against postpetition payment obligations but permits the government to set off a prepetition overpayment claim against a prepetition payment obligation that was not satisfied prior to the filing of the bankruptcy petition.<sup>30</sup>

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provider overpayment and would have provided for the recovery (and non-dischargeability of any unpaid claims) of penalties, fines, and assessments.

28. *Tidewater Memorial Hosp., Inc. v. Bower* (*In re Tidewater Memorial Hosp., Inc.*), 106 B.R. 876, 878 (Bankr. E.D. Va. 1989); *see also* Rulon, *supra* note 1 (quoting sources stating that "many" of West Virginia's 4500 patients no longer eligible for home health services after the enactment of the Balanced Budget Act of 1997 may have died due to their inability to pay for needed services).

29. *See, e.g., Ambulance Corp. of Am. v. Schweiker* (*In re Ambulance Corp. of Am.*), 27 B.R. 910, 912 (Bankr. E.D. Pa. 1983) ("It is undisputed that the Defendants are authorized to set off past overpayments against reimbursements currently due under the Medicare program. 42 U.S.C. § 1395g. This right of setoff is preserved under the Bankruptcy Code. 11 U.S.C. § 553.")

30. *Compare In re Healthback L.L.C.*, 226 B.R. 464, 489 (Bankr. W.D. Okla. 1998) (claim for prepetition overpayments could not be set off against obligation to pay for services provided postpetition), *with In re South Park Care Assocs., Inc.*, 203

Both setoff and recoupment permit a creditor who both has a “claim” against a debtor and owes a claim to the debtor to apply the amount the debtor owes to it against the amount it owes to the debtor to reduce the latter amount. The primary differences between the two doctrines are as follows:

- Setoff applies as long as the claims are mutual (which imposes the limitation that both claims must arise prepetition).<sup>31</sup> Recoupment requires that the “claims” arise out of the “same transaction” but does not require that both “claims” arise prepetition or are otherwise “mutual”.<sup>32</sup>
- More specifically, setoff is a claim asserted against a debtor, usually arising out of a transaction different than the one in which the debtor’s claim arose.<sup>33</sup> Recoupment is not so much a claim against the debtor (hence the quotation marks in the previous bullet point), but a defense to the debtor’s claim asserted to enable determination of the proper amount of the debtor’s claim. As will be made clear below, the question of exactly what recoupment is, is critical in determining its proper application in bankruptcy;

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B.R. 445 (Bankr. W.D. Mo. 1996) (prepetition overpayment could be set off against debtor’s prepetition claim for payment of cost limit exception amounts).

31. See, e.g., *WJM, Inc. v. Mass. Dept. of Pub. Welfare*, 840 F.2d 996 (1st Cir. 1988) (setoff permitted only if claims are “mutual” and mutuality requirement must be narrowly construed); *Boston & Maine Corp. v. Chicago Pacific Corp.*, 785 F.2d 562 (7th Cir. 1986) (creditor cannot set off prepetition claim against postpetition claim); see also Samuel R. Maizel, *Setoff and Recoupment in Bankruptcy*, 767 PLI/COMM 389, 398-401 (1998) (collecting cases). The courts have consistently held that the “mutuality” requirement under Bankruptcy Code’s setoff provision must be strictly construed. *Farrell v. Worm (In re Donnay)*, 184 B.R. 767 (Bankr. D. Minn. 1995); *Fed. Nat’l Mortgage Ass’n v. County of Orange (In re County of Orange)*, 183 B.R. 609 (Bankr. C.D. Cal. 1995); *United States v. Maxwell (In re Pyramid Indus., Inc.)*, 170 B.R. 974 (Bankr. N.D. Ill. 1994), *aff’d*, 210 B.R. 445 (N.D. Ill. 1997), *rev’d on other grounds* 157 F.3d 1099 (7th Cir. 1998); *In re Lakeside Community Hosp., Inc.*, 139 B.R. 886 (Bankr. N.D. Ill. 1992), *aff’d*, 151 B.R. 887 (N.D. Ill. 1993); *In re Chamblin*, 107 B.R. 122 (Bankr. N.D. Tex. 1989); *Walter E. Heller & Co. v. Food Mktg. Assocs., Ltd. (In re Fasano/Harriss Pie Co.)*, 43 B.R. 864 (Bankr. W.D. Mich. 1984), *aff’d*, 70 B.R. 285 (W.D. Mich. 1987).

32. See, e.g., *In re Flagstaff Realty Assocs.*, 60 F.3d 1031 (3d Cir. 1995); *Ashland Petroleum Co. v. Appel (In re B & L Oil Co.)*, 782 F.2d 155 (10th Cir. 1986).

33. *United States Abatement Corp. v. Mobile Exploration & Producing U.S., Inc. (In re United States Abatement Corp.)*, 79 F.3d 393, 398 n.16 (5th Cir. 1996) (A setoff is asserted for the purpose of reducing or extinguishing a creditor’s claim against the debtor when the mutual debt and claim contemplated are generally those arising from different transactions. “Recoupment, on the other hand, is the setting up of a demand arising from the same transaction as the plaintiff’s claim or cause of action, strictly for the purpose of abatement or reduction of such claim.”) (citations and internal quotation marks omitted).

- Although both setoff and recoupment are common-law doctrines,<sup>34</sup> setoff is incorporated into bankruptcy law by statute.<sup>35</sup> Recoupment, even in a bankruptcy context, remains a purely common-law right that is not expressly addressed in the Bankruptcy Code<sup>36</sup>; and
- Setoff is subject to the automatic stay pursuant to Bankruptcy Code section 362(a)(7) but recoupment is not.<sup>37</sup>

34. See *B.F. Goodrich Employees Fed. Credit Union v. Patterson (In re Patterson)*, 967 F.2d 505 (11th Cir. 1992); *Sisk v. Saugus Bank & Trust Co. (In re Saugus General Hosp., Inc.)*, 698 F.2d 42 (1st Cir. 1983); *United States v. Norton*, 717 F.2d 767 (3d Cir. 1983); *In re Express Freight Lines, Inc.*, 130 B.R. 288 (Bankr. E.D. Wis. 1991); *In re Chestnut Co.*, 39 B.R. 519 (Bankr. D.S.C. 1984.)

35. Bankruptcy Code section 553 both preserves a creditor's common-law right of setoff and limits its application in bankruptcy, as follows:

(a) Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case, except to the extent that—

(1) the claim of such creditor against the debtor is disallowed;

(2) such claim was transferred, by an entity other than the debtor, to such creditor—

(A) after the commencement of the case; or

(B)(i) after 90 days before the date of the filing of the petition; and

(ii) while the debtor was insolvent; or

(3) the debt owed to the debtor by such creditor was incurred by such creditor—

(A) after 90 days before the date of the filing of the petition;

(B) while the debtor was insolvent; and

(C) for the purpose of obtaining a right of setoff against the debtor.

(b)(1) Except with respect to a setoff of a kind described in section 362(b)(6), 362(b)(7), 362(b)(14), 365(h), 546(h), or 365(i)(2) of this title, if a creditor offsets a mutual debt owing to the debtor against a claim against the debtor on or within 90 days before the date of the filing of the petition, then the trustee may recover from such creditor the amount so offset to the extent that any insufficiency on the date of such setoff is less than the insufficiency on the later of—

(A) 90 days before the date of the filing of the petition; and

(B) the first date during the 90 days immediately preceding the date of the filing of the petition on which there is an insufficiency.

(2) In this subsection, "insufficiency" means amount, if any, by which a claim against the debtor exceeds a mutual debt owing to the debtor by the holder of such claim.

(c) For the purposes of this section, the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of the filing of the petition.

11 U.S.C.A. § 553 (West 2000); see also *In re Lakeside Community Hosp., Inc.*, 139 B.R. 886, 888 (setoff is allowed in bankruptcy only if the requirements of both state law and the Bankruptcy Code have been met).

36. *United States v. Dewey Freight Sys., Inc.*, 31 F.3d 620 (8th Cir. 1994).

37. *Newbery Corp. v. Fireman's Fund Ins. Co.*, 95 F.3d 1392, 1399 (9th Cir. 1996); *Aetna Life & Cas. Co. v. LaPierre (In re LaPierre)*, 180 B.R. 95, 100 (Bankr. D.S.C.

In short, if both doctrines are available, in most respects, recoupment is clearly the more favorable one from the standpoint of the creditor.<sup>38</sup> The main drawback to recoupment is the “single” or “same” transaction requirement. Not surprisingly, it is this requirement that has resulted in much of the litigation over recoupment.

## II. ROUND ONE TO THE DEBTOR – THE *UNIVERSITY MEDICAL CENTER* Decisions

### A. Introduction

#### 1. The Facts in *University Medical Center*

The leading decision on a number of issues likely to arise in a healthcare bankruptcy is unquestionably the Third Circuit’s opinion in *University Medical Center*.<sup>39</sup> University Medical Center (“UMC”) was a general care hospital that provided services to Medicare patients pursuant to a provider agreement executed in 1966. As the court noted, the statute requires monthly estimated payments to providers “[t]o insure that providers are paid promptly.”<sup>40</sup> The actual amounts that should have been paid to a provider are then determined in an annual audit. Following the audit, the government either pays additional amounts to the provider if it turns out that the provider had been underpaid or reduces future payments to account for prior overpayments, an adjustment that is “mandated by Medicare’s [Prospective Payment System].”<sup>41</sup>

UMC filed a chapter 11 petition on January 1, 1988. One week later, Blue Cross of Greater Pennsylvania, the fiscal intermediary, informed UMC that the hospital had been overpaid for 1985 in the amount of \$267,042 and that Blue Cross would withhold 100% of future estimated payments until the overpayment

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1994); Anthem Life Ins. Co. v. Izaguirre (*In re Izaguirre*), 166 B.R. 484 (Bankr. N.D. Ga. 1994); American Cent. Airlines, Inc. v. United States Dept. of Transp. (*In re American Cent. Airlines, Inc.*), 60 B.R. 587 (Bankr. N.D. Iowa 1986).

38. Gary W. Marsh & Angelyn M. Wright, *New Trends in Set-Off v. Recoupment: Hot Topic in the Health Care Arena*, 18 AM. BANKR. INST. J. (April 1999) (stating that “creditors invariably prefer recoupment to set-off.”).

39. University Med. Ctr. v. Bowen (*In re University Med. Ctr.*), 93 B.R. 412 (Bankr. E.D. Pa. 1988) [hereinafter *University Med. Ctr. I*], *aff’d in part, rev’d in part on other grounds sub nom.* University Med. Ctr. v. Sullivan, 122 B.R. 919 (E.D. Pa. 1990) [hereinafter *University Med. Ctr. II*], *reconsideration denied*, 125 B.R. 121 (E.D. Pa. 1991)[hereinafter *University Med. Ctr. III*], *aff’d*, *University Med. Ctr. IV*, 973 F.2d 1065 (3d Cir. 1992).

40. *University Med. Ctr. IV*, 973 F.2d at 1070.

41. *Id.*

had been recovered. UMC did not respond to Blue Cross until Blue Cross actually withheld a \$58,000 payment on February 18. At that point, UMC negotiated a repayment of the 1985 overpayment at the rate of \$15,000 per month, subject to UMC providing Blue Cross with requested documentation. UMC did not seek or obtain bankruptcy court approval of its agreement with Blue Cross. It also did not provide Blue Cross with the promised information. As a result, on March 28, Blue Cross announced that it would resume 100% withholding. The debtor closed its doors three days later and ceased doing business. Ultimately, HHS, through Blue Cross, determined that UMC had received additional overpayments in both 1986 and 1987 totaling \$536,000 and withheld a total of \$312,000 from UMC.<sup>42</sup>

UMC initiated an adversary proceeding against HHS, alleging that HHS had violated the automatic stay both by demanding repayment of the prepetition overpayments and by withholding postpetition payments to recover the prepetition overpayments. HHS asserted contractual recoupment as an affirmative defense.<sup>43</sup>

## 2. The Bankruptcy Court: Discrimination Under Section 525

The bankruptcy court concluded that because UMC had not assumed the provider agreement, HHS's demand that the debtor repay prior overpayments as a condition of receiving future payments constituted discrimination against the debtor in violation of Bankruptcy Code section 525(a).<sup>44</sup> The bankruptcy court began its discussion by noting that the debtor had made an "appealing argument" that "HHS is not seeking recoupment pursuant to an executory contract, but is merely attempting to pursue recoupment pursuant to federal statues [sic]."<sup>45</sup> HHS, however, apparently argued that its recoupment rights were

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42. *Id.* at 1070-71.

43. *Id.* at 1071.

44. Section 525(a) states that, with certain exceptions not here relevant, a governmental unit may not "deny, revoke, suspend or refuse to renew a license, permit, charter, franchise, or other similar grant to, condition such a grant to, [or] discriminate with respect to such a grant against" a debtor "solely" because of the financial condition of the debtor or the fact that the debtor is or has been a debtor or has failed to pay a claim that can be, or has been, discharged in bankruptcy. 11 U.S.C.A. § 525(a) (West 2000).

45. *University Med. Ctr. I*, 93 B.R. 412, 415 (Bankr. E.D. Pa. 1988) (quoting *In re St. Mary Hosp.*, 89 B.R. 503, 507, 507 n. 4 (Bankr. E.D. Pa. 1988)). The bankruptcy court relied heavily on its earlier decision in *St. Mary*. That decision was also appealed and the appeal was pending when the bankruptcy court entered its *University Medical Center* decision. Ultimately, the district court vacated the order in *St. Mary*



contractual and the court decided, as it had in *St. Mary*, to assume *arguendo* that the provider agreement was an executory contract. Having so decided, the court concluded that absent a formal motion to assume the contract, the debtor could not be deemed to have assumed it.<sup>46</sup> The court did not expressly rule that the recoupment rights, if they were based on contract, were not enforceable against the debtor absent assumption of the contract. It also did not indicate how its analysis might have been different if the government's recoupment rights were deemed to be statutory rather than contractual.<sup>47</sup>

Instead, the court held that "requiring the Debtor to pay an otherwise dischargeable obligation to reimburse HHS for past overpayments as a condition to receive the 'benefit' of rights otherwise enforceable by the Debtor under the [Provider] Agreement in the future is an example of precisely the sort of governmental discrimination against debtors prohibited by § 525(a)."<sup>48</sup> Again, the court relied entirely on its *St. Mary* opinion. It did not analyze the distinction between recoupment and setoff in bankruptcy, stating only that attempting to recover prepetition obligations from a debtor violates section 525(a) regardless of whether the attempt is characterized as setoff or as recoupment.<sup>49</sup>

### 3. The District Court: No Discrimination, But No Recoupment Either

HHS appealed to the district court, which affirmed the decision that HHS had violated the automatic stay but rejected the bankruptcy court's argument that the debtor was the victim of discrimination prohibited by section 525(a).<sup>50</sup> The district court interpreted *St. Mary* (correctly) as having held that the discrimination prohibited by section 525 does not require a finding that the government treated a bankruptcy debtor differently than it would have treated a similarly situated nonbankruptcy debtor.<sup>51</sup> Instead, the bankruptcy court had analogized to cases involving

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after the parties settled their dispute, but did not reach the merits of any of the issues that had been addressed by the bankruptcy court in its order.

46. *Id.* at 415-16.

47. The significance of this issue is set forth in the district court's opinion, which is discussed *infra* at notes 60-62 and accompanying text.

48. *University Med. Ctr. I*, 93 B.R. at 416.

49. *Id.* at 417.

50. *University Med. Ctr. II*, 122 B.R. 919, 923 (E.D. Pa. 1990).

51. *Id.* at 924.

government contracts<sup>52</sup> and public housing,<sup>53</sup> concluding that “the significant factor in these cases was not that the government treated the bankrupt parties dissimilarly, but rather that the government attempted to collect a debt that would otherwise be discharged in bankruptcy proceedings.”<sup>54</sup>

The district court stated that the “analogy [to these cases] is probably overdrawn.”<sup>55</sup> In those cases, “the government did not treat the bankrupt debtors differently from debtors who had not filed in bankruptcy, but were in similar financial trouble,” but “did treat bankruptcy debtors differently from contractors and tenants who were not in bankruptcy and not eligible to file.”<sup>56</sup> The district court concluded that provider agreements give HHS the authority to adjust future payments whether or not the provider is in bankruptcy, so that a finding of discrimination under section 525 requires a finding that the withholding of future payments “is motivated by discrimination.”<sup>57</sup>

The district court did not remand for fact-finding on the section 525 issue, however, because it concluded that HHS’s actions were authorized neither by setoff nor by recoupment. It first disposed of the setoff issue in short order: “[Section 553] does not allow set-off where the creditor’s debt to the debtor arises after the debtor filed for bankruptcy.”<sup>58</sup>

The court then addressed the recoupment issue:

[R]ecoupment applies where the creditor’s claim against the debtor arises from the same transaction as the debtor’s claim and is “essentially a defense to the debtor’s claim . . . rather than a mutual obligation. . . . It is deemed inequitable, when a single transaction is at issue, to allow a debtor to cut off a creditor’s defense and thus recover an amount greater than what the debtor is due under the transaction, simply because the defense arose prepetition and the claim arose postpetition. . . . Recoupment, however, does not allow a creditor to service a

52. *In re Son-Shine Grading, Inc.*, 27 B.R. 693 (Bankr. E.D.N.C. 1983).

53. *Housing Auth. of the City of Erie v. Szymecki (In re Szymecki)*, 87 B.R. 14 (Bankr. E.D. Pa. 1988).

54. *University Med. Ctr II*, 122 B.R. at 924 (citing *In re St. Mary Hosp.*, 89 B.R. 503, 512 (Bankr. E.D. Pa. 1988)).

55. *Id.*

56. *Id.*

57. *Id.* The court acknowledged as an “interesting coincidence” the fact that Blue Cross began withholding for 1985 overpayments one week after the debtor filed its bankruptcy petition in January 1988, but did not deem that fact dispositive. *Id.*

58. *Id.* at 925 (citing *Lee v. Schweiker*, 739 F.2d 870, 875 (3d Cir. 1984)). HHS did not argue that any of the statutory exceptions to the automatic stay were applicable. *Id.*

claim against the bankruptcy estate; rather, it prevents the debtor from asserting unmerited claims against the creditor to improperly augment that estate.<sup>59</sup>

The court also explained the significance of the statutory/contractual distinction noted, but not addressed, by the bankruptcy judge. In *Lee*, the Third Circuit had held that recoupment is a defense available only in contract actions. Because the dispute in that case involved adjustments of retirement benefits payable to the recipient under the Social Security laws, the recipient's rights were a statutory entitlement and thus not subject to recoupment.<sup>60</sup> The district court distinguished *Lee* by concluding that although HHS's ability to recover overpayments is "granted by statute, . . . UMC qualifies as a provider not by the statute but by the Provider Agreement."<sup>61</sup> Therefore, although the statutory overpayment recovery provisions are incorporated into the agreement, the relationship between HHS and the provider is "properly regarded as contractual."<sup>62</sup>

UMC argued that HHS had no contractual recoupment rights it could exercise absent assumption of the provider agreement. The district court stated that if UMC had assumed the provider agreement, it would necessarily have also assumed the burden of recoupment of prepetition overpayments, but the court agreed with the debtor and the bankruptcy court that the provider agreement had never properly been assumed.<sup>63</sup>

The court, however, rejected the argument that a right of recoupment can only be exercised after assumption of the underlying contract. It stated that recoupment is an equitable principle applicable to contracts even if not specifically set forth therein,<sup>64</sup> and cited *NLRB v. Bildisco & Bildisco*<sup>65</sup> as support for the proposition that "in the period between a bankruptcy filing and before assumption or rejection of executory contracts, eq-

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59. *Id.* at 925-26 (quoting *Lee*, 739 F.2d at 775) (other citations omitted, first ellipses in original). The court also held that even if *Lee* had left open the issue of whether recoupment was available in bankruptcy as an exception to the automatic stay (as the bankruptcy court had suggested), it did not agree with the debtor that the "better-reasoned" view was that recoupment was not so available. *Id.* at 925.

60. *Id.* at 926 (citing *Lee*, 739 F.2d at 870, 876).

61. *Id.*

62. *Id.*

63. *Id.* at 927.

64. *Id.* (citing *In re B & L Oil Co.*, 782 F.2d 155, 159 (10th Cir. 1986). *B & L Oil*, 782 F.2d at 159).

65. *NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1984).

uity controls the relationship between the debtor and the creditors when performance under the contract is continued.”<sup>66</sup>

It then distinguished *Bildisco* on the ground that that case had involved whether and how much a debtor was *obligated to pay* for postpetition services it received under the contract, whereas the Medicare recoupment situation involves whether and how much a debtor is *entitled to be paid* for postpetition services rendered under an unassumed contract. The court concluded that the majority, and better-reasoned, view was that a provider who seeks payments for postpetition services pursuant to an unassumed provider agreement necessarily accepts “the burden of recoupment” by seeking payment under the contract.<sup>67</sup>

The court then considered whether HHS’s prepetition overpayment claims arose out of the same transaction as UMC’s postpetition payment claims and concluded that they did not. It distinguished two cases permitting recoupment and rejected HHS’s argument that because all of the rights and obligations of it and UMC arose under a single provider agreement, they necessarily involved a single transaction.<sup>68</sup>

In *United States v. Midwest Services & Supply Co. (In re Midwest Serv. & Supply Co.)*,<sup>69</sup> the court concluded that a series of service and repair contracts, which allowed the contractor to bill the government periodically for work in progress, constituted a single transaction,<sup>70</sup> thus permitting the government to recoup prepetition overpayments from the amount due to the debtor when the debtor presented a final bill after filing its bankruptcy case. According to the court, the government was “simply applying the progress payment clause to the single transaction to determine how much [the debtor] was due.”<sup>71</sup>

66. *University Med. Ctr. II*, 122 B.R. at 928.

67. *Id.* (citing *Tidewater Memorial Hosp. v. Bower (In re Tidewater Memorial Hosp.)*, 106 B.R. 876 (Bankr. E.D. Va. 1989); *Advanced Professional Home Health Care, Inc. v. Bower (In re Advanced Prof'l Home Health Care, Inc.)*, 94 B.R. 95 (E.D. Mich. 1988); *In re Provident Hosp. & Training*, No. 87 B 11069, slip op. (Bankr. N.D. Ill. 1988); *In re Yonkers Hamilton Sanitarium, Inc.*, 22 B.R. 427 (Bankr. S.D.N.Y. 1982), *aff'd*, 34 B.R. 385 (S.D.N.Y. 1983); and declining to follow *In re Memorial Hosp. of Iowa City, Inc.*, 82 B.R. 478, 484 (W.D. Wis. 1988) (concluding that bankruptcy court approval is required before any party to any executory contract can collect prepetition overpayments)).

68. *Id.* at 929-30.

69. *United States v. Midwest Serv. & Supply Co. (In re Midwest Serv. & Supply Co.)*, 44 B.R. 262 (D. Utah 1983).

70. *Id.* at 266.

71. *Id.*

In *Waldschmitt v. CBS*,<sup>72</sup> CBS had made advance payments to a recording artist under a royalties agreement. When the record covered by the royalties agreement was released after the artist filed for bankruptcy, the court held that CBS's claim to recover the advance royalty payments and the artist's claim to receive royalty payments under the agreement both arose in one transaction and that CBS could properly recoup the prepetition advances out of the postpetition royalty payments.<sup>73</sup> The district court distinguished both of these cases on the facts, stating that "[i]t would be a distortion of the record to conclude that overpayments for Medicare services performed in 1985 are a defense to a claim for unrelated services provided in 1988."<sup>74</sup>

Although originally presenting this argument as an unconvincing tautology, the district court did provide a cogent argument for its conclusion when it addressed HHS's contention that it should follow *B & L Oil*, which had held that multiple purchases under an oil delivery contract were all part of a single transaction.<sup>75</sup> The court ruled that:

The Provider Agreement is a unique type of contract. It does not provide for a defined transaction or even a series of defined transactions. It simply establishes a relationship between the parties: if UMC treats eligible patients, HHS will reimburse them for their costs. Under the agreement, the parties established an arrangement for payment, with HHS providing reimbursement with respect to each patient treated. The arrangement called for the payments to be estimates and thus contemplated that over time an overpayment or underpayment might result, creating a debt in one or the other party. The arrangement called for this debt to be calculated on an annual basis. The result is that the overpayment debt owed by UMC is distinct from and bears no direct relation to the particular claims for reimbursement for services performed postpetition. . . . Absent an assumption of the contract's terms, HHS is left to rely on common law recoupment, which simply does not apply in this case. It must be remembered that the question is not whether a debt is owed, but whether HHS should be given preferred status with respect to that debt. I hold that they should not.<sup>76</sup>

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72. *Waldschmitt v. CBS*, 14 B.R. 309 (M.D. Tenn. 1981).

73. *Id.* at 314.

74. *University Med. Ctr. II*, 122 B.R. 919, 929 (E.D. Pa. 1990).

75. *Id.*

76. *Id.* at 930.

On reconsideration, the district court reaffirmed its prior decision in its entirety, issuing a second opinion only to clarify its reasoning regarding an argument previously made by the Secretary.<sup>77</sup> The Secretary argued imaginatively that he was not seeking repayment of a prepetition debt, but was only trying to avoid paying twice for the same services: “HHS attempted to raise the defense of prepayment, arguing that the net overpayment for the fiscal years of 1985, 1986 and 1987 amounted to prepayment for services provided in the beginning. I held that this was a mischaracterization, in light of the Medicare reimbursement scheme and the equitable foundation of the recoupment doctrine.”<sup>78</sup> The court then explained the policy considerations supporting its conclusion that HHS’s exercise of its recovery rights should be subject to the automatic stay:

Under the Medicare reimbursement scheme, a provider that derives a substantial portion of its revenue from Medicare patients might be indebted to HHS, through no fault of its own, for amounts totaling hundreds of thousands or even millions of dollars at the time of a bankruptcy filing. To allow HHS to recoup this debt by completely withholding interim payments as they accrue, would place the hospital in a stranglehold. HHS argues that unless it is permitted to put hospitals under such a squeeze, federal taxpayers will be forced to pay for the same services twice. However, by observing the stay, HHS is only forced to postpone its claim for overpayment, and then only for a limited time. My ruling applies only to the period after the bankruptcy filing and before the Medicare provider decides to assume or reject the provider agreement.<sup>79</sup>

The court also held, however, that HHS was no longer obligated to pay the provider’s estimated costs; it could now pay UMC only its actual costs. The court explained that its prior holding was not intended to abrogate an HHS regulation that provides that if a provider is in, or is about to enter, bankruptcy, HHS “will” adjust payments “to a level necessary to insure that no overpayment to the provider is made.”<sup>80</sup>

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77. *University. Med. Ctr. III*, 125 B.R. 121, 123 (E.D. Pa. 1991).

78. *Id.* at 124.

79. *Id.*

80. *Id.* at 125 (quoting 42 C.F.R. §413.64(i) (West 2000)). The regulation quoted by the court provides that:

Bankruptcy or insolvency of provider. If on the basis of reliable evidence, the intermediary has a valid basis for believing that, with respect to a provider, proceedings have been or will shortly be instituted in a State or Federal court for purposes of determining whether such provider is insolvent or bankrupt under an appropriate State or Federal law, any payments to the

#### 4. The Third Circuit: No Recoupment Because “Same Transaction” Requirement Not Met

##### a. *The Preliminary Issues*<sup>81</sup>

Both parties appealed to the Third Circuit.<sup>82</sup> That court first rejected HHS’s argument (asserted for the first time on this appeal) that the bankruptcy, district, and circuit courts all lacked jurisdiction over the dispute because section 405 (g) and (h) of Title 42 precludes judicial review of any “claim arising under” the Medicare statutes prior to the exhaustion of administrative remedies.<sup>83</sup> Section 405(h) is made applicable in Medicare-re-

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provider will be adjusted by the intermediary, notwithstanding any other regulation or program instruction regarding the timing or manner of such adjustments, to a level necessary to insure that no overpayment to the provider is made.

*Id.*

81. A full discussion of the issues identified in this section is outside the scope of this article. These issues should, however, be kept in mind if disputes arise between a provider and a governmental entity regarding prepetition overpayments because the issue of recoupment does not properly come before the court until all of these preliminary issues are either resolved or determined to be inapplicable.

82. HHS appealed for obvious reasons. UMC appealed because the bankruptcy court had awarded it sanctions against HHS and the district court reversed the award. See *University Med. Ctr. II*, 122 B.R. 919, 931-33 (E.D. Pa. 1990).

83. Section 405(g) states that:

Any individual, after any final decision of the Commissioner of Social Security made after a hearing to which he was a party, irrespective of the amount in controversy, may obtain a review of such decision by a civil action commenced within sixty days after the mailing to him of notice of such decision or within such further time as the Commissioner of Social Security may allow. . . . The court shall have power to enter, upon the pleadings and transcript of the record, a judgment affirming, modifying, or reversing the decision of the Commissioner of Social Security, with or without remanding the cause for a rehearing. The findings of the Commissioner of Social Security as to any fact, if supported by substantial evidence, shall be conclusive, and where a claim has been denied by the Commissioner of Social Security or a decision is rendered under subsection (b) of this section which is adverse to an individual who was a party to the hearing before the Commissioner of Social Security, because of failure of the claimant or such individual to submit proof in conformity with any regulation prescribed under subsection (a) of this section, the court shall review only the question of conformity with such regulations and the validity of such regulations. . . . The judgment of the court shall be final except that it shall be subject to review in the same manner as a judgment in other civil actions. Any action instituted in accordance with this subsection shall survive notwithstanding any change in the person occupying the office of Commissioner of Social Security or any vacancy in such office.

42 U.S.C.A. § 405(g) (West 2000). Section 405(h) provides that:

The findings and decision of the Commissioner of Social Security after a hearing shall be binding on all individuals who were parties to such hearing. No findings of fact or decision of the Commissioner of Social Security shall

lated disputes by section 1395ii, which states that various provisions of sections 405, 406, and 46 of title 42 are applicable in “this subchapter” (i.e., subchapter XVIII, which contains all of the various 1395 sections, including section 1395g(a), which is the basis for HHS’s asserted right of recoupment).<sup>84</sup>

The court acknowledged that the phrase “claims arising under” should be broadly construed to “encompass any claims in which ‘both the standing and the substantive basis for the presentations’ of the claims is the Medicare Act.”<sup>85</sup> HHS asserted that both requirements were met because “the administrative review channel set forth in the Medicare Act and regulations is available only for claims brought by a provider when dissatisfied with final reimbursement determinations of the fiscal intermediary.”<sup>86</sup> UMC responded that the argument was irrelevant because the parties did not dispute the amounts due to UMC for its postpetition services or the amounts UMC had been overpaid prepetition.<sup>87</sup> Thus, argued UMC, its claim against HHS for violating the automatic stay by withholding postpetition payments and seeking repayment of those overpayments arose under the Bankruptcy Code, not under the Medicare Act.<sup>88</sup>

The court agreed with UMC, holding that “[UMC’s] challenge to the Secretary’s attempt to recover prepetition overpayments through postpetition withholding is not inextricably intertwined with any dispute concerning the fiscal intermediary’s reimbursement determinations.”<sup>89</sup> The court did not explain the relevance of the “inextricably intertwined” standard it applied. As dis-

be reviewed by any person, tribunal or governmental agency except as herein provided. No action shall be brought under section 1331 or 1346 of Title 28 to recover on any claim arising under this subchapter.

*Id.* § 405(h).

84. See 42 U.S.C.A. § 1395ii (West 2000).

85. *University Med. Ctr. IV*, 973 F.2d 1065, 1073 (3d Cir. 1992) (quoting *Heckler v. Ringer*, 466 U.S. 602, 615 (1984) and *Weinberger v. Salfi*, 422 U.S. 749, 760-61 (1975)).

86. *Id.* (citing 42 C.F.R. § 405.1841 (1991)).

87. *Id.*

88. *Id.* Neither the parties nor the court distinguished between refusing to pay the total amounts due for postpetition services by reason of prepetition overpayments and affirmatively seeking repayment of those overpayments. The distinction is probably irrelevant. If recoupment applies because there is only a single transaction, the automatic stay is inapplicable, because recoupment is a defense and the stay only applies to actions to collect on claims. On the other hand, if the “single transaction” requirement is not met, the prepetition overpayments do constitute claims and, thus, attempts to recover them should be subject to the stay.

89. *Id.*



cussed below, the Supreme Court adopted that test in *Salfi* and *Ringer*.

Although the court did not specifically so state, its conclusion appears to have been based on the “standing” prong of the Supreme Court’s definition of “claim arising under.” The court stated that outside of bankruptcy, there would have been no “dispute concerning the monies owed to HHS or the method for recovering them.”<sup>90</sup> The issue was before the court only because UMC, as a bankruptcy debtor, had claimed that HHS violated the automatic stay.<sup>91</sup>

The court recognized that a broad reading of section 405(h) “might accord” with Congress’ intent to allow HHS to develop the record and bases decisions on its “unique expertise in the health care field.”<sup>92</sup> It concluded, however, that it was not impinging on the Secretary’s authority under the Medicare Act because “there is no system of administrative review in place to address the issues raised by UMC in its adversary proceeding” and because there was an independent basis for bankruptcy court jurisdiction.<sup>93</sup>

The court then turned to the substantive issues, identifying four questions it needed to resolve:

- Does the automatic stay apply to governmental entities?
- If it does, did UMC assume its provider agreement by its actions so as to permit the government to recover prepetition overpayments notwithstanding the stay?
- If the stay is applicable and UMC did not assume the provider agreement, did HHS’s withholding of postpetition payments fall within the scope of recoupment?
- If the recoupment doctrine does not apply, does equity control the postpetition relationship between UMC and HHS and, if so, does the Medicare Act permit HHS to reimburse a provider without making adjustments for past overpayments?<sup>94</sup>

The court did not tarry long on the first question. It concluded that the automatic stay does apply to governmental entities and that HHS’s withholding of prior overpayments

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90. *Id.*

91. *Id.*

92. *Id.* (citing *Sullivan v. Hiser (In re St. Mary Hosp.)*, 123 B.R. 14, 17 (E.D. Pa. 1991)).

93. *Id.* at 1073-74 (citing *In re Town & Country Home Nursing Servs., Inc.*, 963 F.2d 1164 (9th Cir. 1991)).

94. *Id.* at 1074.

“certainly did not fall within [the] police power exception to the stay,<sup>95</sup> and the Secretary does not contend as much.”<sup>96</sup>

The court also upheld the conclusion of the district and bankruptcy courts that assumption requires a formal motion approved by the bankruptcy court and cannot be done informally.<sup>97</sup> The Secretary responded with a new argument, suggesting that because, under the statutes and the implementing regulations, a provider agreement remains in effect until the provider goes out of business or either party formally terminates it, the agreement binds the debtor even in the absence of assumption. Thus, because the provider performed under the agreement postpetition, it should be deemed to have assumed the agreement. The court responded that “[Bankruptcy Code] section 365 includes all executory contracts except those specifically exempted,”<sup>98</sup> and that Congress had exempted certain contracts (collective bargaining agreements and certain real property leases), but not Medicare provider agreements.<sup>99</sup> Thus, a debtor can assume a provider agreement by only complying with section 365 and obtaining court approval of the assumption.<sup>100</sup>

Finally, HHS argued that implied assumption would benefit the debtor’s other creditors by ensuring the continued flow of Medicare payments into the estate. The court rejected this argument as well, pointing out that (a) while this might be true in certain cases, it is not always true — in this case, the Secretary would have the equivalent of an administrative claim of \$800,000 based on its prepetition overpayments even though the

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95. The automatic stay created by section 362(a)(1), (2), (3), and (6) does not apply to “the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit’s . . . police and regulatory power, including the enforcement of a judgment other than a money judgment.” 11 U.S.C.A. § 362(b)(4)(West 2000). See generally *Hillis Motors, Inc. v. Hawaii Auto. Dealers’ Ass’n*, 997 F.2d 581, 591 (9th Cir. 1993) (stating the terms “police or regulatory power” refer to “the enforcement of state laws affecting health, morals and safety but not regulatory laws that directly conflict with the control of the res or property by bankruptcy court”); *EEOC v. Rath Packing Co.*, 787 F.2d 318 (8th Cir. 1986) (holding that suits by governmental units against the debtor to prevent or stop violations of fraud, environmental protection, consumer protection, safety, or similar police or regulatory laws are not barred by the automatic stay).

96. *University Med. Ctr. IV*, 973 F.2d at 1075. It is possible that, under appropriate circumstances, recovery of prepetition overpayments may fall within the “police power” exception to the automatic stay.

97. *Id.* at 1076.

98. *Id.* (citing *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 521 (1984)).

99. *Id.* at 1076-77.

100. *Id.* at 1077.

debtor stayed in business only six weeks after it “assumed” the provider agreement; (b) such a holding would require a debtor to decide immediately whether to assume or reject the provider agreement, without any opportunity to first determine whether it made financial sense to do so; and (c) HHS could have filed a motion to compel assumption or rejection and thus protect its interests, but failed to do so.<sup>101</sup>

Another issue addressed by the court was whether the postpetition relationship between UMC and HHS was governed by equity, *i.e.*, was UMC entitled to be paid for its services despite the fact that it did not assume the provider agreement and, if so, what was it entitled to receive?<sup>102</sup> UMC argued that under *Bildisco*, it was entitled to receive payments equal to the reasonable value of its services. The Secretary responded that under the Medicare Act, UMC was entitled to receive payment only if it was a party to a valid, effective provider agreement.<sup>103</sup> The Secretary also advanced the argument that forcing HHS to pay for postpetition, pre-assumption services provided by a debtor to its Medicare patients would amount to the imposition of an equity-based monetary remedy against the government, something the Supreme Court had ruled cannot be done.<sup>104</sup>

The court stated that both parties were focusing too much on the actual, and fairly narrow, holding in *Bildisco*, and that it would apply the broader principle articulated in that case to the effect that courts faced with intersecting or overlapping statutes that appear to be inconsistent should harmonize them and give effect to both whenever possible.<sup>105</sup> After noting the various

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101. *Id.* at 1078-79. The court acknowledged that its conclusion departed from *Tidewater Mem'l Hosp.*, 106 B.R. at 883-84; *Advanced Prof'l Home Health Care*, 94 B.R. at 96; *Yonkers Hamilton Sanitarium*, 22 B.R. at 427; and *In re Monsour Med. Ctr.*, 8 B.R. 606, 615 (Bankr. W.D. Pa.), *aff'd*, 11 B.R. 1014 (W.D. Pa. 1981), all of which had held that because of the unique Medicare statutory scheme, a provider could not continue as such postpetition without assuming the agreement, but refused to follow those cases. *University Med. Ctr. IV*, 973 F.2d at 1079 n. 19.

102. *Id.* at 1082.

103. *Id.* The statute relied on by the Secretary states in relevant part that “[a]ny provider of services . . . shall be qualified to participate under this subchapter and shall be eligible for payments under this subchapter if it files with the Secretary an agreement. . . .” 42 U.S.C. § 1395cc(1) (West 2000). Note that, read literally, this statute merely requires that an agreement be on file. It does not address what happens after filing and there does not appear to be any Medicare statute that does address the situation created when a provider files for bankruptcy and does not immediately assume or reject its provider agreement.

104. *University Med. Ctr. IV*, 973 F.2d at 1084 (citing *Office of Pers. Mgmt. v. Richmond*, 496 U.S. 414 (1990)).

105. *Id.* at 1082.

concerns expressed by the Secretary,<sup>106</sup> the court concluded that the proper balance would be established by holding that a debtor who continues to provide services to Medicare patients prior to assumption of the provider agreement remains a provider subject to all of the requirements of the Medicare Act and the regulations promulgated thereunder. In particular, prior to assumption, a provider debtor remains “subject to the Prospective Payment System and the program’s health and safety standards.”<sup>107</sup> Thus, the court accepted the Secretary’s arguments in part by holding that lack of assumption does not authorize a provider who continues providing services to patients to ignore health or safety standards or get paid any more for the services it provides than it would have been paid for those services outside of bankruptcy. The court accepted the debtor’s arguments to the extent that it held that HHS may not recover prepetition overpayments out of reimbursement for postpetition services.<sup>108</sup>

*b. Recoupment Requires a “Single Transaction,” and That Requirement is Not Met When HHS Seeks to Deduct Overpayments Made in 1985 From Payments for Services Rendered in 1988*

The court then turned to recoupment. It first distinguished recoupment from setoff, focusing primarily on the well-settled principle that recoupment applies only to claims and defenses arising out of a single transaction.<sup>109</sup> The court also adopted several other well-established principles:

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106. The Secretary argued that (i) recoupment “is vital to the success of the Medicare statutory scheme;” (ii) paying a debtor the “reasonable value” of its services instead of what it would receive under the Medicare statutes and regulations would undercut the goal of containing health care costs; (iii) the district court’s decision would allow Medicare providers to evade health and safety standards and otherwise applicable civil rights laws; and (iv) if the debtor’s status as a provider is not immediately determined by assumption or rejection of its provider agreement, Medicare services to the community might be disrupted. *Id.* at 1083.

107. *Id.* at 1084.

108. *Id.* UMC cooperatively filed its bankruptcy petition on January 1. The court does not address whether, if a debtor files a petition in the middle of the year, prepetition overpayments for services rendered in that year can be recouped from postpetition services also rendered in that year. If the focus is on the yearly audit, the answer should clearly be “yes.”

109. *Id.* at 1079 (citing 4 COLLIER ON BANKRUPTCY § 553.03, at 553-15-17 (L. King, ed. 15th Ed. 1991)).

- Recoupment is not a bankruptcy law creation, but a common-law doctrine;<sup>110</sup>
- Recoupment is not subject to the limitations placed on set-off by Bankruptcy Code section 553;<sup>111</sup>
- It is often applied “where the relevant claims arise out of a single contract ‘that provide[s] for advance payments based on estimates of what ultimately would be owed, subject to later correction’”;<sup>112</sup> and
- It does not need to be expressly set forth in the contract.<sup>113</sup>

The court also set forth one final principle, for which it cited no authority: “Nor does the fact that a contract exists between the debtor and the creditor automatically enable the creditor to effect a recoupment.”<sup>114</sup>

Because the Secretary’s argument as to why the court should have concluded that the “single transaction” requirement was met forms the bases for the most oft-repeated attacks on *University Medical Center*, it is worth setting forth in its entirety:

The Secretary contends, nevertheless, that the text of the Medicare statute itself evinces the error of the district court’s conclusion. In particular, the Secretary advances that portion of the Medicare statute which provides:

The Secretary shall periodically determine the amount which should be paid under this part to each provider of services with respect to the services furnished by it, and the provider of services shall be paid, at such time or times as the Secretary believes appropriate (but not less often than monthly) and prior to audit or settlement by the General Accounting Office, from the Federal Hospital Insurance Trust Fund, the amounts so determined, with necessary adjustments on account of previously made overpayments or under payments. . . .

42 U.S.C. § 1395g(a). According to the Secretary, this language renders each claim for Medicare reimbursement both subject to and contingent upon the Department’s right to recover prior overpayments. It establishes the “mutuality of obligation” necessary for recoupment. Furthermore, the

110. *Id.*

111. *Id.* at 1080 (noting, although not expressly, that recovering prepetition overpayments out of postpetition payments was not permitted by Bankruptcy Code section 553 but could be permitted as “recoupment” if the requirements of that doctrine were met).

112. *Id.* (citing *In re B & L Oil Co.*, 782 F.2d 155, 157 (10th Cir. 1986)).

113. *Id.* (citing *In re Holford*, 896 F.2d 176, 178 (5th Cir. 1990)).

114. *Id.* There is, however, authority for this proposition. See *Conoco, Inc. v. Styler (In re Peterson Distrib., Inc.)*, 82 F.3d 956, 960 (10th Cir. 1996); *In re Healthback, L.L.C.*, 226 B.R. 464, 475 (Bankr. W.D. Okla. 1998).

Secretary asserts that Medicare's reimbursement methodology is predicated on the principle that a provider has an ongoing legal relationship to the program that enables it to receive a stream of estimated payments subject to reconciliation at a later date. Because overpayments are a contemplated element of this relationship, HHS in each instance must consider prior overpayment as a factor determining the amount due on a subsequent claim for reimbursement. In the Secretary's view, this type of relationship cannot be parsed into a series of transactions, but instead amounts to one continuous transaction between the provider and HHS.

In an effort to bring the Department's postpetition withholding within the purview of the recoupment doctrine, the Secretary advocates an expansive definition of "transaction." He supports his position with citations from our decision in *Lee* and a discussion of compulsory counterclaims in *United States v. Aquavella*, 615 F.2d 12 (2d Cir.1979). The Secretary contends that the same "broad and flexible standard" employed to determine the scope of compulsory counterclaims should be utilized to determine the applicability of recoupment in the bankruptcy setting.<sup>115</sup>

The Third Circuit rejected the argument that the expansive interpretation of "same transaction" used to determine when a counterclaim is a compulsory one was also appropriate in bankruptcy proceedings, stating that recoupment and setoff play far different roles in bankruptcy than they did when they originated in the rules of pleading, and that

For the purposes of recoupment, a mere logical relationship is not enough: the "fact that the same two parties are involved, and that a similar subject matter gave rise to both claims, . . . does not mean that the two arose from the 'same transaction.'" *Id.* [citing *Lee*, 739 F.2d at 875]. 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. Use of this stricter standard for delineating the bounds of a transaction in the context of recoupment is in accord with the principle that this doctrine, as a non-statutory, equitable exception to the automatic stay, should be narrowly construed. *See B & L Oil*, 782 F.2d at 158.<sup>116</sup>

The court concluded that the "single transaction" requirement was not met because, despite the ongoing relationship between

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115. *University Med. Ctr. IV*, 973 F.2d. at 1081 (ellipsis in original).

116. *Id.* (ellipsis in the original; bracketed material added).

HHS and the provider, “[t]he 1988 payments were independently determinable and were due for services completely distinct from those reimbursed through the 1985 payments.”<sup>117</sup> Having reached that conclusion on that basis, the court further noted that the account reconciliation process works on an annual basis.<sup>118</sup> Finally, the court pointed out that “the typical situation” in which recoupment is applied involves “a credit and a debt arising out of a transaction for the same goods or services.”<sup>119</sup>

The court defined the relevant transaction as follows: “[E]ach of these transactions begins with services rendered by the provider to a Medicare patient, includes payment to the provider, and concludes with HHS’s recovery of any overpayment.”<sup>120</sup> Using this definition, the court concluded that the services UMC rendered to its Medicare patients in 1988 were not part of the services it rendered in 1985.<sup>121</sup>

The court’s conclusion on this point is not entirely clear. Are services to a single patient over the course of two or more years a single transaction because they are all services to the same patient, multiple transactions because they took place in more than one year, or multiple transactions because each provision of a service to a patient is a separate transaction? The court’s discussion of the yearly audit suggests that the end of the year is a cut-off point, but the court also describes UMC’s 1988 postpetition services as “the beginning of transactions that would stretch into the future,”<sup>122</sup> a description that would be both superfluous and largely erroneous if all 1988 transactions necessarily terminated at the end of that year. Further confusing the application of *University Medical Center* in other situations is the court’s unexplained statement that “the ability to recoup across the petition boundary is questionable.”<sup>123</sup>

A number of courts have rejected this conclusion, holding that all services to all beneficiaries are part of a single transaction because they are rendered pursuant to a single provider

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117. *Id.*

118. *Id.* (citing *University Med. Ctr. II*, 122 B.R. 919, 930 (E.D. Pa. 1990)).

119. *Id.* (citing *Waldschmitt v. CBS*, 14 B.R. 309, 314 (M.D. Tenn. 1981) (stating that advance royalty payments for a specific album could be recouped from actual royalties subsequently generated by that album)).

120. *Id.* at 1081-82.

121. *Id.* at 1082.

122. *Id.*

123. *Id.* at 1080.

agreement.<sup>124</sup> At least one court, however, arguably has taken an even narrower approach to “same transaction” than did the Third Circuit, concluding that each separate service provided by the debtor to a patient is a separate transaction.<sup>125</sup> The competing approaches are evaluated below in Part V.

### III. ROUND TWO TO THE GOVERNMENT—THE D.C. CIRCUIT’S DECISION IN *CONSUMER HEALTH SERVICES*

Five years after *University Medical Center* was decided, the D.C. Circuit addressed the same issue, reaching entirely opposite results.<sup>126</sup> The bankruptcy court followed *University Medical Center* and ruled against HHS on all relevant issues. First, the court followed the majority rule and held that the provider agreement was an executory contract.<sup>127</sup> It then ruled that absent formal, court-approved assumption of the provider agreement, the agreement could not have been assumed. Accordingly, the agreement had not been assumed merely by the debtor’s providing postpetition services to Medicare patients and seeking payment for those services and, therefore, the Secretary could not enforce any contractual right to recoupment he might otherwise have had.<sup>128</sup>

The court then turned to the question of equitable recoupment. Although stating that it was only following *University Medical Center*, the bankruptcy court in fact rejected the Third Circuit’s distinction between recoupment pursuant to statute and pursuant to contract.<sup>129</sup> It stated that the distinction was irrelevant because “whatever existing relationship between the debtor and the creditor is at stake, the same principles govern the task of harmonizing that relationship with the goals of the

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124. See, e.g., *AHN Homecare, L.L.C. v. Health Care Fin. Admin.* (*In re AHN Homecare, L.L.C.*), 222 B.R. 804, 810 (Bankr. N.D. Tex. 1998); *In re S. Inst. for Treatment and Evaluation, Inc.*, 217 B.R. 962, 965 (Bankr. S.D. Fla. 1998).

125. *In re Healthback L.L.C.*, 226 B.R. 464, 477 (Bankr. W.D. Okla. 1998)

126. See *United States v. Consumer Health Servs. of Am.* (*In re Consumer Health Servs. of Am.*), 171 B.R. 917 (Bankr. D.D.C. 1994) [hereinafter *Consumer Health Servs. I*], *rev’d*, 108 F.3d 390 (D.C. Cir. 1997).

127. *Id.* at 920.

128. *Id.* at 920-21.

129. “The court believes that the labels of statutory recoupment versus common law recoupment are irrelevant.” *Id.* at 921. As noted above, however, under the Third Circuit’s analysis, the remedy of recoupment is not available if the right to payment is based solely on statute. See *Lee v. Schweiker*, 739 F.2d 870, 876 (3d Cir. 1984).



Bankruptcy Code and deciding whether equitable recoupment ought to be allowed.”<sup>130</sup>

Except for that point, however, the court did follow *University Medical Center* very closely and reached the same conclusion. One of its observations, however, goes deeper than did *University Medical Center* and is particularly worth noting:

The typical recoupment scenario does not exist in this case. The Secretary’s claim for overpayment for the years 1980 and 1981 relates to services provided in 1980 and 1981, and those services are not the same services for which the debtor now seeks reimbursement. Furthermore, the Secretary’s claim for overpayment would have arisen even if it were contemplated the debtor would never perform any services after 1981: it was not an advance, as in *Waldschmidt*, against future performance by the debtor. Therefore, the debtor’s right to payment for postpetition services cannot be said to be integral to the Secretary’s claim for overpayment. Accordingly, the transaction that gave rise to the Secretary owing the debtor monies cannot be said to be the same transaction that gave rise to Secretary’s claim for overpayment.<sup>131</sup>

The court also concluded that allowing recoupment under the facts before it would:

- Override the debtor’s ability to preserve a contract until it can make an informed decision to assume or reject it under section 365;
- Prefer one prepetition creditor at the expense of others by converting a prepetition claim that confers no benefit on the estate into an administrative claim; and
- Possibly damage the estate by creating postpetition operating losses if the amount left after recoupment is less than the cost of operations.<sup>132</sup>

The court further held, consistent with *University Medical Center*, that the Medicare Act itself “provides for the parties’ relationship to be divided into a series of annual transactions.”<sup>133</sup>

The district court affirmed in a one-sentence opinion adopting the reasoning of the bankruptcy court.<sup>134</sup> Without addressing the bankruptcy court’s arguments directly, however, the court of

130. *Consumer Health Servs. I*, 171 B.R. at 921.

131. *Id.* at 922 (citing *In re California Cannery & Growers*, 62 B.R. 18 (Bankr. 9th Cir. 1986)).

132. *Id.* at 923.

133. *Id.*

134. *Consumer Health Servs. II*, 108 F.3d 390, 393 (D.C. Cir. 1997).

appeals rejected the bankruptcy court's analysis entirely on the basis of its interpretation of the language of 42 U.S.C. § 1395g(a). It treated the doctrine of recoupment as a relatively minor secondary issue.

The court noted that the statute first states that the secretary is to determine what a provider "should be paid" for its services, and only then that the provider "shall be paid" the amount so determined after making "necessary adjustments" on account of previous over- or underpayments.<sup>135</sup> Thus, the Third Circuit reached the wrong result because it first calculated the amount that the provider "should be paid" and concluded that that was the provider's claim against the government, and only then addressed whether and under what circumstances the government could deduct any amount due to it from the amount thus determined. This was error because, under the statute, the actual amount of the debtor's claim (the amount that, under the statute, "shall be paid") *includes* the amount the government has a right to deduct by reason of prior overpayments. In other words, the government has no obligation whatsoever to pay the amount that "should be paid," only the amount that "shall be paid."<sup>136</sup>

To conclude otherwise, we think, would allow the Bankruptcy Code to modify an explicit statutory scheme defining liability for particular services. Neither the trustee, the bankruptcy court, nor the Third Circuit in *In re University Medical Center* has offered authority for the proposition that the Bankruptcy

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135. *Id.* at 394.

136. *Id.* The National Association of Attorneys General ("NAAG") applauded this result, stating that the Third Circuit's failure to take into account this statutory language "removed a substantive protection that the government had included before it agreed to extend large amounts of unsecured financing to these providers." *Id.* at 390; 1997-Apr NAAG BANKR. BULL. (April 1997) at 29; *see also Bankruptcy Law and the Health Care Financing System*, 1995-Aug NAAG BANKR. BULL. (August 1995), at 2 (also describing the Medicare payment system as "an advance source of steady financing at no cost to the provider"). This characterization of the relationship between the government and the provider is interesting because it raises the possibility that a provider agreement cannot be assumed under Bankruptcy Code section 365 because it is "a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor." 11 U.S.C. § 365(c)(2) (West 2000). There is one reported decision addressing this argument. In *In re Advanced Professional Home Health Care*, 82 B.R. 837, the bankruptcy court held that a provider agreement is just such a financial accommodation and, therefore, cannot be assumed by a debtor. On appeal, the district court reversed on other grounds, 94 B.R. 95, but noted that "[n]either party supports the Bankruptcy Judge's conclusion on the applicability of 11 U.S.C. § 365(c)(2)." *Advanced Prof'l Home Health Care, Inc. v. Bower (In re Advanced Prof'l Home Health Care, Inc.)*, 94 B.R. 95, 96 n.2 (E.D. Mich. 1988).

Code can act to override an explicit statutory limitation on what the government owes for a particular service. That the limitation in question is defined by the amount the government has previously (over)paid to the provider does not, in our view, alter the analysis.<sup>137</sup>

The court then addressed recoupment. It adopted essentially all of the analysis used by the Third Circuit, except that it concluded that even under the Third Circuit's definition of "single transaction," all services rendered by a provider under one provider agreement are part of a "single transaction."<sup>138</sup> Again, the court relied on the statute. It held that because the calculations of payments due to a provider for one service requires taking into account overpayments on previous services, "Congress rather clearly indicated that it wanted a provider's stream of services to be considered one transaction for purposes of any claim that the government would have against the provider."<sup>139</sup>

Finally, the court returned again to the statute and read its own interpretation of that statute out of existence. As noted above, the court concluded that a provider is only entitled to receive the amount that "shall be paid," which is the amount that "should be paid" less "necessary" deductions for prior overpayments. Neither recoupment nor setoff are necessary because the government simply does not owe the full amount the debtor claims for its postpetition services. The government only owes the amount of that claim less all "necessary" adjustments.

So, when is an adjustment "necessary"? The D.C. Circuit's answer appears to be "never." According to the court, "it is not entirely clear what Congress meant by 'necessary,' or, to put it another way, what is necessary in any given case may involve drawing a balance between what would be the quickest repayment to the government, and what would give the provider sufficient incentive to continue providing services."<sup>140</sup> The court then turned to the Medicare regulations to determine how the Secretary had interpreted "necessary" and stated that it would

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137. *Consumer Health Servs. II*, 108 F.3d at 394-95.

138. *Id.* at 395.

139. *Id.* Note that, with the exception of its comment regarding the yearly audits, the D.C. Circuit simply ignores the bankruptcy court's analysis as to why the HHS-provider relationship involves multiple transactions in favor of its wholly unsubstantiated assertion regarding congressional intent.

140. *Id.* at 396.

defer to that interpretation if it “represents a ‘permissible construction’ of the statute.”<sup>141</sup>

In *Consumer Health Services*, HHS argued that the “necessary” deduction was the entire amount of the outstanding prepetition overpayments. The court rejected the argument. According to the court, HHS’s regulations allow an intermediary to seek to recover the full amount of the overpayment and suspend a provider’s participation in Medicare if it does not pay that amount or to enter into an agreement allowing for periodic deductions until the overpayments are fully recovered.<sup>142</sup> The court stated that “[i]f we were to conclude otherwise, the Secretary might be forced to insist on a provider’s immediate repayment of the full amount . . . which could jeopardize the operation of the [Medicare] program. We do not think this comports with the statute, which sought to protect the taxpayers’ interest yet provide the Secretary with the flexibility necessary to operate the program.”<sup>143</sup> On this basis, the court remanded the action, not to HHS or an administrative court, but to the bankruptcy court to determine what the debtor “shall be paid.”

It is difficult to imagine a more tortured, self-contradictory, and unpersuasive interpretation of a statute (actually, of a single word within a statute) than the D.C. Circuit’s intellectual contortions over the word “necessary.” The statute simply states that HHS can deduct prior overpayments from future payments. It does not assert or suggest that all services and payments involving a Medicare provider constitute a single transaction or that HHS’s deduction rights should be characterized as recoupment, setoff, or anything else. As the court itself acknowledges, there is no legislative history available to give clues to Congress’s intent. Given the apparent total lack of significance ascribed to this word by Congress, the best approach is to apply

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141. *Id.* (citing *Consumer Fed’n of Am. v. HHS*, 83 F.3d 1497, 1503 (D.C. Cir. 1996) (quoting *Chevron, U.S.A. v. Natural Resources Defense Council*, 467 U.S. 837, 842-43 (1984))).

142. See 42 C.F.R. § 405.376(c) (West 2000), which provides that:

(c) Basic conditions. A claim for recovery of Medicare overpayments against a debtor may be compromised, or collection action on it may be suspended or terminated, by the Health Care Financing Administration (HCFA) if;

(1) The claim does not exceed \$100,000 or such higher amount as the Attorney General may from time to time prescribe, exclusive of interest; and

(2) There is no indication of fraud, the filing of a false claim, or misrepresentation on the part of the debtor or any director, partner, manager, or other party having an interest in the claim.

143. *Consumer Health Servs. II*, 108 F.3d at 396.

Occam's Razor<sup>144</sup> and conclude that this section simply saves time and money for the government by allowing it to reduce future payments to recover past overpayments, thus putting the burden on the provider to assert the impropriety of the deductions instead of requiring the government to sue to recover those overpayments. The "necessary adjustments" language was inserted for administrative convenience and to reduce costs, nothing more.

Admittedly, there is nothing in the legislative history to support this interpretation either, but note what happens if the D.C. Circuit's reasoning is adopted. First, the court makes deductions for past overpayments mandatory in determining the amount that is due to the provider (that is the sole basis for its holding), but discretionary in determining whether and to what extent the amounts should actually be deducted. It is generally recognized that in the absence of relevant legislative history, a court should apply the plain, ordinary meaning of a word contained in a statute.<sup>145</sup> *Webster's Dictionary* defines "necessary" as "of an inevitable nature," "logically unavoidable," "compulsory," and "absolutely needed."<sup>146</sup> The way the D.C. Circuit applies the term, however, the Secretary has absolute discretion to work out a claim for overpayments on any basis he or she deems appropriate. While there is no doubt that Congress could delegate such authority to the Secretary if it chose to do so, given the ordinary meaning of the word "necessary," it is unconvincing to argue that Congress made such a decision and then implemented it by using a word with a definition that is the antithesis of unbridled discretion.

Second, having stated that the Secretary has the power to determine what constitutes a "necessary adjustment," the court then *rejected* the Secretary's determination that recovery of the

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144. "One should not increase, beyond what is necessary, the number of entities required to explain anything" Principia Cybernetica Web, at <http://pespmc1.vub.ac.be/OCCAMRAZ.html> (last visited Feb. 22, 2001). It is often stated as "the simplest explanation that fits all of the facts is the best."

145. See, e.g., *In re Emory Properties, Ltd.*, 106 B.R. 318 (Bankr. N.D. Ga. 1989).

146. WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY (Merriam-Webster 1989), at 790; see also MICROSOFT BOOKSHELF 2000, defining "necessary" as follows:

1. Absolutely essential. See synonyms at indispensable.
2. Needed to achieve a certain result or effect, requisite: the necessary tools.
3. a. Unavoidably determined by prior conditions or circumstances; inevitable: the necessary results of overindulgence. b. Logically inevitable.
4. Required by obligation, compulsion, or convention: made the necessary apologies.

*Id.*

entire outstanding amount of prepetition overpayments was necessary. Compounding this surreal application of its own doctrine, the court concluded by remanding the question of necessity, not to HHS to apply and interpret the Medicare Act and its own regulations, but to the bankruptcy court to determine what level of withholding was “necessary.”<sup>147</sup> If the amount of an overpayment that should be deducted from a current payment can be determined by either HHS or the courts, and there are no limitations on the amount or timing of such deductions, it is meaningless to refer to such deductions as “necessary.”

An interesting side note to this issue is the fact that the one regulation cited by the court does not state what the court says it states and never has. 42 C.F.R. § 405.373(a)(2) provides only that a carrier intending to “recoup” a prior overpayment from a current one must give the provider an opportunity to rebut the carrier’s right to do so. The authority to compromise an overpayment claim is set forth, not in section 405.373, but in section 405.376.<sup>148</sup> That section begins by stating that it “contains requirements and procedures for the compromise of, or suspension or termination of collection action on, claims for overpayments against a provider, physician, or other supplier of services under the Medicare program.”<sup>149</sup>

What is completely missing from any of the applicable regulations, however, is any reference whatever to determining when a deduction of a prior overpayment is “necessary,” a fact that strongly suggests that until the D.C. Circuit informed HHS in 1997 that its power to compromise overpayment claims arose from Congress’s use of the word “necessary” in 42 U.S.C.

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147. The court completely ignores the jurisdictional issues involved in this conclusion. As noted above and more fully discussed below, although I do not agree that it is interpreting the statute correctly, HHS has successfully taken the position before a number of courts that the determination of payments due to a provider is within its exclusive jurisdiction until the all administrative remedies have been exhausted.

148. 42 C.F.R. § 405.376(a) (West 2000) (former 42 C.F.R. § 405.374(a)). It authorizes the Health Care Finance Administration (“HFCA”) to compromise a claim for overpayments if the amount in controversy does not exceed \$100,000 and “[t]here is no indication of fraud, the filing of a false claim, or misrepresentation on the part of the debtor, or any director, partner, manager, or other party having an interest in the claim.” *Id.* At the time of the events involved in *Consumer Health Services*, the applicable regulation was contained in section 405.374. Because the court cites to the wrong section under either version of the rules and does not provide a date for the regulation it does cite, it is not entirely clear whether it is relying on the then-recently enacted current rules or the rules in force when the order it was reviewing was entered.

149. *Consumer Health Servs. II*, 108 F.3d 390, 397 (D.C. Cir. 1997) (citing former 42 C.F.R. § 405.373(a)(2)).

§ 1395g(a), no one at HHS had ever interpreted the statute that way. In fact, and as further proof that the D.C. Circuit's interpretation of "necessary" was made from whole cloth for the first time in 1997, the relevant regulation does not even refer to section 1395g(a) as the statutory basis for the assertion of the authority contained in the regulation. Instead, HHS stated that the regulation "is adopted pursuant to the Federal Claims Collection Act (31 U.S.C. 951-953)."<sup>150</sup>

In short, the interpretation of section 1395g(a) adopted by the D.C. Circuit is unsupported and insupportable. It renders the most critical term in the statute, "necessary," meaningless by depriving it of the "mandatoriness" element included in every standard dictionary definition of that term, makes the statute the alleged basis for a regulatory assertion of authority by HHS that neither uses the term "necessary" nor cites to the statute on which it supposedly based, and ultimately undermines the reimbursement jurisdiction of HHS by authorizing the bankruptcy court to determine when a deduction is "necessary" notwithstanding the fact that the court unequivocally stated that HHS has that authority under the court's interpretation of the statute.

#### IV. ROUND THREE TO THE GOVERNMENT—UNIVERSITY MEDICAL CENTER AND ITS CRITICS

Probably the leading commentator on this issue, and a consistent critic of *University Medical Center*, has been health law attorney Samuel Maizel. Mr. Maizel's first salvo against *University Medical Center* was an article he co-authored for *Bankruptcy Developments Journal* in 1994. Entitled "*The Medicare Contract In Bankruptcy: In Which Direction Does University Medical Center Lead?*" ("*Maizel I*"),<sup>151</sup> the article makes it absolutely clear that *University Medical Center* takes us in a direction in which no one should want to go.

Mr. Maizel first takes issue with whether a bankruptcy court has any jurisdiction over the debtor's complaint that withholding prepetition overpayment from postpetition reimbursement violates the automatic stay. He concludes that it does not.<sup>152</sup>

150. 42 C.F.R. § 405.376(a) (West 2000) (formerly 42 C.F.R. § 405.374(a)).

151. Elizabeth Swinton Schoen & Samuel R. Maizel, *The Medicare Contract In Bankruptcy: In Which Direction Does University Medical Center Lead?*, 11 BANKR. DEV. J. 405 (1995) (hereinafter *Maizel I*).

152. *Id.* at 415-17. Mr. Maizel actually does not disagree with most of the Third Circuit's analysis. Both agree that under 42 U.S.C. § 405, absent the exhaustion of all administrative remedies, no federal court has jurisdiction over a "claim arising under"

His principal argument is that the Third Circuit erred (and failed to follow controlling Supreme Court precedent) by concluding that UMC's automatic stay "claim" was not "inextricably intertwined" with a Medicare benefit determination. This is, however, incorrect.

Mr. Maizel misses the point of the Third Circuit's jurisdictional analysis. It is true that the Third Circuit and other courts have noted that disputes between the debtor and the government implicate issues within the bankruptcy jurisdiction of the district court and thus create an independent basis for bankruptcy jurisdiction. The more important fact on which the court relied, however, is that, outside of the bankruptcy court system, there would have been no mechanism at all by which UMC could have obtained a decision on its automatic stay claim: "There is no danger of rendering the administrative review channel superfluous, for there is no system of administrative review in place to address the issues raised by UMC in its adversary proceeding."<sup>153</sup>

As the Third Circuit noted, intersecting statutory schemes should be harmonized whenever possible. The court's compromise gives an appropriate (*i.e.*, substantial but not unlimited) deference to HHS while protecting the bankruptcy court's jurisdiction over the debtor and its estate, and the enforcement of bankruptcy laws. Under Mr. Maizel's reading of section 405, there is no balance. All power to review and determine the controversy is vested in a government agency that has no jurisdiction to interpret bankruptcy law while the one forum that Congress intended to have that jurisdiction is powerless to exercise it. The problem here is not so much the result that the automatic stay will never apply to HHS when the debtor is a Medicare provider (notwithstanding the nearly unanimous conclusion of courts that the stay does apply to all governmental

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the Medicare statutes, that the foregoing phrase should be broadly construed, and that it encompasses claims founded on other jurisdictional bases if they are "inextricably intertwined" with benefit determinations under the Medicare statutes. *Compare University Med. Ctr. IV*, 973 F.2d 1065, 1073 (3d Cir. 1992), with *Maizel I*, *supra* note 151, at 415-16.

153. *University Med. Ctr. IV*, 973 F.2d at 1073. As the court also noted earlier in its discussion, the administrative review procedure that is available under the Medicare statutes and regulations is available only when a provider disagrees with the Secretary's reimbursement determination. UMC and HHS had agreed as to the amount due for UMC's postpetition services under the statutes and regulations and the amount of the prepetition overpayments. Under those circumstances, administrative review is unavailable because there is nothing to review. *Id.* at 1072-73.



agencies unless a statutory exception is available), but that there exists no forum that can even determine whether the automatic stay applies.

A. *The Third Circuit Improperly Narrowed the Scope of the Recoupment Doctrine in Bankruptcy*

The discussion of recoupment in *Maizel I* is fairly brief and cursory. Essentially, Mr. Maizel and the Third Circuit agree on practically all of the principles applicable to determining when a right to recoupment exists, except for one: Mr. Maizel argues that the court's interpretation of "single" or "same" transaction creates a new, narrower definition of that term in bankruptcy and that such a creation was contrary to Supreme Court precedent, Third Circuit precedent, and decisions from other courts. This argument, however, does not give sufficient weight to the context and the specific holdings of many of the cases Mr. Maizel cites.

He points out that recoupment arises out of common-law pleading rules<sup>154</sup> and that the courts have held that "'transaction' is a word of flexible meaning, including a series of occurrences, depending not so much on the immediateness of their connection as upon their logical relationship."<sup>155</sup> He further argues that "[i]n general terms, these rules allow a defendant to respond to a claim or suit by positing defenses without having to bring a separate suit."<sup>156</sup>

He then describes the Supreme Court's discussion of the application of recoupment in bankruptcy as follows:

In *Reiter v. Cooper*,<sup>157</sup> the Court clarified the relationship between recoupment and compulsory counterclaims by defining recoupment as "the setting off against asserted liability of a counterclaim arising out of the same transaction." Moreover, the Court found no difference between the right of recoupment in bankruptcy and the ability to assert a compulsory counterclaim in district court under Federal Rule of Civil Procedure 13. The Court stated that, "[f]or purposes of applying

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154. *Maizel I*, *supra* note 151, at 418 (citing *Lee v. Schweiker*, 739 F.2d 870, 875 (3d Cir. 1984); *Frederick v. United States*, 386 F.2d 481, 487 (5th Cir. 1967); *FSLIC v. Burdette*, 696 F. Supp. 1183, 1187 (E.D. Tenn. 1988)).

155. *Id.* (citing *Moore v. New York Cotton Exch.*, 270 U.S. 593, 610 (1926); *Montgomery Ward Dev. Corp. v. Juster*, 932 F.2d 1378, 1380 (11th Cir. 1991); *Savarese v. Agriss*, 883 F.2d 1194, 1208 (3d Cir. 1989); *United States v. Johnson*, 853 F.2d 619, 621 (8th Cir. 1988)).

156. *Id.*

157. *Reiter v. Cooper*, 507 U.S. 258 (1993).

the [rules] governing counterclaims, it does not matter that this action arose in bankruptcy . . . . Federal Rule of Civil Procedure 13 is made applicable, with only minor variations not relevant here, by Bankruptcy Rule 7013.” The Court recognized that, “[i]t is well settled, moreover, that a bankruptcy defendant can meet a plaintiff-debtor’s claim with a counterclaim arising out of the same transaction, at least to the extent that the defendant merely seeks recoupment.” Finally, the Court noted that recoupment “permits a determination of the ‘just and proper liability on the main issue,’ and involves ‘no element of preference.’”<sup>158</sup>

What Mr. Maizel’s analysis overlooks, however, is that *Reiter* has nothing whatever to do with the substantive scope, significance, or application of recoupment in bankruptcy. *Reiter* merely concluded that if a carrier sues a shipper to recover freight undercharges with respect to certain specific shipments, the shipper’s “unreasonable rate” issue regarding the same shipments can be raised as a defense even though it is technically a counterclaim. The mere fact that the counterclaim is erroneously asserted as a defense does not bar the court’s consideration of it because Federal Rule of Civil Procedure 8(c) allows a court to treat a claim that has been misdesignated as a defense or a defense that has been misdesignated as a claim as if the litigant had correctly characterized her or his assertion.<sup>159</sup> The language of which Mr. Maizel makes so much is nothing more than the incontrovertible statement that the defendant’s misdesignation of a claim as a defense is no more relevant in bankruptcy than it is in any other proceeding because Federal Rule 8(c) is made applicable to bankruptcy adversary proceedings by Bankruptcy Rule 7008.<sup>160</sup>

To convert this purely procedural conclusion regarding technical designations in pleadings into a wholesale importation into bankruptcy proceedings of recoupment as a substantive doctrine is unwarranted. Furthermore, the Court did not even purport to rule on what constitutes a “single” or the “same” transaction. In

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158. *Maizel I*, *supra* note 151, at 419 (quoting *Reiter*, 507 U.S. at 265, n. 2; *In re B & L Oil*, 782 F.2d 155, 157 (10th Cir. 1986); *Lee*, 739 F.2d at 875; and 4 COLLIER ON BANKRUPTCY, ¶ 553.03 at 553-17 (15th ed)).

159. *Reiter*, 507 U.S. at 265. Federal Rule 8(c) provides in part that “[w]hen a party has mistakenly designated a defense as a counterclaim or a counterclaim as a defense, the court on terms, if justice so requires, shall treat the pleading as if these had been a proper designation.” FED. R. CIV. P. 8(c).

160. Bankruptcy Rule 7008 states that “Rule 8 Federal Rule of Civil Procedure applies in [bankruptcy] adversary proceedings.” FED. R. BANKR. P. 7008.

*Reiter*, the defendant's recoupment defense/counterclaim was asserted with respect to exactly the same shipments as to which the debtor/carrier sought additional payments. This is completely consistent with the Third Circuit's conclusion in *University Medical Center* that recoupment of overpayments with respect to the provision of certain services can be asserted to reduce a claim for payment for those same services.

As noted above, *Reiter* cites with approval to *Lee v. Schweiker*, and Mr. Maizel apparently has no dispute with that decision either.<sup>161</sup> In that 1984 decision, however, the Third Circuit clearly stated that pleading rules regarding the proper assertion of claims and defenses cannot be imported uncritically into substantive bankruptcy law:

The doctrines of "setoff" and "recoupment" had their origins in the era of common law pleading, under which the scope of a "case" was far less inclusive than it is today, and under which claim joinder was far narrower. Both doctrines permitted countervailing claims, which otherwise could not have been asserted together, to be raised in a case based on any one of them. Both doctrines were subsequently adopted in bankruptcy, setoff by statute, and recoupment by decision. *In bankruptcy, however, setoff and recoupment play a role very different from their original role as rules of pleading.* Setoff, in effect, elevates an unsecured claim to secured status, to the extent that the debtor has a mutual, prepetition claim against the creditor. Setoff is limited, however, by the provisions of 11 U.S.C. § 553. Among those limitations is that prepetition claims against the debtor cannot be setoff against postpetition debts to the debtor. Recoupment, on the other hand, allows the creditor to assert that certain mutual claims extinguish one another in bankruptcy, in spite of the fact that they could not be "setoff" under 11 U.S.C. § 553. The justification for the recoupment doctrine is that where the creditor's claim against the debtor arises from the same transaction as the debtor's claim, it is essentially a defense to the debtor's claim against the creditor rather than a mutual obligation, and application of the limitations on setoff in bankruptcy would be inequitable.<sup>162</sup>

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161. In fact, he criticizes *University Medical Center* as departing from the (apparently correct) standards set out in *Lee*. See *Maizel I*, *supra* note 151, at 422-23 & nn. 115-16.

162. *Lee*, 739 F.2d at 875 (emphasis added; citations and footnotes omitted); *accord B & L Oil*, 782 F.2d at 157 ("Modern rules of pleading have diminished the importance of the common law distinctions surrounding recoupment and its companion, setoff. . . . but in bankruptcy, these distinctions remain important.").

Mr. Maizel argues that the Third Circuit held in *Lee v. Schweiker* that “the recoupment doctrine has been applied primarily where the creditor’s claim against the debtor and the debtor’s claim against the creditor arise out of the same contract.”<sup>163</sup> He then asserts that *University Medical Center* is inconsistent with *Lee v. Schweiker*. This conclusion, however, is also incorrect. *Lee v. Schweiker* did not address the general scope of equitable recoupment in bankruptcy but only whether equitable recoupment was applicable to the recovery of overpayments of Social Security benefits to the beneficiary. In discussing equitable recoupment, the court noted that the doctrine had been applied in bankruptcy when a single contract was at issue, but it did not state that the “same transaction” requirement was always met when claims arise under one contract.

Mr. Maizel also cites *In re Monongahela Rye Liquors*<sup>164</sup> as a case addressing the “same transaction” requirement,<sup>165</sup> but in that case the court held that the trustee’s claims against the state of Pennsylvania could not be asserted as a setoff or recoupment against unrelated tax claims against the debtor because they did not arise out of the “same transaction.” There is nothing in this decision that is inconsistent with, or relevant to, *University Medical Center*.

The final step of Mr. Maizel’s argument is the assertion that *University Medical Center* improperly failed to follow the common law pleading rules that construed the “same transaction” standard broadly. He asserts that *United States v. Texas*<sup>166</sup> supports the argument that “in order to abrogate the common law principle of recoupment, the Bankruptcy Code would have to ‘speak directly’ to the question addressed by the common law: what is the same transaction or occurrence?”<sup>167</sup>

In *United States v. Texas*, the Court considered provisions of the federal Debt Collection Act as applied to the States. It first noted that the federal government had a “longstanding” right under the common law to collect prejudgment interest on debts owed to it by the states if the underlying claim was contractual in nature.<sup>168</sup> It then stated twice that statutes that “invade the common law” are to be read with a presumption that the com-

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163. *Maizel I*, *supra* note 151, at 422-23.

164. *In re Monongahela Rye Liquors*, 141 F.2d 864, 869 (3d Cir. 1944).

165. *Maizel I*, *supra* note 151, at 422.

166. *United States v. Texas*, 507 U.S. 529 (1993).

167. *Maizel I*, *supra* note 151, at 421.

168. *Texas*, 507 U.S. at 533.

mon law will continue to apply unless “a statutory purpose to the contrary is evident.”<sup>169</sup> Texas argued that a provision in the act that required the head of a federal agency to charge a minimum annual interest rate on a debt owed to the federal government by a person demonstrated “Congress’ intent to relieve the states of their common-law obligation to pay prejudgment interest” because the statute defined the term “person” as excluding state governments.<sup>170</sup> The Court rejected the argument, holding that the statute’s exclusion of the States from the minimum-interest-rate requirement and its silence on prejudgment interest did not evidence an intent to change the common law regarding liability for prejudgment interest.<sup>171</sup>

*United States v. Texas* is irrelevant to the application in bankruptcy cases of recoupment as a substantive doctrine. The right to prejudgment interest is a rule of substantive law; the common-law definition of “same transaction” arose in the rules of pleading. The Debt Collection Act does not purport to govern an entire area of law; the Bankruptcy Code, however, is an integrated statutory scheme directly or indirectly covering all matters related to bankruptcy cases. By its very nature, the Bankruptcy Code necessarily invades the common law.

In fact, Mr. Maizel has the process backward: the issue is not whether the Bankruptcy Code modifies a rule of the common law but whether and on what terms common-law principles can appropriately be incorporated into the Bankruptcy Code at all. There is no basis for suggesting that when Congress has clearly articulated its desire to establish a comprehensive statutory framework governing an area of law committed to it by the Constitution<sup>172</sup> that it is also necessary for Congress specifically to address each and every federal, state, or common-law principle it intends to change or abrogate. It is precisely because of the Bankruptcy Code’s comprehensive nature that the Third Circuit pointed out that recoupment, as an equitable exception to the automatic stay, should be narrowly construed.<sup>173</sup> In so holding, the court simply followed *B & L Oil*, which, despite its conclusion that recoupment was appropriate under the facts before it,

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169. *Id.* at 534.

170. *Id.* at 535.

171. *Id.*

172. The Constitution authorizes Congress to adopt “uniform Laws on the subject of Bankruptcies throughout the United States.” U.S. CONST., art. I, § 8, cl. 4.

173. *University Med. Ctr. IV*, 973 F.2d 1065, 1081 (3d Cir. 1992).

also agreed that the doctrine should be narrowly construed.<sup>174</sup> In fact, all but one of the circuit courts that have addressed the issue have held that recoupment is to be narrowly construed in bankruptcy.<sup>175</sup> For example, the Eighth Circuit has stated that, “[o]nce a petition is filed, debts that arose before the petition may not be satisfied through postpetition transactions. . . . Any recoupment exception to this general principle should perhaps be narrowly construed.”<sup>176</sup>

Furthermore, as the dissent noted in *United States v. Texas*, determining the relationship between a statute and the common law first requires a determination of what the common law is: “Favoring the retention of long-established and familiar principles does not mean favoring the retention of rules that have not yet fallen into place.”<sup>177</sup> Essentially, Mr. Maizel and some of the other commentators have taken a carefully-cropped snapshot of what the common law was at a certain point in time, in the eyes of certain courts, and used it to argue that all courts are forever bound by that snapshot.<sup>178</sup>

But the common law has never stopped developing. Recoupment was originally a defense, not a claim.<sup>179</sup> The distinctions between setoff and recoupment have been largely erased outside of bankruptcy.<sup>180</sup> To a more limited extent they are undergoing the same process in the bankruptcy courts.<sup>181</sup> What Mr. Maizel fails to justify is why the courts should be bound by

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174. See *In re B & L Oil Co.*, 782 F.2d 155, 158 (10th Cir. 1986).

175. See *infra*, notes 202-204 and accompanying text.

176. *United States v. Dewey Freight Sys., Inc.*, 31 F.3d 620, 623 (8th Cir. 1994); see also *Malinowski v. New York State Dept. of Labor (In re Malinowski)*, 156 F.3d 131, 134 (2d. Cir. 1998) (adopting the Third Circuit’s statement that recoupment must be more narrowly construed in bankruptcy).

177. *United States v. Texas*, 507 U.S. 529, 544 (1993) (Stevens, J., dissenting) (internal quotations and brackets omitted).

178. Thus, despite his lengthy analyses of *University Medical Center* in several articles, Mr. Maizel has never directly addressed the Third Circuit’s argument that because recoupment functions so differently in bankruptcy than it does in the rules of pleading, it should be narrowly construed. Similarly, the National Association of Attorneys General, also without considering the unique circumstances of a bankruptcy case, states that “[r]ecoupment involves claims that arise in a single transaction, i.e., the same claims that fall under FRCP 13 (mandatory counterclaims).” *Bankruptcy Law and the Healthcare Financing System*, 1995-Aug NAAG BANKR. BULL., Aug. 1995, at 4.

179. See Seybert, *supra* note 9, at 500.

180. *Id.* at 501.

181. See, e.g., *Jobin v. L.D. Arnot (In re M & L Bus. Mach. Co.)*, 178 B.R. 270, 272 (Bankr. D. Colo. 1995) (holding that setoff or recoupment may be asserted as either an affirmative defense or as a counterclaim).

prior nonbankruptcy definitions of “same transaction” (which are used in a completely different context) and yet not be bound by the elimination of the distinctions between recoupment and setoff, so that they must continue to treat recoupment as a defense rather than as a claim.

In fact, this latter point demonstrates precisely why recoupment cannot simply be imported uncritically into the bankruptcy context. There is no practical significance outside of bankruptcy between a defense that reduces a claim and a counterclaim that reduces a claim. But the distinction is critical in bankruptcy. If recoupment is a defense, it is not subject to the automatic stay, which applies only to the assertion of claims. If it is a claim, however, it is subject to the automatic stay.<sup>182</sup> Furthermore, as a practical matter, in a lawsuit between two solvent entities, the resolution of their dispute will not affect other creditors. In bankruptcy, amounts that a creditor does not have to pay to the debtor as a result of setoff or recoupment are amounts that will not be available to satisfy the claims of the debtor’s other creditors. The point of this article is not that it is never appropriate to permit setoff or recoupment but that those doctrines should be carefully and narrowly applied in bankruptcy so that they do not undermine the overarching policy of equal distributions to similarly situated creditors and that *University Medical Center* preserved that policy with respect to bankruptcies involving healthcare entities in a fair and even-handed way.

Mr. Maizel subsequently reiterated his arguments against *University Medical Center* in a brief article (hereinafter “*Maizel II*”) that again took the Third Circuit to task for not incorporating definitions created in pleading rules into substantive bankruptcy law.<sup>183</sup> He also criticized the D.C. Circuit for not rejecting the Third Circuit’s definition of “same transaction.”<sup>184</sup> *Maizel II*, however, is more interesting because of Mr. Maizel’s comments on *Consumer Health Services*, a decision whose result he applauds but whose reasoning he finds unpersuasive. Mr. Maizel makes three points: (1) the court ignored the fact that HHS’s own regulations define its recovery right as “recoupment”; (2) the court took another step down a dangerous road

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182. See generally 11 U.S.C. § 362(a)(6) (West 2000) (staying all actions to “collect, assess or recover a claim against the debtor that arose before the commencement of the case.”).

183. Samuel R. Maizel, *Medicare’s Recoupment Rights Get More Confusing*, 16 AM. BANKR. INST. J. 18 (Sept. 1997) (hereinafter *Maizel II*).

184. *Id.*

by defining HHS's rights as something other than recoupment or setoff and entirely unaffected by the Bankruptcy Code; and (3) although the court read the statute as mandating deductions for overpayments, HHS and HCFA "ha[ve] the discretion to ignore such over-payments. . . . [D]espite the seemingly mandatory language of the statute, HCFA can permit healthcare providers to be paid without recovery of prior overpayments."<sup>185</sup>

Perhaps if HHS's regulations had defined its recovery rights as "recoupment" before HHS litigated and lost the issue before the Third Circuit and several other courts, that definition might have some persuasive authority. In fact, however, the regulations promulgated by HHS in 1972, when it had no economic axe to grind on this issue and thus was more likely to be setting forth what it thought the statute actually meant (as opposed to what it now wishes the statute had said) do not even mention the term "recoupment." It was only after *University Medical Center* and other decisions adopting its reasoning, held that HHS's recovery rights are not recoupment that HHS belatedly redefined those rights to support the conclusion it wanted the courts to reach.<sup>186</sup> Under such circumstances, its current inter-

185. *Id.*

186. The current version of regulation 405.370 defines recoupment and offset as follows:

Offset. The recovery by Medicare of a non-Medicare debt by reducing present or future Medicare payments and applying the amount withheld to the indebtedness. (Examples are Public Health Service debts or Medicaid debts recovered by HCFA).

Recoupment. The recovery by Medicare of any outstanding Medicare debt by reducing present or future Medicare payments and applying the amount withheld to the indebtedness.

42 C.F.R. § 370 (amended by 61 Fed. Reg. 63740, \*63745, 1996 WL 685303 (F.R.) (Dec. 2, 1996)). The 1972 version of section 405.370 that was in effect until 1996, however, read as follows:

(a) Medicare payments to providers and suppliers, as authorized under this chapter (excluding payments to beneficiaries), may be suspended, in whole or in part, by an intermediary or a carrier when—

(1) The intermediary or carrier has determined that the provider or other supplier to whom such payments are to be made has been overpaid under title XVIII of the Social Security Act, or

(2) The intermediary or carrier has reliable evidence, although additional evidence may be needed for a determination, that such overpayment exists or that the payments to be made may not be correct.

(b) A suspension shall be put into effect only after the provisions in §§ 405.371 and 405.372 have been complied with and the intermediary or carrier has determined that the suspension of payments, in whole or in part, is needed to protect the program against financial loss. The provisions of this section and §§ 405.371-405.373 shall be effective on May 27, 1972.



pretation of the Medicare Act is clearly self-serving and is not entitled to deference.

Mr. Maizel's second fact is that placing the government's right to recover prior overpayments out of subsequent payments outside of bankruptcy law by making it part of the definition of the amount due on the subsequent payment rather than a right to be exercised against the payee "creates a new creditor right that apparently makes certain governmental actions immune to the automatic stay."<sup>187</sup> In his view, the courts should simply recognize the governmental agency's recovery rights as statutorily created recoupment.

Leaving aside the fact that there is no significant practical difference between a statutory right that is outside the automatic stay because it constitutes recoupment and a statutory right that is outside the automatic stay because it is something other than recoupment, this argument fails to address the Third Circuit's argument that recoupment is only available in contract, not by statute. As noted above, that court stated in *Lee v. Schweiker* that:

The courts have generally taken a different approach in dealing with government benefits to individuals, such as social security. In these circumstances, the courts have held that a social-welfare statute entitling an individual to benefits is not a contract, and that the obligation to repay a previous overpayment is a separate debt subject to the ordinary rules of bankruptcy. *E.g. In re Neavear*, 674 F.2d 1201 (7th Cir.1982); *In re Hawley*, 23 B.R. 236 (Bankr.E.D.Mich.1982); *In re Rowan*, 15 B.R. 834 (Bankr. N.D. Ohio 1981); *In re Howell*, 4 B.R. 102 (Bankr. M.D. Tenn. 1980) (all dealing with the question whether the obligation to repay prior overpayments is a debt dischargeable in bankruptcy).<sup>188</sup>

If, as the Third Circuit held, the common law right of recoupment is based in contract, and thus cannot be created by statute, then any statute purporting to create such a right necessarily invades the common law. Under Mr. Maizel's argument in *Maizel I*, the intent to create such a right must be evident on the face of the statute. Section 1395g(a) of the Medicare Act, however, makes no reference to recoupment or to bankruptcy. There is nothing in the statute that evidences an intent to create a statu-

187. *Maizel II*, *supra* note 183, at 19 (discussing *Pettibone Corp. v. United States*, 34 F.3d 536, 539 (7th Cir. 1994)).

188. *Lee v. Schweiker*, 739 F.2d 870, 876 (3d Cir. 1984).

tory right of recoupment in addition to the contractual right existing in the common law.

Finally, Mr. Maizel argues that the D.C. Circuit's analysis of section 1395g(a) as mandating deductions for previous overpayments is flawed because, in another bankruptcy case involving a healthcare provider, "HCFA not only waived its ability to recover prior overpayments, but . . . in effect, guarantee[d that] there would be no future efforts to recover future overpayments."<sup>189</sup> The D.C. Circuit, however, agreed that HHS has the right not to insist on full payment of previous overpayments. It found that right in the term "necessary" and HHS's supposed right to promulgate regulations as to when and to what extent recovery of prior overpayments is "necessary." In other words, the D.C. Circuit never held that deduction of overpayments was mandatory. It specifically rejected the Secretary's argument in that specific case that it was "necessary" that all outstanding overpayments had to be recovered immediately, a position that makes no sense in the light of its overall argument but also does not support the assertion that the D.C. Circuit held that the statute makes such deductions mandatory.

In a paper prepared for an April 1998 seminar, Mr. Maizel acknowledged that "most courts" have not accepted his "logical relationship" standard for recoupment in bankruptcy and have "take[n] a much more restrictive view of 'transaction,' usually requiring a single contract or a single transaction under a contract."<sup>190</sup> Mr. Maizel cited only one case as applying, in a bankruptcy context, the expansive "logical relationship" test he favors: *Newbery Corp. v. Fireman's Fund Insurance Co.*<sup>191</sup> That decision does not, however, endorse that standard, although it has subsequently been interpreted by a different panel of the Ninth Circuit as so doing. For the reasons set forth below, the author believes the Ninth Circuit got it right the first time, but not the second.

Newbery Electric, Inc. was a large electrical subcontractor that obtained performance and payment bonds from Fireman's

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189. *Maizel II*, *supra* note 183, at 19 (discussing *In re First Am. Health Care Servs. of Ga.*, Case No. 96-20218 (Bankr. S.D. Ga. 1996)).

190. Samuel R. Maizel, *Governmental Entities' Rights to Setoff and Recoupment in Healthcare Bankruptcy Cases* (paper prepared for the Seminar: Reorganizing Healthcare Providers in the Bankruptcy Court: The Interface of Health Law and Chapter 11 of the Bankruptcy Code (April 20, 1998)) (on file with author).

191. *Newbery Corp. v. Fireman's Fund Ins. Co.*, 95 F.3d 1392 (9th Cir. 1996).

Fund.<sup>192</sup> Newbery entered into a contract with Fireman's Fund to indemnify it for all payments the insurer had to make under the bonds. Newbery had also granted Citibank a lien on its equipment. Newbery defaulted on its projects, and Fireman's Fund paid the bonds. Newbery, Citibank, and Fireman's Fund then entered into an agreement under which Fireman's Fund could use Newbery's equipment to finish the projects on which Newbery had defaulted and would pay rent to Citibank for the use of that equipment. The agreement incorporated by reference the Newbery/Fireman's Fund indemnity agreement. Newbery then filed for bankruptcy and sued Citibank for lender liability. In the settlement, Citibank assigned to Newbery its rights to receive equipment rental payments from Fireman's Fund. When Fireman's Fund failed to make the rental payments, Newbery sued it. Fireman's Fund filed a motion for summary judgment, asserting both setoff and recoupment rights.

The United States District Court for the District of Arizona accepted Fireman's Fund's argument that the term "transaction" should be flexibly and liberally construed.<sup>193</sup> Applying this test, the district court then concluded that because the indemnity agreement had been incorporated into the later agreement among Newbery, Citibank, and Fireman's Fund, Newbery's claim for equipment rentals and Fireman's Fund's claim for indemnity both arose from a single agreement and Fireman's Fund was entitled to recoup its indemnity claims out of the rent claims.<sup>194</sup>

After an extensive discussion of *University Medical Center*, the Ninth Circuit did *not* conclude that the district court applied the correct standard. Instead, it held that the district court did not err in this particular case by applying the "logical relationship" standard because, under the more restrictive *University Medical Center* definition that the court *did* endorse, recoupment was appropriate under the facts before it. Specifically, the court stated that:

In our view, the district court in the present case did not err by applying *Moore*'s "logical relationship" test. However, we agree with the Third Circuit's observation that courts should apply the recoupment doctrine in bankruptcy cases only when

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192. For the facts of the case, see generally *Newbery Corp*, 95 F.3d at 1396-97.

193. *Id.* at 1402 (discussing the district court's reasoning and citing *Moore v. New York Cotton Exchange*, 270 U.S. 593 (1926) and *Albright v. Gates*, 362 F.2d 928 (9th Cir. 1966)).

194. *Id.* at 1402.

“it would . . . be inequitable for the debtor to enjoy the benefits of that transaction without meeting its obligations.” *University Medical Center*, 973 F.2d at 1081. For the reasons stated above, we conclude that this standard is clearly met in the facts of this case.<sup>195</sup>

Thus, a more accurate reading of the Ninth Circuit’s *Newbery* decision is that it endorsed the *University Medical Center* approach to defining “same transaction” and affirmed the district court’s decision, not because that court applied the correct standard but because, even if it had done so, the result would have been the same: the incorporation of the insurer’s indemnity rights into the subsequent contract calling for equipment rental payments meant that both those rights and the obligation to pay rent arose out of the same transaction—the subsequent contract. In fact, the court expressly states that “this standard,” *i.e.*, the one used in *University Medical Center*, “is clearly met in the facts of this case.”<sup>196</sup>

Last year, however, the Ninth Circuit expressly repudiated *University Medical Center*. In *Sims v. HHS (In re TLC Hospitals, Inc.)*,<sup>197</sup> the court stated “under [Medicare’s] specialized and continuous system of estimated payments and subsequent adjustments, HHS’s overpayments and its underpayments in a subsequent fiscal year were parts of the same transaction for

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195. *Id.* at 1403. Note that the language quoted with approval by the Ninth Circuit is precisely the language criticized by Mr. Maizel as being part of the Third Circuit’s improperly narrow definition of “same transaction.” Thus, Mr. Maizel states that:

Despite the guidance of the Supreme Court, the UMC court created a new, bankruptcy-specific “circumscribed definition of ‘transaction,’” to be used to evaluate a recoupment in bankruptcy: “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.” The UMC court distinguished between recoupment in and outside of bankruptcy, finding that a “mere logical relationship” was insufficient to support a recoupment in bankruptcy.

*Maizel I*, *supra* note 151, at 420 (citing *University Med. Ctr. IV*, 973 F.2d 1065, 1081(3d Cir. 1992) (footnotes omitted)).

196. *Newbery Corp.*, 95 F.3d at 1403. One court and (not surprisingly) the NAAG agreed that *Newbery* endorses the broader “logical relationship” test and rejects *University Medical Center* for improperly narrowing the definition of “same transaction.” *Sims v. HHS (In re TLC Hosp., Inc.)*, 225 B.R. 709, 712-13 (N.D. Bankr. Cal. 1998) (criticizing *University Medical Center* for allegedly “depart[ing] from the traditional standard”), *aff’d*, 224 F.2d 1008 (9th Cir. 2000); *Newbery Corp. v. Fireman’s Fund Ins. Co.*, 1996-Oct, NAAG BANKR. BULL. (October 1996), at 30 (stating that the Ninth Circuit “rejected the Third Circuit’s narrowing of the term ‘same transaction’ in . . . *University Medical Center.*”).

197. *Sims v. HHS (In re TLC Hosp., Inc.)*, 224 F.2d 1008 (9th Cir. 2000).

purposes of recoupment.”<sup>198</sup> Although the Court cited *Consumer Health Services* with approval several times, it did not address the statutory argument adopted in that decision.<sup>199</sup> So what advice does the Ninth Circuit have for bankrupt healthcare providers? “If a provider in bankruptcy does not wish to be subject to Medicare’s system of adjustments, it can cease providing Medicare services.”<sup>200</sup> Medicare beneficiaries in areas in which there are no providers other than the debtor will no doubt take great comfort from these words.

As one commentator correctly concluded:

For the vast majority of health care providers that would be required to file a bankruptcy petition in the Ninth Circuit, the chances for reorganization have grown decidedly slimmer in the absence of an agreement with HHS. Any health care provider who has received substantial Medicare or Medicaid overpayments will not be protected by bankruptcy from HHS’s efforts to recoup such payments from post-petition reimbursements owed to a debtor. For many health care entities, reimbursements from Medicare or Medicaid may be the difference between reorganization and liquidation. These entities will essentially be at the mercy of HHS if they wish to reorganize. If HHS wishes to fully exercise their recoupment rights in a particular case, then it is likely that the cash flow necessary for a reorganization will be unavailable and the debtor health care entity may be dead on arrival.<sup>201</sup>

The Tenth Circuit’s decision in *B & L Oil* has been repeatedly cited by cases and commentators supporting a broad application of recoupment in bankruptcy as establishing the correct standards to be applied.<sup>202</sup> Assuming that these authorities are cor-

198. *Id.* at 1012. The court specifically stated that *Newbery* had adopted the broader “logical relationship” test in determining when recoupment should be available in bankruptcy and that it was following *Newbery*. *Id.* In fact, however, the decision in *TLC* rejects precisely the language from *University Medical Center*. That was quoted with approval in *Newbery*.

199. *See id.* at 1012 n. 9 and 1013 n. 11. HHS contends that the plain language of the Medicare statute is dispositive of the issue and that the Bankruptcy Code does not bar the application of the Medicare Act’s substantive provisions. It argues that, when engaged in continuous payments to a provider under Medicare’s statutory system, HHS may not be treated as a “creditor” in the bankruptcy when it seeks to adjust for a prior overpayment. Because we hold that HHS may recover the overpayments under the doctrine of equitable recoupment, we do not address these contentions.

200. *Id.* at 1014.

201. James Markus & John Young, *Ninth Circuit Weighs in on Recoupment of Medicare Overpayments*, 19 AM. BANKR. INST. J. 16, 16 (Nov. 2000).

202. *See, e.g., Maizel I, supra* note 151; Maureen A. Tighe, *A Guide to Making a Criminal Bankruptcy Fraud Referral*, 6 AM. BANKR. INST. L. R. 409, 423-436 and n.103 (1998).

rect in concluding that result in *University Medical Center* is difficult to reconcile with *B & L Oil*,<sup>203</sup> it is highly questionable whether *B & L Oil* continues to be good law. In *Conoco, Inc. v. Styler (In re Peterson Distributing)*,<sup>204</sup> the Tenth Circuit expressly adopted the Third Circuit's "single integrated transaction" standard that has been the subject of so much criticism:

In light of recoupment's equitable foundation, the doctrine is only applicable to claims that are so closely intertwined that allowing the debtor to escape its obligation would be inequitable notwithstanding the Bankruptcy Code's tenet that all unsecured creditors share equally in the debtor's estate. Use of this stricter standard for delineating the bounds of a transaction in the context of recoupment is in accord with the principle that this doctrine, as a non-statutory, equitable exception to the automatic stay, should be narrowly construed.<sup>205</sup>

Without repudiating *B & L Oil* in any way, the Tenth Circuit nevertheless held that a contract creating a relationship resulted in multiple transactions such that recoupment was unavailable to the creditor notwithstanding the fact that there was but a single contract between the parties.<sup>206</sup>

### *B. University Medical Center Permits A Debtor to Compel Performance From the Government Without Being Subject to the Terms of the Provider Agreement*

Mr. Maizel also criticizes *University Medical Center* for supposedly permitting a provider to compel payment from the government for postpetition services rendered under the provider

203. The two decisions are inconsistent with each other. In fact, the district court specifically rejected the argument that *B & L Oil* should control the resolution of Medicare disputes. See *In re University Med. Ctr II*, 122 B.R. 919, 925 (E.D. Pa. 1990). The Third Circuit quoted *B & L Oil* with approval for some general principles applicable to recoupment, but carefully avoids the implications of the Tenth Circuit's decision in applying those principles to the particular dispute before it. See *In re University Med. Ctr. IV*, 973 F.2d 1065, 1080-81 (3d. Cir. 1992).

204. *Conoco, Inc. v. Styler (In re Peterson Distributing)*, 82 F.3d 965 (10th Cir. 1996); accord *Commercial Fin. Servs., Inc. v. Jones (In re Commercial Fin. Servs., Inc.)*, 251 B.R. 397 (Bankr. N.D. Okla. 2000) ("In bankruptcy, recoupment and setoff against claims of a debtor are permitted in very narrow circumstances.")

205. *Conoco, Inc.*, 82 F.3d at 960-61 (citations omitted).

206. *Id.* at 962-63. The Tenth Circuit distinguished *B & L Oil* by noting that in that case, "[t]he situation . . . is not one in which the creditor seeking relief consciously . . . extended credit" whereas the Peterson Distributing creditor, Conoco, had voluntarily extended credit to the debtor. *Id.* at 963. As its own defenders have stated, in making periodic payments subject to later adjustment, the government is extending credit to a provider. If so, it should be subject to the same rules as are other voluntary prepetition lenders.

agreement prior to its assumption or rejection, thus allowing the debtor to enforce the provider agreement against the government while escaping its burdens (such as recoupment).<sup>207</sup> On the contrary, *University Medical Center* correctly applies the holding of *Bildisco*. That decision specifically stated that, upon a bankruptcy filing, an executory contract becomes temporarily unenforceable against the debtor.<sup>208</sup> The majority rule now is clearly that “[a]fter a debtor commences a Chapter 11 proceeding, but before executory contracts are assumed or rejected under § 365(a), those contracts remain in existence, enforceable by the debtor but not against the debtor.”<sup>209</sup>

As the Third Circuit pointed out, the Bankruptcy Code provides a specific remedy for a creditor when the debtor attempts to compel performance of an executory contract but is unwilling to perform its own obligations thereunder—the creditor can request that the court order the debtor to assume or reject the contract by a specified date.<sup>210</sup> If a creditor, including the government, chooses not to avail itself of a statutory remedy, there is no reason for a court to create an additional judicial one in its favor.

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207. *Maizel I*, *supra* note 151, at 436-40 and cases cited therein.

208. *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 532 (1984) (quoted in *University Med. Ctr. IV*, 973 F.2d at 1075). The Court further stated that “[i]f the debtor-in-possession elects to receive benefits from the other party to an executory contract pending a decision to reject or assume the contract, [it] is obligated to pay for the reasonable value of those services which, depending on the circumstances of a particular contract, may be what is specified in the contract.” *Id.* at 531-32. Such a statement would be totally unnecessary if the contract could be enforced against the debtor according to its terms.

209. *United States v. Dewey Freight Sys., Inc.*, 31 F.3d 620, 627 (8th Cir. 1994); *see also In re El Paso Refinery, L.P.*, 220 B.R. 37, 43 (Bankr. W.D. Tex. 1998) (“From the moment of filing to the moment of assumption or rejection, the non-debtor party is held to be barred from enforcing the contract and its terms.”); *St. Francis Physician Network, Inc. v. Rush Prudential HMO, Inc. (In re St. Francis Physician Network, Inc.)*, 213 B.R. 710, 714 (Bankr. N.D. Ill. 1997) (“It is settled law that a pre-bankruptcy contract is not enforceable against the debtor until it is assumed, but may be enforced by the debtor even before it is assumed.”); *S.N.A. Nut Co. v. The Haagen-Dazs Co. (In re S.N.A. Nut Co.)*, 191 B.R. 117, 120 (Bankr. N.D. Ill. 1991); *In re Monarch Capital Corp.*, 163 B.R. 899, 907 (Bankr. D. Mass. 1994); *In re Providence Television Ltd. Partnership*, 113 B.R. 446, 451 (Bankr. N.D. Ill. 1990); *In re Gunter Hotel Assocs.*, 96 B.R. 696, 699-700 (Bankr. W.D. Tex. 1988).

210. 11 U.S.C.A. § 365(d)(2) (West 2000) (“The trustee may assume or reject an executory contract or unexpired lease of residential real property or of personal property of the debtor at any time before the confirmation of a plan but the court, on the request of any party to such contract or lease, may order the trustee to determine within a specified period of time whether to assume or reject such contract or lease.”).

## V. ISSUES NOT RESOLVED BY *UNIVERSITY MEDICAL CENTER*

*University Medical Center* left a number of issues unaddressed and its conclusions on the issues it did address have certainly not been uniformly followed. This section addresses those issues and the subsequent treatment of *University Medical Center* by the courts.

### A. *Does a Bankruptcy Court Have Jurisdiction to Determine a Medicare Recoupment Dispute When the Parties Disagree Whether the Debtor Has Received Overpayments?*

#### 1. *The Narrowness of the Holding in University Medical Center*

The Third Circuit's holding on the jurisdictional issue was favorable to UMC, but it is a fairly narrow holding that leaves unaddressed the critical issue of how jurisdictional questions should be resolved when the debtor does dispute the fact or the amount of overpayments it has allegedly received from the government. In concluding that section 405(h) did not deprive the bankruptcy court of jurisdiction to hear the dispute between UMC and HHS, the Third Circuit expressly relied on the fact that "the parties do not dispute the amount of reimbursement due for any cost reporting period."<sup>211</sup> It used that fact to distinguish two Supreme Court decisions holding that when a claimant invokes federal court jurisdiction to compel the payment of Social Security benefits, the claim "arises under" the Social Security statutes, and is thus subject to section 405(h), even if the claimant has a valid argument that his or her claim is also based on other applicable federal law.<sup>212</sup>

*University Medical Center* can be read only as acknowledging bankruptcy court jurisdiction when a debtor asserts claims that may implicate the Medicare program or statutes but that are

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211. *University Med. Ctr. IV*, 973 F.2d at 1073. ("We agree with [UMC]. Its challenge to the Secretary's attempt to recover prepetition overpayments through postpetition withholding is not inextricably intertwined with any dispute concerning the fiscal intermediary's reimbursement determinations.")

212. See *Heckler v. Ringer*, 466 U.S. 602, 615 (1984), and *Weinberger v. Salfi*, 422 U.S. 749, 760-61 (1975), discussed *supra* at notes 85 – 123 and accompanying text. In both cases, the Court stated that even though the plaintiffs' claims were based on alleged violations of the Due Process Clause of the Constitution, they nevertheless arose under the Medicare Act. Therefore, the plaintiffs' claims had to be presented to the Secretary for determination before a federal court could exercise jurisdiction over them.



based solely on the Bankruptcy Code. The decision does not address whether a bankruptcy court (a) has jurisdiction to resolve questions of bankruptcy law but does not have jurisdiction to address any issue “arising under” the Medicare statutes (*i.e.*, the fact or amount of either the debtor’s claims against the government or the government’s claims against the debtor); or (b) can resolve questions of bankruptcy law and any Medicare issues that must be resolved in order to apply bankruptcy law (*i.e.*, whether a debtor has defaulted under its provider agreement and, if so, what the debtor must do to cure its defaults and compensate the government for any damages it has sustained as a result of those defaults).

## 2. The Application of Medicare Act Section 405(h) in Bankruptcy Cases

Courts outside of the Third Circuit have split sharply on the issue of whether a bankruptcy court has jurisdiction to decide a matter in which the debtor and the government contest the validity and amount of each other’s claims. The majority rule, however, appears to favor an expansive interpretation of the section 405 jurisdictional bar in bankruptcy cases in which the parties do not agree on the amounts of their respective claims.<sup>213</sup>

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213. See *United States v. James*, 256 B.R. 479 (W.D. Ky. 2000) (bankruptcy court had no jurisdiction to review debtor’s exclusion from participation in the Medicare program as a provider until the debtor had exhausted all of his administrative remedies); *Livingston Care Ctr., Inc. v. United States*, 1990 WL 125000 (E.D. Mich. 1990) (debtor challenging validity of Medicare decertification requirement must exhaust administrative remedies first); *Home Comp Care, Inc. v. United State Dept. of Health and Human Servs.*, 221 B.R. 202, 205-06 (Bankr. N.D. Ill. 1998) (debtor cannot institute adversary proceeding to compel turnover of Medicare payments until after it has exhausted its administrative remedies even if the amount of the payments is not at issue.); *Sullivan v. Hiser (In re St. Mary Hosp.)*, 123 B.R. 14, 17 (E.D. Pa. 1991) (court lacked jurisdiction to hear Medicare reimbursement claim until after debtor had exhausted its administrative remedies); *Andrews v. Blue Cross & Blue Shield of Mich. (In re Clawson Med., Rehabilitation and Pain Care Ctr., P.C.)* 12 B.R. 647 (E.D. Mich. 1981) (debtor could not challenge interim reimbursement rate in bankruptcy court without first exhausting its administrative remedies); *Tri County Home Health Services, Inc. v. United States Dept. of Health and Human Servs. (In re Tri County Home Health Servs., Inc.)*, 230 B.R. 106, 108 n. 1 (Bankr. W.D. Tenn. 1999); *In re St. Johns Home Health Agency, Inc.*, 173 B.R. 238 (Bankr. S.D. Fla. 1994); *In re Upsher Labs., Inc.*, 135 B.R. 117, 119 (Bankr. W.D. Mo. 1991); *Pennsylvania Peer Review Org., Inc. v. Heckler (In re Pennsylvania Peer Review Org., Inc.)*, 50 B.R. 640 (Bankr. M.D. Pa. 1985) (claiming improper termination of government contract); *In re Berger*, 16 B.R. 236, 237 (Bankr. S.D. Fla. 1981); *cf. McDonald v. Centra, Inc.*, 946 F.2d 1059, 1063 (4th Cir. 1991) (noting the unequivocal language of section 405(h)). The cases upholding bankruptcy court jurisdiction are far less numerous. See *In re Healthback, L.L.C.*, 226 B.R. 464 (Bankr. W.D. Okla. 1998); *First Am. Health Care of Ga., Inc. v.*

By its terms, however, section 405(h) refers only to 28 U.S.C. §§ 1331 (federal question jurisdiction) and 1346 (granting concurrent jurisdiction to the district court and other federal courts as to certain claims against the United States). Under the Supreme Court's "plain meaning" doctrine, section 405(h) should be read literally as affecting federal court jurisdiction only as to the two jurisdictional statutes to which it specifically refers.

Nevertheless, a number of cases have held that section 405(h) originally referred to all of the statutes creating jurisdiction in the federal courts, including bankruptcy jurisdictional provisions, and that the elimination of those references in technical amendments to section 405(h) enacted in 1984 was inadvertent.<sup>214</sup> The basis for this holding is, almost invariably, the complex history of the two statutes and their relationship to each other.

As originally enacted in 1939, section 405(h) barred all actions brought pursuant to 28 U.S.C. § 41.<sup>215</sup> At that time, the grant of bankruptcy jurisdiction to the district courts was contained in 28 U.S.C. § 41(19), and therefore, there was little doubt that an action of the type covered by section 405(h) could not be heard by a court invoking bankruptcy jurisdiction.<sup>216</sup> In 1948, the jurisdictional grants contained in 28 U.S.C. § 41 were broken out into separate sections.<sup>217</sup> This change to the Judicial Code was not reflected in section 405(h) until thirty-six years after it occurred. In 1984, Congress enacted a statute amending section 405(h) by "striking out section 24 [*i.e.*, section 41(19)] of the Ju-

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Shalala (*In re First Am. Health Care of Ga., Inc.*), 208 B.R. 985, 988-91 (Bankr. S.D. Ga. 1996), *vacated and superseded by settlement*, 1996 WL 282149 (Bankr. S.D. Ga. March 11, 1996); *see also* Healthmaster Home Health Care, Inc. v. Shalala (*In re Healthmaster Home-Health Care, Inc.*), *availale at* 1995 WL 928920, at \*2 (Bankr. S.D. Ga., April 13, 1995); *Gingold v. United States (In re Shelby County Healthcare Serv. of Ala., Inc.)*, 80 B.R. 555, 560 (Bankr. N.D. Ga. 1987).

214. *See Upsher Labs.*, 135 B.R. at 119; *Berger*, 16 B.R. at 237-38; *see also* Bodimetric Health Servs. Inc. v. Aetna Life & Cas., 903 F.2d 480 (7th Cir. 1990) (section 405(h) bars action brought under diversity jurisdiction statute [28 U.S.C. § 1332] even though section 1332 is no longer mentioned in section 405(h)); *Clawson Med.*, 12 B.R. at 652; *In re Visiting Nurse Assoc. of Tampa Bay, Inc.*, 121 B.R. 114 (Bankr. M.D. Fla. 1990); *AHN Homecare v. Home Health Reimbursement & HCFA*, 222 B.R. 804, 807-808 (Bankr. N.D. Tex. 1998); *St. Johns*, 173 B.R. at 244.

215. *See* Social Security Act Amendments of 1939, Pub. L. No. 379, § 205(h), 53 Stat. 1360, 1371 (1939) (codified as amended as 28 U.S.C.A. § 405(h)(1982)); *see also Upsher Labs.*, 135 B.R. at 119.

216. *See St. Mary Hosp.*, 123 B.R. at 17.

217. *See Upsher Labs.*, 135 B.R. at 119 (citing Pub. L. No. 80-773, 62 Stat. 869, 930-35 (1948)).

dicial Code of the United States and inserting in lieu thereof section 1331 or 1346 of title 28, United States Code.”<sup>218</sup>

The implementing statute that amended section 405(h) provides that “none of the amendments made by section 2663 “shall be construed as changing or affecting any right, liability, status, or interpretation which existed . . . before that date.”<sup>219</sup> According to the Seventh Circuit, section 405(h) continues to preclude a court from having jurisdiction as to any action over which that court could not have exercised jurisdiction under the statute as it was enacted in 1939 because “Congress clearly expressed its intent not to alter the substantive scope of section 405(h).”<sup>220</sup>

Resort to congressional intent is inappropriate in applying section 405(h) in bankruptcy cases. The Supreme Court has stated that a dispute over the meaning of a statute “begins where all such inquiries must begin: with the language of the statute itself. . . . In this case, it is also where the inquiry should end, for where, as here, the statute’s language is plain, the sole function of the courts is to enforce it according to its terms.”<sup>221</sup>

The cases construing section 405(h) generally do not mention the Supreme Court’s “plain meaning” decisions. The court in *St. Mary*, however, found an ambiguity between the first two sentences of section 405(h) and the third sentence of that section. It then used this ambiguity as a justification for delving into the legislative history of section 405(h).<sup>222</sup> The *Upsher Laboratories* court implicitly denied that any ambiguity exists or was even necessary.<sup>223</sup> There is, however, no ambiguity in section 405(h). Read as it is written, as to matters arising under the Social Security Act, the statute only restricts the jurisdiction of district courts hearing such matters by reason of the jurisdictional grants created in 28 U.S.C. §§ 1331 and 1346, a fact that was tacitly acknowledged by the Seventh Circuit in its

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218. See Pub. L. No. 98-369, §2663(a)(4)(d), 99 Stat. 1162.

219. *Id.* § 2664(b).

220. See *Bodimetric Health Servs.*, 903 F.2d at 489.

221. *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 242, (1989); see also *Conn. Nat’l Bank v. Germain*, 503 U.S. 249, 253-54 (1992). (“We have stated time and again that the courts must presume that a legislature says in a statute what it means and means in a statute what it says there. . . . When the words of a statute are unambiguous, then this first canon is also the last: ‘Judicial inquiry is complete.’”).

222. *Sullivan v. Hiser (In re St. Mary Hosp.)*, 123 B.R. 14, 17 (E.D. Pa. 1991).

223. *Upsher Labs.*, 135 B.R. at 120 (stating that because Congress’ interpretive instructions are found in the enabling statute rather than the legislative history, it “[was] not relying on mere legislative history to interpret the statute. The statement [regarding the interpretation of the amendment to section 405(h)] comes directly from the enacted statute and must be given full effect.”).

*Bodimetric Health Services* decision.<sup>224</sup> Because section 405(h) is clear on its face, resort to any other source to determine its meaning is inappropriate.<sup>225</sup>

The text of former 28 U.S.C. § 41 supports the argument that current statutes 42 U.S.C. § 405(h) and 28 U.S.C. § 1334 cannot properly be reconciled merely by noting that because section 405(h) incorporated a limitation on the grant of bankruptcy jurisdiction contained in the old Judicial Code, it necessarily has the same effect with respect to current section 1334. Former section 41(19) stated nothing more than that the district courts had “original jurisdiction” over “all matters and proceedings in bankruptcy cases.”<sup>226</sup>

The former and current bankruptcy jurisdiction statutes are completely different from each other. There is nothing in the old statute that corresponds to the statements in the current statute that the district courts have (1) original *and exclusive* jurisdiction over bankruptcy cases; (2) *exclusive* jurisdiction over the property of the debtor and of the estate; and (3) jurisdiction over bankruptcy civil proceedings “notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts.”<sup>227</sup> Accordingly, the fact that section 405(h) may have limited jurisdiction under former section 41(19) does not establish that the same limitations were intended to be preserved with respect to a completely different section 1334. Finally, section 405 has been amended three times in the nine years since *University Medical Center* was decided but it continues to refer only to sections 1331 and 1346.<sup>228</sup>

Given the Supreme Court’s admonitions regarding the necessity of applying the plain meaning of a statute, language in the implementing statute (which is itself ambiguous) relating to the amendment to section 405(h) should not be permitted to modify the unambiguous meaning of the statute as actually amended by Congress. At least two decisions have so held. In *Healthback*, the court held that section 405(h) should be read literally as ap-

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224. *Bodimetric Health Servs.*, 903 F.2d at 488 (“Curiously, this section, on its face, appears to bar actions brought pursuant to federal question jurisdiction and actions brought against the United States but appears to permit actions brought pursuant to diversity jurisdiction.”).

225. See *Germain*, 503 U.S. at 254.

226. 28 U.S.C.A. § 41(19) (repealed 1948) (emphasis added).

227. 28 U.S.C.A. §§ 1334(a), (b), (e) (West 2000).

228. The statute was amended in 1994, 1996, and 1997. See Historical and Statutory Notes to 42 U.S.C.A. § 405 (West Supp. 1998), at 123.

plying only to actions in which jurisdiction is predicated on sections 1331 or 1346.<sup>229</sup> The court further noted that “it is the court’s responsibility to execute absolute congressional enactments as they are stated. If the result is ‘unwelcome’ then Congress is free to alter the law.”<sup>230</sup> These courts are correct: section 405(h), by its express terms, does not preclude bankruptcy court jurisdiction over Medicare payment disputes when the resolution of those disputes is necessary to apply the bankruptcy laws.

### 3. The Effect of the Federal Government’s Waiver of its Sovereign Immunity

The cases supporting a broad reading of section 405(h) as sharply limiting the jurisdiction of the bankruptcy courts also generally do not discuss Bankruptcy Code section 106, under which the federal government has waived its sovereign immunity as to various matters, including the application to the government of Bankruptcy Code sections 362 (automatic stay), 365 (assumption and rejection of executory contracts), 502 (allowance of claims against the debtor), and 542 (turnover of property of the estate).<sup>231</sup> Section 106 also states that the “court may hear and determine any issue arising with respect to the application of such sections to governmental units.”<sup>232</sup> Section 106 does not expressly refer to jurisdiction but there is a good argument that subsections (a)(1) and (a)(2), read together, authorize a bankruptcy court to resolve Medicare claim and payment disputes if the resolution of those disputes is necessary in applying the Bankruptcy Code provisions in section 106(a)(1) to HHS or other governmental units.

229. See *In re Healthback, L.L.C.*, 226 B.R. 464, 469 (Bankr. W.D. Okla. 1998) (“[T]he specific language of 42 U.S.C. § 405(h) does not state that jurisdiction under 28 U.S.C. § 1334 is subordinate to 42 U.S.C. § 405. It is a primary rule of construction to look to the plain language of the statute. Thus, under the plain language rule, 28 U.S.C. § 1334 grants bankruptcy jurisdiction over matters involving Medicare.”)

230. *Id.* at 469 n. 3 (citing *In re Horwitz*, 167 B.R. 237 (Bankr. W.D. Okla. 1994); accord *First Am. Health Care of Ga., Inc. v. Shalala (In re First Am. Health Care of Ga., Inc.)*, 208 B.R. 985, 988-89 (Bankr. S.D. Ga. 1996), *vacated as superseded by settlement*, 1996 WL 282149 (Bankr. S.D. Ga. March 11, 1996) (stating that the fact that Congress amended 28 U.S.C. § 1334 and 42 U.S.C. § 405(h) within eight days of each other in 1984, yet did not make jurisdiction under section 1334 subordinate to section 405, meant that it could exercise jurisdiction over Medicare matters under section 1334.)

231. 11 U.S.C.A. § 106(a)(1) (West 2000).

232. *Id.* § 106(a)(2) (emphasis added).

First, the legislative history to section 106 expressly states that “[t]he bankruptcy and appellate courts will have *jurisdiction* to apply the specified sections [of the Bankruptcy Code] to any kind of governmental unit as provided in section 106(a)(2).”<sup>233</sup> Second, several courts have stated or suggested that section 106 confers jurisdiction on the bankruptcy courts with respect to matters as to which sovereign immunity has been waived. For example, in *Gross v. USDA (In re Iverson)*,<sup>234</sup> the court stated that issue before it was “whether 11 U.S.C. § 106(c),<sup>235</sup> as augmented by . . . 28 U.S.C. § 1334(b) extends jurisdiction to the Bankruptcy Court in civil proceedings against the United States” and concluded that it did.<sup>236</sup> Under these decisions, even if an “exhaustion of remedies” doctrine is otherwise applicable to a particular dispute (as is true with respect to, *e.g.*, Medicare payment disputes), if the government waives sovereign immunity as to a dispute, it also waives the right to demand that persons who contract with it exhaust administrative remedies with respect to that dispute. At least two courts have reached this conclusion with respect to the current version of section 106.<sup>237</sup>

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233. 140 CONG. REC. H10752-01 (October 4, 1994) (emphasis added).

234. *Gross v. USDA (In re Iverson)*, 108 B.R. 272 (Bankr. D. Or. 1989).

235. When *Iverson* was decided, section 106(b) was designated as section 106(c). Section 106(b) currently provides that if a governmental unit files a proof of claim in a bankruptcy case, it waives sovereign immunity as to all claims of the debtor that arise out of the “same transaction” as does the government’s proof of claim.

236. *Id.* at 273. *Iverson* was followed in *Apex Oil Co. v. United States Customs Serv. (In re Apex Oil Co.)*, 122 B.R. 559, 565 (Bankr. E.D. Mo. 1990), *aff’d in relevant part, overruled in part on other grounds*, 131 B.R. 712 (E.D. Mo. 1991). *Cf.* *In re R & W Enters.*, 181 B.R. 624 (Bankr. N.D. Fla. 1994), in which the court stated:

[Former s]ection 106(a) is a separate, independent waiver of sovereign immunity, unhampered by administrative processes and requirements. The exhaustion of administrative remedies, which may otherwise be jurisdictional outside of bankruptcy, becomes unnecessary as to a cause of action brought which relates to a claim of the government against the bankruptcy estate.

*Id.* at 643 (citing *University Med. Ctr. IV*, 973 F.2d 1065; *In re Town & Country Home Nursing Servs., Inc.*, 963 F.2d 1164 (9th Cir. 1991); *In re The MacLeod Co., Inc.*, 935 F.2d 270, 1991 WL 96718 (6th Cir. June 6, 1991) (table); *Anderson v. F.D.I.C.*, 918 F.2d 1139 (4th Cir. 1990); *Ashbrook v. Block*, 917 F.2d 918 (6th Cir. 1990); *In re Gribben*, 158 B.R. 920 (S.D.N.Y. 1993); *In re Motivation Resources, Inc.*, 158 B.R. 184 (Bankr. C.D. Cal. 1993); *In re Windrush Assocs. II*, 105 B.R. 195 (Bankr. D. Conn. 1989); and *In re Shelby County Healthcare Servs. of Al., Inc.*, 80 B.R. 555 (Bankr. N.D. Ga. 1987)).

237. See *Brown v. United States (In re Brown)*, 211 B.R. 1020, 1023-24 (Bankr. S.D. Ga. 1997) (“Under § 106(a)(3), a bankruptcy court may issue against any governmental unit a judgment for attorney’s fees where authorized under the Bankruptcy Code such as § 362(h) . . .”); *Field v. Montgomery County (In re Anton Motors, Inc.)*, 177 B.R. 58, 62 (Bankr. D. Md. 1995) (quoting the legislative history cited in the text).

The waiver of sovereign immunity in section 106(a) suggests that the *St. Johns* court was incorrect in concluding that even if a bankruptcy court has jurisdiction to decide whether a debtor can assume its provider agreement, it does not have jurisdiction to decide whether the debtor has cured all of its defaults thereunder so as to permit assumption. Section 106(a)(2) expressly permits the bankruptcy court to determine “any issue” that arises with respect to the application of the enumerated sections of the Bankruptcy Code to a governmental unit. The requirement that defaults under a provider agreement be cured before the agreement can be assumed and, accordingly, the issue of what constitutes a cure of those defaults, arises only by reason of the application to governmental units of Bankruptcy Code section 365. Therefore, a bankruptcy court necessarily has jurisdiction to determine what claims the debtor and the government have against each other so that it can then determine when the debtor has met the Bankruptcy Code requirements for assuming its provider agreement.<sup>238</sup>

#### 4. The Doctrine of “Primary Jurisdiction”

Under the doctrine of “primary jurisdiction,” a court that can validly exercise jurisdiction over a dispute nevertheless may, in its discretion, decline to exercise that jurisdiction if the issues in dispute are within the expertise of another court, administrative agency, or other tribunal. Thus, it can be argued that even if a bankruptcy court has jurisdiction to resolve Medicare payment disputes between the debtor and the government, the court should decline to exercise that jurisdiction and defer to HHS’s expertise on Medicare payment questions.

As one bankruptcy court has stated:

Application of the primary jurisdiction doctrine is appropriate where jurisdiction for decision-making lies in both the judicial and administrative agency provinces, there are issues of fact raised which are not within the conventional experience and expertise of the particular court, and the exercise of administrative agency discretion is an area created by Congress for regulation of that subject area. Concomitant with the primary jurisdiction doctrine is the principal that a court should defer to resolution of a factual issue or issues by the “specialized tribunal or administrative agency also having jurisdiction and

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238. Arguments based on section 106 are likely to be inapplicable in Medicaid disputes with State governmental units. See *supra* note 7 and the cases cited therein.

possessing expertise beyond the normal competency of the referring judge.”<sup>239</sup>

That court therefore suspended the debtor’s adversary proceeding to obtain payment on Medicaid claims for 120 days to permit the Pennsylvania Department of Public Welfare to address the merits of those claims.<sup>240</sup>

Other courts have declined to apply the primary jurisdiction doctrine in bankruptcy cases involving healthcare providers. In *Townview Nursing Home v. New York (In re Townview Nursing Home)*,<sup>241</sup> the court dismissed recitations in New York’s statutes describing the “[D]epartment of Health as possessing special expertise in determining reimbursement rates for the Medicaid and other federally assisted public health programs, . . .” focusing instead on the fact that “New York state courts do not require these administrative remedies to be exhausted where the action is brought by the State Attorney General” suggested that the state agency had no special expertise to which courts should be required to defer.<sup>242</sup>

As noted by the *First American* court, when the provider is a large entity with numerous facilities and patients, even HHS’s initial review of the provider’s cost reports can take years to complete. A provider who is dependent on continued Medicare reimbursement and is a chapter 11 debtor is not likely to survive long enough for administrative review to be completed.<sup>243</sup> In such circumstances, the doctrine of primary jurisdiction should

239. *Hiser v. Pennsylvania Dept. of Public Welfare (In re. St. Mary’s Hosp.)*, 125 B.R. 422, 430 (Bankr. E.D. Pa. 1991) (quoting *In re Mountain View Coach Line, Inc.*, 99 Bankr. 555, 559 (Bankr. S.D.N.Y. 1989)) (deferring to state agency’s expertise in Medicaid payment issues), *abrogated on other grounds*, *Sacred Heart Hosp. v. Pennsylvania Dept. of Public Welfare (In re Sacred Heart Hosp.)*, 133 F.3d 237 (3d Cir. 1998). The *St. Mary* court reiterated its support of the “primary jurisdiction” doctrine in *In re Sacred Heart Hosp. of Norristown*, 181 B.R. 195 (Bankr. E.D. Pa. 1995).

240. *See St. Mary’s Hosp.*, 125 B.R. at 432; *see also Shelby County*, 80 B.R. at 562 (concluding the court would suspend its exercise of jurisdiction over a Medicare payment dispute because it was satisfied that the Medicare matters can be determined by HHS without either undue delay or impact upon the administration of this bankruptcy case).

241. *Townview Nursing Home v. New York (In re Townview Nursing Home)*, 28 B.R. 431, 441-42 (Bankr. S.D.N.Y. 1983).

242. *See also Healthback L.L.C.*, 224 B.R. at 470 (determining whether the debtor had received overpayments involved nothing more than the use of basic accounting principles to determine the accuracy of the debtor’s cost reports, a matter that was not “beyond the competency of the court”).

243. *See First Am. Health Care of Ga., Inc. v. Shalala (In re First Am. Health Care of Ga., Inc.)*, 208 B.R. 985, 991-92. (Bankr. S.D. Ga. 1996), *vacated and superseded by settlement*, No. 96-2007, 1996 WL 282149 (Bankr. S.D. Ga. March 11, 1996).



be inapplicable because deferral to HHS would destroy or seriously impair the debtor's prospects for reorganization.

*B. Can the Government Rely on the Strumpf Doctrine to Withhold Payments for Postpetition Services While it Determines Whether it Has Made Prepetition Overpayments?*

A related issue that should be considered in recoupment disputes is whether the principles espoused in *Citizens Bank v. Strumpf (In re Strumpf)*<sup>244</sup> create an additional argument in favor of the government's right to withhold postpetition payments while it determines whether it made prepetition overpayment to the debtor and the amount of those overpayments. In *Strumpf*, the Supreme Court held that a creditor may temporarily hold monies that are due to a debtor if it does so to preserve its right of setoff and if it acts diligently to obtain relief from the stay while the hold is in effect.<sup>245</sup> The decision left open numerous issues, including how long such a freeze may be kept in place and what it means for a creditor "diligently" to pursue relief from the stay. It is clear, however, that a creditor may not rely on *Strumpf* to hold the debtor's funds indefinitely while the creditor attempts to extract concessions from the debtor but does not pursue relief from the stay.

In *In re Heffernan Memorial Hospital District*,<sup>246</sup> the court, without considering these limitations on the doctrine, stated that "HHS is not required to release funds to Debtor while it evaluates its right to setoff and seeks court permission to setoff."<sup>247</sup> The court did not address the fact that administrative freezes imposed by HHS are likely to last years, not weeks or even months.<sup>248</sup>

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244. *Citizens Bank v. Strumpf (In re Strumpf)*, 516 U.S. 16 (1995).

245. *Id.* at 20.

246. *In re Heffernan Memorial Hospital Dist.*, 192 B.R. 228 (Bankr. S.D. Cal. 1996).

247. *Id.* at 230 n.2.

248. *Cf. Holden v. United States (In re Holden)*, 217 B.R. 161, 166 (D. Vt. 1997) ("[T]he IRS did not simply maintain the status quo. It utilized an open-ended 'administrative freeze' to coerce an agreement and to secure the payment of a debt, without seeking prior approval from the Bankruptcy Court. Moreover, on its face, the IRS's withholding of \$2050 to ostensibly secure collection of \$184 was unfair and apparently not in good faith. Here, the result of the freeze imposed on the Holdens' refund was the collection of a prepetition claim without first seeking relief from the stay."). At least one court has held that a four-month administrative hold is excessive and not permitted under the *Strumpf* doctrine. See *Hempstead Employees Fed. Credit Union v. Wicks (In re Wicks)*, 215 B.R. 316, 319 (E.D.N.Y. 1997).

The result in *Heffernan* is incorrect. The *Strumpf* exception is designed solely to maintain the status quo while giving the creditor a brief period to determine whether it has an enforceable right to setoff. It does not create an independent, substantive right to withhold payments. In cases in which the government should not be allowed to recoup or setoff alleged prepetition overpayments because of the harm that would cause the debtor and its patients, it should not be allowed to freeze funds indefinitely pending a determination whether it holds a right to recoup. As noted by the *First American* court, in most Medicare cases, HHS will not be able to quantify or establish its recoupment rights within a short time of the filing, with the result that giving it a right to freeze payments to the debtor indefinitely will simply delay the process even further and hasten the debtor's demise.

C. *The Right to Recover Overpayments:  
Is it a Claim in Bankruptcy?*

The issue is significant because, as set forth above, if a right of recoupment is not a claim, it is arguably unaffected by both the automatic stay and the Bankruptcy Code's discharge provisions, each of which apply only to "claims."<sup>249</sup> This issue is not really addressed in either circuit court decision, although the D.C. Circuit's statutory analysis inevitably leads to the conclusion that because the government never owes a provider any amount claimed by the provider that is not in excess of any prior overpayments received by that provider, the government does not have a claim for the amount of the overpayment.<sup>250</sup> Similarly, cases that view recoupment rights as a defense to the debtor's claim rather than as a separate claim against the debtor would also support a conclusion that recoupment rights are not claims, although the blurring of the lines between defenses, counterclaims, and compulsory counterclaims in the rules of pleading illustrates the danger of converting those rules into substantive principles of law by importing them into a situation (*i.e.*, bank-

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249. 11 U.S.C. § 3623(a)(1), (6), and (7) (West 2000) (all referring only to "claims"), 523(a) (discharge is a discharge of all specified "debt[s]"). The use of the term "debt" in section 523 instead of "claim" does not appear significant. The Bankruptcy Code defines a "debt" as "liability on a claim." 11 U.S.C.A. § 101(12) (West 2000).

250. As noted by the Ninth Circuit, HHS now argues, in reliance on *Consumer Health Services*, that its recovery rights do not make it a creditor in a bankruptcy case. See *In re TLC Hosp., Inc.*, 224 F.2d 1008, 1012 n. 9 (9th Cir. 2000).

ruptcy) in which the designation of a right as a “claim” or as something else has great significance.

In *Kings Terrace Nursing Home v. New York Department of Social Services (In re Kings Terrace Nursing Home)*,<sup>251</sup> the bankruptcy court held that the New York Department of Social Services’ (the “DSS”) right to recover overpayments was “a classic example of a dischargeable, contingent, claim.”<sup>252</sup> From the court’s discussion, it appears that the DSS did not assert that its right was “recoupment” (an argument the court also rejected) and, therefore, not a claim, but argued only that until the audits were complete and it was determined whether and how much the debtor had been overpaid prepetition, it had no claim to assert.” Relying on *United States v. LTV Corporation (In re Chateaugay)*,<sup>253</sup> the court held that because the DSS’s “alleged remedy of recoupment is an alternative to both the government’s incurrence of costs and its affirmative efforts to seek payment from the debtor,” the remedy was a claim, regardless of whether it was viewed as a right to payment or an equitable remedy.<sup>254</sup> Both the *Kings Terrace* decision and the *Chateaugay* decision on which it relies found the language of Bankruptcy Code section 101(5)(b)<sup>255</sup> to be dispositive, even though (as discussed below) the *Kings Terrace* court later states in its decision that neither the provider’s reimbursement rights against the government nor the governments recovery rights against the provider arise pursuant to a contract.

Because of its conclusion that DSS’s right was a claim, the court held that DSS’s failure to file a proof of claim in the bankruptcy case, coupled with the terms of the order confirming the debtor’s plan, discharged DSS’s overpayment claim and permanently stayed all efforts to collect on it.<sup>256</sup> On appeal, the district court addressed only the claim issue. DSS argued that its recoupment right “[i]s merely an equitable remedy that gives no right to actual payment and, in consequence, is not a ‘claim.’”<sup>257</sup>

251. *Kings Terrace Nursing Home v. New York Dept. of Social Servs. (In re Kings Terrace Nursing Home)*, 1995 WL 65531 (Bankr. S.D.N.Y. Jan. 27, 1995), *aff’d*, 184 B.R. 200 (S.D.N.Y. 1995).

252. *Id.* at \*5.

253. *United States v. LTV Corp. (In re Chateaugay)*, 944 F.2d 997 (2d Cir. 1991).

254. *In re Kings Terrace Nursing Home*, 1995 WL 65531, at \*5; *accord Baker v. United States*, 100 B.R. 80 (M.D.Fla.1989).

255. The definition of “claim” includes “an equitable remedy for breach of performance, if such breach gives rise to a right of payment.” 11 U.S.C. § 101(5)(B).

256. *Kings Terrace*, 1995 WL 65331, at \*6.

257. *Kings Terrace*, 184 B.R. at 202.

The court focused on the broadness of the term “claim” as used in the Bankruptcy Code to conclude that recoupment presupposes an underlying right of recovery against the debtor and is essentially an equitable alternative to that right, and is therefore, a “claim.”<sup>258</sup>

Notwithstanding the fact that the bankruptcy court had held that DSS’s right was wholly noncontractual, the district court stated, “[i]t is undeniable, as DSS conceded at oral argument, that *any alleged overpayment to the debtor gave rise to a right on the part of DSS to recover money pursuant not only to the DSS’s own regulations, but also in contract and quasi contract.*”<sup>259</sup> The district court did not mention the bankruptcy court’s analysis on this issue or the Second Circuit case on which that court relied.

Finally, the court addressed the policies of the Bankruptcy Code and distinguished or rejected two well-known early cases that upheld the DSS’s “recoupment” rights. The court did not reject the theory that recoupment rights generally survive confirmation of a plan; it merely held that DSS must assert the right in bankruptcy court so that “the court can make an informed decision on whether the plan is feasible.”<sup>260</sup> It distinguished *In re Yonkers Hamilton Sanitarium, Inc.*,<sup>261</sup> solely on the ground that the decision did not involve a determination of whether a right to recoupment was a claim that had to be asserted in the bankruptcy case or be lost on confirmation.<sup>262</sup> It rejected *Mercy Hospital of Watertown v. New York Department of Social Services*,<sup>263</sup> but only on the same narrow ground; that is, it rejected the argument that an informal assertion of a right to payment does not waive sovereign immunity if the right asserted is recoupment as opposed to setoff.<sup>264</sup>

In short, despite some interesting issues and discussions in the bankruptcy court decision, *Kings Terrace* may be of little relevance because its ultimate holding is applicable only when the government agency fails to file a proof of claim. In addition, the

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258. *Id.* at 203.

259. *Id.* (citation omitted, emphasis added).

260. *Id.* at 203.

261. *In re Yonkers Hamilton Sanitarium, Inc.*, 22 B.R. 427 (Bankr. S.D.N.Y. 1982), *aff’d*, 34 B.R. 385 (S.D.N.Y. 1983).

262. *Kings Terrace*, 184 B.R. at 204.

263. *Mercy Hosp. of Watertown v. New York Dept. of Social Servs.*, No. 90-02501A, Adv. Proc. No. 92-70155A (Bankr. N.D.N.Y. 1993), *aff’d*, 93 Civ. 1685 (N.D.N.Y. 1994)

264. *Kings Terrace*, 184 B.R. at 204-05.

value of the case is undermined by (1) the disparate views of the bankruptcy and district courts regarding whether the government's and provider's rights properly sound in contract, and (2) questions regarding whether a right of recoupment arising under statute (assuming such a right can arise under statute) is a claim because it is an equitable remedy for breach of performance. Finally, the overwhelming majority of the courts that have considered the issue have concluded that a right of recoupment is not a "claim," but merely a defense to a claim. The *Kings Terrace* court either was not apprised of, or chose to ignore, the authority (including the Supreme Court's decision in *Reiter*) stating that a right of recoupment is a "defense," not a "claim."<sup>265</sup>

#### D. *The Impact of Allegations of Fraud and Abuse on the Exercise of the Recovery Rights*

There was no allegation in *University Medical Center* that the debtor had obtained any of its overpayments by fraud. Thus, the Third Circuit did not address whether the presence of that factor could alter its analysis.<sup>266</sup> In more recent years, health-care bankruptcies in which the debtor has apparently obtained large overpayments have often involved allegations of "fraud and abuse" as well. Bankruptcy Code section 362(b)(4) states that the automatic stay does not apply to actions by a governmental unit to enforce its "police and regulatory power." The exception generally covers actions the enforcement of laws affecting the public "health, welfare, morals, and safety."<sup>267</sup> Although the applicability of the exception will depend on the specific facts before the court, there is authority holding that ac-

265. See *Oregon v. Harmon (In re Harmon)*, 188 B.R. 421, 425 (9th Cir. BAP 1995) (holding that recoupment only reduces a debt and is not an independent basis for a debt; therefore, it is not a claim in bankruptcy); see also Samuel R. Maizel, *Setoff and Recoupment in Bankruptcy*, 767 PLI/COMM 389, 472-75 (April 1998) (collecting cases). In *Robinson v. Bowen (In re Pacoima Memorial Hospital)*, 1990 WL 282616 (Bankr. C.D. Cal. 1990), the court, relying on *Quittner v. Los Angeles Steel Casting Co.*, 202 F.2d 814 (9th Cir. 1953), held that recoupment was not available in bankruptcy. As the Ninth Circuit acknowledged in *Newbery, Quittner* was effectively overruled by *Reiter*. Similarly, the continuing viability of the holding in *Baker* that equitable recoupment is a claim is questionable in light of subsequent decisions from the same court. See, e.g., *Visiting Nurse Ass'n of Tampa Bay v. Sullivan (In re Visiting Nurse Ass'n of Tampa Bay)*, 121 B.R. 114, 121 (Bankr. M.D. Fla. 1990).

266. It did state in *dicta*, however, that an action intended solely to enforce contract rights under the provider agreement was not covered by the "police power" exception. See *University Med. Ctr. IV*, 973 F.2d 1065, 1075 (3d Cir. 1992).

267. See, e.g., *In re Universal Life Church, Inc.*, 128 F.3d 1294 (9th Cir. 1997).

tions against healthcare debtors that attempt to prevent, investigate, or recover payments made due to fraud may not be affected by the automatic stay.<sup>268</sup>

In such a case, a bankruptcy court may nevertheless prevent HHS from withholding postpetition reimbursements by relying on Bankruptcy Code section 105(a).<sup>269</sup> The courts have stated that section 105(a) allows a bankruptcy court to issue injunctions or discretionary stays in circumstances beyond the scope of the automatic stay provisions of section 362.<sup>270</sup> In determining whether to grant such relief, a court will consider equitable factors.

Arguments that equitable factors favor a debtor provider have been developed at length by three bankruptcy decisions that concluded that, even given the evidence suggesting the existence of fraud, the government cannot use its recovery rights to put healthcare providers on whom patients depend for necessary services out of business. For example, in one Medicare provider bankruptcy case, the court concluded that despite allegations of widespread fraud, a complete withholding of postpetition reimbursements was unacceptable because it would put the debtors out of business, thus jeopardizing thousands of their patients and employees:

The irreparable harm in this case clearly outweighs any inconvenience or potential harm to the Defendants. Without regular payment of PIPs, First American cannot meet basic overhead obligations or payroll. It will cease to exist. If it cannot meet its payroll obligations, the employees will quit or be laid off and services to approximately 32,000 patients will ab-

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268. See *In re Orthotic Ctr., Inc.*, 193 B.R. 832 (N.D. Ohio 1996) (withholding of reimbursements to provider because of suspected fraud was within police power exception to automatic stay); *In re Medcar Ambulance Co., Inc.*, 174 B.R. 804 (N.D. Cal. 1994) (automatic stay inapplicable to ongoing investigation into debtor's billing practices); *In re Mickman*, 144 B.R. 259 (E.D. Pa. 1992) (action against debtor for fraud in telemarketing scheme not affected by automatic stay); cf. *In re Rusnak*, 184 B.R. 459, 464-66 (Bankr. E.D. Pa. 1993) (in absence of allegations of fraud or incompetence, the automatic stay prohibited HHS from suspending the debtor from participation in the Medicare program).

269. This section provides, in relevant part, that "the court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C.A. § 105(a) (West 2000).

270. See, e.g., *Pennsylvania Pub. Util. Comm'n v. Metro Transp. Co.* (*In re Metro Transp. Co.*), 64 B.R. 968, 974 (Bankr. E.D. Pa. 1986); see also H. R. REP. NO. 95-595, 95th Cong., 1st Sess. 342-43 (1977); S. REP. NO. 95-989, 95th Cong., 2d Sess. 51-52 (1978) (stating the effect of an exception to the automatic stay under section 362(b) is not to make the action immune from injunction and the court has power, under section 105, to stay actions not covered by the automatic stay).

ruptly cease. Some of these patients require daily visits for administration of medications without which the patients' lives may be endangered. Some of these patients live in such rural areas as to have no alternative qualified home care provider which could provide the services currently provided by the Debtors. Thus, irreparable harm to the 32,000 patients and the Debtors and their employees is certain if the requested relief is not granted.<sup>271</sup>

The court also relied on the fact that the government's audit system is so slow that it would take years to determine how much the debtor had been overpaid.<sup>272</sup> In *Healthmaster*, the same court reached the same result based on the same reasoning. In both *Healthmaster* and *First American*, the court noted that (1) only affiliates of the debtors, and not the debtors themselves, had been indicted for fraud; and (2) the debtors had replaced, or had agreed to replace, prepetition management.

In *Healthback*, the court, before it even considered whether the "same transaction" requirement had been met for the application of the doctrine of recoupment, stated that the harm to HHS that would come from denying its right to recover alleged overpayments would "only be a delay in the accounting and recovery of any overpayments."<sup>273</sup> The court stressed that it was not discharging the overpayment claims or permanently preventing HHS from recovering overpayments; it was merely giving the debtor a necessary breathing space to enable it to sur-

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271. *First Am. Health Care of Ga., Inc. v. Shalala* (*In re First Am. Health Care of Ga., Inc.*), 208 B.R. 985, 988-91 (Bankr. S.D. Ga. 1996), *vacated and superseded by settlement*, 1996 WL 282149 (Bankr. S.D. Ga. March 11, 1996); *see also Healthmaster Home Health Care, Inc. v. Shalala* (*In re Healthmaster Home-Health Care, Inc.*), *available at* 1995 WL 928920, at \*3 (Bankr. S.D. Ga., April 13, 1995) (any interest the government might have in recovering prepetition overpayments, whether or not obtained as a result of fraud, was greatly outweighed by the debtor's interest in continuing to provide needed medical services to its 12,000 patients). The two *Medicar* cases are also worth noting. In the first opinion, the court rejected the government's recoupment argument as applied to a Medicare Part B supplier and held that recoupment was not available to the government. *See In re Medicar Ambulance Co., Inc.*, 166 B.R. 918 (Bankr. N.D. Cal. 1994). It is clear from the second opinion that the supplier was under investigation for fraud because the court refused to apply the automatic stay to prevent HHS from retaining corporate records it had seized as part of its investigation.

272. *See First Am. Health Care*, 208 B.R. at 991-92.

273. *Id.* at 476. *But see Tri County Home Health Servs., Inc. v. United States Dept. of Health and Human Servs.* (*In re Tri County Home Health Servs., Inc.*), 230 B.R. 106, 114 ("The public interest would be grievously disserved if HHS were required to continue payments under the circumstances of this case before first recouping the overpayments previously made to plaintiffs.") (citation omitted).

vive and reorganize.<sup>274</sup> On the other hand, if the Secretary's request were to be granted and the debtor would be required to exhaust HHS's administrative review procedures, "there is little doubt that the debtor will cease to exist. Thus, the harm to the debtor, its 200 employees, patients, and creditors will be the highest degree of harm possible."<sup>275</sup>

#### CONCLUSION: IS IT THE SAME TRANSACTION OR NOT?

As several commentators have noted, the development of the case law since *University Medical Center* was decided has not produced consistency—or anything close to it—on the one critical issue in disputes between the debtor/provider and the government: Are all services and payments under a single Medicare or Medicaid agreement part of a single transaction? As already noted, *University Medical Center* itself is not entirely clear as to what constitutes the relevant transaction. Although the court ultimately resolved the issue in that case based on the yearly audits, it also suggested in *dicta* that services to a single patient over a period of years may constitute a single transaction. The district court in *University Medical Center* and the bankruptcy court in *Consumer Health Services* focused on the nature of a provider agreement as creating a relationship within which transactions occur as opposed to itself being a transaction involving the provision of services and the receipt of payments for those services. Finally, the *Healthback* court held that each pro-

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274. The district court in *University Medical Center* also focused on the fact that denying recoupment to give the debtor a chance to reorganize and determine whether to assume its provider agreement also did not destroy the government's claim; it merely delayed payment on that claim. See *University Med. Ctr. III*, 125 B.R. 121, 124 (E.D. Pa. 1991).

275. *Id.* Not all courts share this interest in protecting the debtor and, in particular, its patients. In *St. Johns*, the court concluded it lacked jurisdiction to allow the debtor to assume its provider agreement when the debtor and the government could not agree on the amount of overpayments for which the debtor was liable. *In re St. Johns Home Health Agency*, 173 B.R. 238 (Bankr. S.D. Fla. 1994). The court ruled that the debtor would have to await the outcome of HHS's administrative review process and was unmoved by the debtor's argument that, as a practical matter, it had no adequate administrative remedy it could pursue:

St. Johns does have an administrative remedy under the Medicare Program upon the issuance of an NPR; the possibility that its administrative remedy may not provide relief as quickly as St. Johns desires, or indeed may require to survive, is one of the potentially unfortunate consequences of doing business in a heavily regulated field where compensation is highly dependent upon administrative processes.

*Id.* at 42-43; see also *In re TLC Hosp., Inc.*, 225 B.R. 709, 712-13 (N.D. Bankr. Cal. 1998).



vision of services from a debtor to each patient should constitute a separate transaction but adopted the Third Circuit's year-by-year analysis as the appropriate practical resolution of the issue because calculation of which amounts were due (or had already been paid) for each service would be too difficult.<sup>276</sup>

On one point, at least, the criticism of *University Medical Center* is well-taken. The fact that there are periodic calculations of what is due to or from the provider does seem to be merely a matter of convenience rather than a substantive determination of the parameters of the relevant transaction. On the other hand, with respect to all or nearly all of such transactions, the government will have paid the original claim long before it becomes aware of having made overpayments of any kind to the debtor. Under this analysis, almost every claim for payment for a postpetition service will relate to a different transaction than the service for which the overpayment was made and no right of recoupment will ever exist. In addition, dividing one or more years treating a single patient into hundreds or thousands of individual transactions also seems forced and unnatural. As the district court in *University Medical Center* pointed out, a Medicare provider agreement:

[D]oes not provide for a defined transaction or even a series of defined transactions. It simply establishes a relationship between the parties: if UMC treats eligible patients, HHS will reimburse them for their costs. Under the agreement, the parties established an arrangement for payment, with HHS providing reimbursement with respect to *each patient treated*.<sup>277</sup>

This is the proper perspective from which to evaluate the "same transaction" issue. The government pays providers for providing health care services to individual patients. As the court correctly observed, the Medicare provider agreement creates the relationship under which those services are provided, but does not mandate the treatment of any particular patient by any particular provider or the nature and amount of the services to be provided. But this does not support the contention that

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276. *In re Healthback, L.L.C.*, 226 B.R. 464, 478-79 (Bankr. W.D. Okla. 1998):

Even though, as a matter of logic, it appears that the proper result could be to conclude that each individual provision of a service by the debtor to its patients should constitute a separate transaction, as a practical matter, applying such a holding would be time-consuming and a waste of judicial resources.

*Id.*

277. *In re University Med. Ctr. II*, 122 B.R. 919, 930 (E.D. Pa. 1990) (emphasis added).

each provision of services is a separate transaction because the provision of services should not be analyzed in a legal and factual vacuum.

Once a provider agrees to treat a patient, it cannot simply cease providing services to that patient. Both federal and state laws prohibit health care entities that have begun treating a patient from unilaterally terminating the treatment except as permitted by law. Thus, by accepting a patient, a provider undertakes to render to that patient all health care services needed by that patient that the provider is qualified to provide until the relationship between them is terminated by the patient's recovery or death or as otherwise permitted by law. It is that relationship that is the relevant "transaction" for determining recoupment rights. Other boundaries for the "transaction" are either overly broad (the idea that all services and payments under one provider agreement are part of one transaction even if the provider operates for decades under a single agreement) or overly narrow (the idea that each provision of services to each patient is a single, discrete transaction). The government should not be able to recoup amounts overpaid for services to one patient from amounts due for services to other patients. It should, however, be able to recover prepetition overpayments for services to a patient from amounts due for postpetition services to that same patient.