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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SANTA ROSA DIVISION

MENDOCINO COAST HEALTH CARE DISTRICT, a political subdivision of the State of California, Debtor.	No. 12-12753 Chapter 9 **UNITED STATES' SUPPLEMENTAL OBJECTION TO DEBTOR'S PLAN OF ADJUSTMENT** Date: March 20, 2015 Time: 10:00 a.m. Place: U.S. Bankruptcy Court 99 South E Street Santa Rosa, CA 95404

The United States of America, on behalf of its agency, the United States Department of Health and Human Services, hereby submits this supplemental objection to the Debtor's October 31, 2014 Plan of Adjustment ("Plan").

Introduction

The United States files this supplemental objection to the Debtor's Plan because in its Reply to the United States' objection to the Plan ("Reply"), the Debtor asserted, for the very first time and directly contrary to the terms of its own Plan, that its $11,899,268 Stark law liabilities

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were not defaults under its Medicare Provider Agreements (MPA) that needed to be cured before it could assume its MPA. Instead, the Debtor proposed to recharacterize its $11,899,268 Stark law liabilities as a Class 8 Unsecured Claim. Contrary to the Debtor's assertion, however, under relevant Medicare law, the Debtor's Stark law liabilities were in fact defaults under its MPA that must be cured before the MPA may be assumed. Moreover, if the Debtor's $11,899,268 Stark law liabilities are recharacterized as a Class 8 Unsecured Claim, the Court should order a re-solicitation of the Plan because the treatment of the holders of the Class 8 Unsecured Claims under the Plan will be adversely affected.

1. **The United States is filing this supplement because the Debtor's Reply asserted, for the first time and directly contrary to the terms of the Plan itself, that its Stark law liabilities were not defaults under its MPA that needed to be cured before its MPA could be assumed.**

The Debtor's Plan has consistently treated the Debtor's Stark law liabilities as a default under the Debtor's MPA that must be cured before the MPA could assumed under 11 U.S.C. § 365(b). Thus, subparagraph 6.4.1 of the Plan provided as follows:

> On the Effective Date, pursuant to Section 1123(b)(2) of the Bankruptcy Code, the Debtor will assume the Medicare Provider Agreement. The CMS Claim will be deemed Allowed as an Assumption Obligation in the reduced amount of $20,000 ("CMS Assumption Obligation"). The Reorganized Debtor will pay the CMS Assumption Obligation, in full and final satisfaction and settlement of any Claims for the cure of any defaults or compensation for any actual pecuniary loss arising under the Medicare Provider Agreement prior to the Effective Date, in four equal installments of $5,000 payable, without interest, on each of the Effective Date (from the Plan Fund) and the first, second and third anniversary of the Effective Date (from the general revenues of the Reorganized Debtor).

The Plan defined "CMS Claim" to mean "[c]ollectively, (a) claim number 112 filed on November 8, 2013, by the Centers for Medicare and Medicaid Services ("CMS") in the amount of $344,169 on account of certain alleged overpayments by CMS to the District under or related to the Medicare Provider Agreement, as it may be amended from time to time, (b) the voluntary

self-disclosure made on June 13, 2014, by the District to CMS pursuant to the physician self-referral law (i.e., Stark law), and (c) any other lump sum adjustments or overpayments computed by or on behalf of CMS under the Medicare Provider Agreement." Subparagraph 1.19 of the Plan.

Claim number 112 and the Debtor's June 13, 2014 self-disclosure represent the Debtor's self-reported Stark law liabilities of $344,169 and $11,555,099, respectively. Therefore, the CMS Claim included the Debtor's self-reported Stark law liabilities totaling $11,899,268.

As set forth above, subparagraph 6.4.1 of the Plan proposed to reduce the CMS Claim to $20,000, and to pay that reduced CMS Claim, referred to as the CMS Assumption Obligation[1], as the cure for all defaults under the MPA so the Debtor could assume its MPA.

Therefore, the Debtor's own Plan treated the $11,899,268 Stark law liabilities as defaults under the MPA that had to be cured, albeit in a proposed reduced amount of $20,000, before the Debtor could assume its MPA. Nowhere in the Debtor's Plan had the Debtor ever treated or considered its Stark law liabilities as a Class 8 Unsecured Claim. Indeed, had the Debtor done so, there would have been no reason for the Debtor's Plan to have proposed to pay the CMS Claim, including the $11,899,268 Stark law liabilities, in the reduced amount of $20,000 as the cure for all defaults under the MPA so that the Debtor could assume its MPA.

[1] The Plan defined "Assumption Obligations" to mean "[a]ny undisputed monetary amounts payable to the non-debtor party to any executory contract or unexpired leases, pursuant to Section 365(b)(1) of the Bankruptcy Code, as a condition to the assumption of such contract or lease." Subparagraph 1.5 of the Plan.

2. **Contrary to Debtor's Reply, the Debtor's Stark law liabilities were in fact defaults under the MPA that must be cured before the MPA could be assumed.**

The Debtor claims that there is no legal authority for the position that its Stark law liabilities were defaults under its MPA that needed to be cured before it could assume its MPA. The Debtor is wrong.

Providers are required to periodically submit and recertify the accuracy of their enrollment information by filing the applicable Medicare enrollment application. 42 C.F.R. 424.515. In addition to these periodic enrollment filings, providers also have to submit an updated enrollment application if there is a change in their information, such as a change of address. 42 C.F.R. 424.516. In its periodic Medicare Enrollment Applications, the Debtor agreed to abide by and comply with the Medicare laws, regulations and program instructions "including, but not limited to, the Federal anti-kickback statue and the Stark law." For example, *see* ¶ 3 under Section 15 on Pg. 48 of Debtor's latest Medicare Enrollment Application, a copy of which is attached hereto as Exhibit A and the form of which has been in use by CMS since July 2011. In addition, the Medicare Enrollment Application provided that "payment of a claim by Medicare [was] conditioned upon the claim and the underlying transaction complying with such laws, regulations and program instructions." *Id.* Thus, to the extent that the Debtor has failed to comply with the Stark law, it is in default under its MPA.

In this case, the Debtor's Stark law violations have resulted in $11,899,268 of potential overpayments. As a result, the Debtor's Stark law violations were defaults under its MPA because the Debtor's underlying transactions failed to comply with the Stark law. Therefore, under 11 U.S.C. § 365(b), the Debtor must cure its $11,899,268 Stark law liabilities before it may assume its MPA.

In its Reply, the Debtor asserted that its $11,899,268 Stark law liabilities were neither an overpayment nor subject to recoupment, and thus not a default under its MPA that must be cured. The United States disagrees. More importantly, whether the Debtor's Stark law liabilities were an overpayment or subject to recoupment is irrelevant since they were still defaults under the MPA because in violating the Stark law, the Debtor failed to comply with the applicable Medicare laws, regulations, and program instructions as it was required to do so under its MPA.

3. **If the Debtor's $11,899,268 Stark law liabilities are to be recharacterized as a Class 8 Unsecured Claim pursuant to the Debtor's proposed modification, the Court should order a re-solicitation of the Plan because the treatment of the Class 8 Unsecured Claims under the Plan will be adversely affected by the modification**.

If a proposed modification to an accepted plan before confirmation will adversely affect the treatment of the claim of any creditor under the plan, re-solicitation of the plan should be ordered and should include a modified disclosure statement and an opportunity for another vote on the Plan. 11 U.S.C. §§ 942 and 1127(d); B.R. 3019(a); In re The New Power Co., 438 F.3d 1113, 1117-18 (11th Cir. 2006) (If the modification materially and adversely changes the way that a claim or interest holder is treated under the plan, "the claim or interest holder is entitled to a new disclosure statement and another vote."); In re Frontier Airlines, Inc., 93 B.R. 1014, 1023 (Bankr. D. Colo. 1988) ("If the modification adversely affects the interest of a creditor who has previously accepted the plan, in more than a purely ministerial de minimis manner, that creditor should have the opportunity to reconsider and change his or her vote."); *cf.* In re Best Products Co., Inc., 177 B.R. 791, 803 (S.D.N.Y.), aff'd, 68 F.3d 26 (2d Cir.1995) ("The court cannot adopt any modification that materially alters the plan and adversely affects a claimant's treatment.").

In this case, the Debtor's Plan has been accepted by, among others, holders of the Class 8 Unsecured Claims. *See* "Declaration of Catherine Claire Janes Certifying Voting on Plan of

Adjustment" (ECF No. 174). Subsequent to this acceptance and in response to the United States' objection to the Plan, the Debtor did not file a modified plan. Instead, the Debtor filed its Reply proposing to modify its Plan by recharacterizing its $11,899,268 Stark law liabilities as a Class 8 Unsecured Claim rather than as a default under its MPA that must be cured before the MPA may be assumed. *Cf.* In re Brewster, 243 B.R. 51, 53 (9th Cir. BAP 1999) ("Debtors did not file a modified plan. Instead, 10 days before the hearing on confirmation of the plan, they filed a reply to [the creditor's] objection in which they proposed to modify their plan . . . .").

The Debtor's proposed modification, however, will adversely affect the treatment of the Class 8 Unsecured Claims under the Plan. As previously proposed, the Plan proposed to effectively pay each holder of a Class 8 Unsecured Claim 45.8% of its claim. If the Debtor's $11,899,268 Stark law liabilities are re-characterized and treated as a Class 8 Unsecured Claim, however, the Plan could end up paying each holder of a Class 8 Unsecured Claim only 4.5% of its claim.[2]

Thus, the Debtor should be required to file an appropriate modified disclosure statement and provide Class 8 Unsecured Claim creditors with an opportunity to change their previous acceptance of the Plan. In re Young Broadcasting, 430 B.R. 99, 120-21 (Bankr. S.D.N.Y. 2010) ("A material modification [to a plan after acceptance but prior to confirmation] requires

[2] The adverse treatment of the Class 8 Unsecured Claims was calculated as follows. The Plan provides that each holder of a Class 8 Unsecured Claim will be paid a *pro rata* share of the GUC Distribution. Subparagraph 4.8.2 of the Plan. The Plan defines "GUC Distribution" to be $600,000. Subparagraph 1.46 of the Plan. The Debtor's Disclosure Statement estimated the allowable Class 8 Unsecured Claims to be $1,310,000 (excluding the Debtor's $11,899,268 Stark law liabilities). *See* Page 6 of the Debtor's Disclosure Statement dated December 15, 2014 (ECF No. 162). Thus, each holder of a Class 8 Unsecured Claim (excluding the United States and its $11,899,268 claim) is expected to receive 45.8% of its claim. However, if the Debtor's $11,899,268 Stark law liabilities will be treated as a Class 8 Unsecured Claim, the Class 8 Unsecured Claim holders' pro rata share of the $600,000 GUC Distribution will be reduced from 45.8% down to 4.5%.

sufficient disclosure to comply with section 1125 of the Bankruptcy Code."). In addition, the United States should be given an opportunity to vote to accept or reject the Plan.

Respectfully submitted,

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Dated: March 9, 2015

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