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## **GOVERNMENT RECOVERY OF MEDICARE OVERPAYMENTS AND THE AUTOMATIC STAY**

### **ABSTRACT**

*The automatic stay in bankruptcy is in place to protect the debtor's fresh start and discourage creditors from pursuing their own collection efforts outside of the equitable distribution bankruptcy contemplates. In healthcare bankruptcies, the automatic stay is not always applied consistently, especially for the largest creditor in these cases, the government.*

*The government, through its agencies, decides whether it will require the bankrupt healthcare provider to repay any Medicare overpayments the agency has previously made. During bankruptcy and the automatic stay, government agencies continue to demand and collect repayments from healthcare entities, allowing the government to jump other creditors based on the equitable doctrine of recoupment.*

*Recoupment is a non-statutory doctrine recognized by bankruptcy courts as a means for creditors to offset their debts against payments, but recoupment is similar to setoff, an action that is stayed under the Bankruptcy Code. This Comment argues that government agencies should not be allowed to continue repayment actions against healthcare entities that will jeopardize their reorganization process during bankruptcy. This Comment suggests that courts can fix this issue by narrowly applying the doctrine of recoupment and reducing the circumstances in which government agencies can collect from bankrupt healthcare entities without seeking relief from the automatic stay.*

## INTRODUCTION

In 2010, the Patient Protection and Affordable Care Act (“ACA”) was passed with the goal of decreasing healthcare costs and increasing the quality of patient care.<sup>1</sup> The ACA is the most comprehensive healthcare law passed in recent times, making health law one of the fastest-growing fields in the legal profession. Many people understand the new healthcare reforms affecting individuals, such as the individual mandate and preexisting condition limitations. However, most people are unaware of the greater impact that the ACA and other federal healthcare regulations have on healthcare providers and their ability to deliver services and conduct business.

Since the passage of the ACA, healthcare entities have been subject to numerous new regulations promulgated by the Department of Health and Human Services (“HHS”).<sup>2</sup> Some of these regulations closely monitor the quality of care the public receives by requiring healthcare providers to report quality and readmission rates to determine “winners and losers” in the healthcare system.<sup>3</sup> When healthcare providers report these factors, patients can make more informed decisions about their providers, and the government can determine which entities are efficiently spending government funds.<sup>4</sup>

In this “winner-loser” system, more healthcare entities will be pushed into bankruptcy by consumers or the government.<sup>5</sup> When healthcare entities file for bankruptcy, they will likely find that the goals of bankruptcy and healthcare regulations frequently clash.<sup>6</sup> Although healthcare regulations seek to provide efficient health services to citizens, a goal of bankruptcy is to reorganize businesses to allow for creditor recovery on debts.<sup>7</sup> A common issue that could have a drastic effect on healthcare entities is receiving necessary Medicare payments from the government during bankruptcy. The Medicare system operates by estimating the amount of reimbursement the healthcare provider

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<sup>1</sup> See generally Patient Protection and Affordable Care Act, 42 U.S.C. § 300gg (2012).

<sup>2</sup> See ABI HEALTH CARE INSOLVENCY MANUAL 11 (Leslie Ann Berkoff, Bobby Guy, Timothy Lupinacci & Clifford Zucker eds., 3d ed. 2012).

<sup>3</sup> See Symposium, *Corporate Bankruptcy Panel—The Healthcare Industry Post-Affordable Care Act: A Bankruptcy Perspective*, 31 EMORY BANKR. DEV. J. 249, 252 (2015); Center for Medicare and Medicaid Services, *Linking Quality to Payment*, MEDICARE.GOV, <https://www.medicare.gov/hospitalcompare/linking-quality-to-payment.html> (last visited Mar. 4, 2017).

<sup>4</sup> See *Linking Quality to Payment*, *supra* note 3.

<sup>5</sup> See Symposium, *supra* note 3, at 252.

<sup>6</sup> See Deryck A. Palmer & Michele J. Meises, *Collision Course between Bankruptcy and Health Care Laws: Which Will Ultimately Control?*, 1999 ANN. SURV. OF BANKR. LAW 1.

<sup>7</sup> See *id.*

should receive from servicing Medicare recipients.<sup>8</sup> This estimation process often leads to overpayments that the government must recover from the provider.<sup>9</sup> When a healthcare entity files for bankruptcy, HHS's Centers for Medicare and Medicaid Services ("CMS") frequently argues that it may continue to seek repayments from healthcare entities for the excess funds it provided prior to the bankruptcy.<sup>10</sup> Healthcare providers question whether these recovery actions are violations of the automatic stay under § 362 of the Bankruptcy Code (the Code).<sup>11</sup>

Alternatively, CMS utilizes the non-statutory doctrine of recoupment as a permissible way to recover debts from future payments. Because courts allow recoupment of debts made during the same transaction as an equitable remedy, CMS regularly argues that recovery of Medicare overpayments during bankruptcy does not violate the automatic stay.<sup>12</sup> However, Medicare payments are vital to the survival of the majority of healthcare providers.<sup>13</sup> Taking prepetition payments back from these providers after they filed for bankruptcy strips them of assets needed for reorganization, and even forces some hospitals to close their doors.<sup>14</sup> Unfortunately, courts have yet to resolve whether the automatic stay applies to these recovery actions by the government.<sup>15</sup>

The split in judicial opinions hinges on whether Medicare payments and Medicare overpayment recovery actions are considered to be within the "same transaction."<sup>16</sup> If overpayment recovery actions are considered separate transactions from Medicare payments, CMS's recovery actions fall under the definition of setoff and are subject to the automatic stay.<sup>17</sup> On the other hand, if Medicare payments and overpayment recovery efforts are considered to be

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<sup>8</sup> ABI, *supra* note 2, at 14–15; *see* 42 U.S.C. § 1395g (2012).

<sup>9</sup> *See* ABI, *supra* note 2, at 15.

<sup>10</sup> *See* Palmer, *supra* note 6.

<sup>11</sup> 11 U.S.C. § 362 (2012); *see* Palmer, *supra* note 6.

<sup>12</sup> *See* Palmer, *supra* note 6.

<sup>13</sup> *See* U.S. Dept. of Health & Human Servs., *Medicare Pays Almost Half of Rural Hospital Stays: AHRQ News and Numbers*, AGENCY FOR HEALTHCARE RESEARCH AND QUALITY (Jan. 28, 2010), <https://archive.ahrq.gov/news/newsroom/news-and-numbers/012810.html>.

<sup>14</sup> *See, e.g.,* Univ. Med. Ctr. v. Sullivan (*In re* Univ. Med. Ctr.), 973 F.2d 1065, 1071 (3d Cir. 1992); *In re* Bayou Shores SNF, LLC, 525 B.R. 160, 164 (Bankr. M.D. Fla. 2014); *In re* Tidewater Mem'l Hosp., Inc., 106 B.R. 876, 879 (Bankr. E.D. Va. 1989).

<sup>15</sup> *See* Ted A. Berkowitz & Veronique A. Urban, *Medicare Issues in Bankruptcies*, 31 AM. BANKR. INST. J. 28 (2012).

<sup>16</sup> *See, e.g.,* *In re* TLC Hosps., Inc., 224 F.3d 1008, 1011 (9th Cir. 2000).

<sup>17</sup> 11 U.S.C. § 553 (2012); *see In re* LaPierre, 180 B.R. 95, 100 (Bankr. D.S.C. 1994) (stating that recovery efforts for obligations arising out of separate transactions are considered setoff and subject to the provisions of the automatic stay).

within the same transaction, the equitable doctrine of recoupment allows overpayment recovery without implicating the automatic stay.<sup>18</sup> Five federal circuits and several bankruptcy courts have addressed this specific issue by analyzing the “same transaction” distinction.<sup>19</sup>

When courts determine that the government’s post-petition recovery efforts should be exempt from the automatic stay solely based on their understanding of “same transaction,” courts are ignoring the unique nature of the healthcare industry and its regulatory system. In contrast, the minority view implements a test that considers other factors relevant to the rules of construction and public policy when determining the appropriate definition of “same transaction”: the “single integrated transaction test.” In turn, this Comment proposes that courts adopt the minority approach by utilizing the single integrated transaction test and considering the public policy issues that specifically affect healthcare providers.

First, this Comment will discuss the conflicting provisions of Medicare law and bankruptcy law that courts must resolve. Next, this Comment will compare the tests that circuits have used to resolve the issue of Medicare overpayment recovery within bankruptcy. Finally, this Comment will advocate for the minority approach to this issue by highlighting the appropriateness of limiting the equitable doctrine of recoupment, looking to CMS’s accounting practices to evaluate separate transactions, and considering the public policy implications for healthcare providers in bankruptcy.

## BACKGROUND

In general, conflicts occur when the government attempts to regulate the healthcare system in the United States.<sup>20</sup> Healthcare laws and regulations seek to protect the public health by providing efficient services, but also regulate the costs and availability of services for all Americans.<sup>21</sup> The conflicting policies in health law are of particular concern when a healthcare organization files for bankruptcy.<sup>22</sup> While one goal of bankruptcy is to allow equitable recovery for

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<sup>18</sup> See *In re LaPierre*, 180 B.R. at 100.

<sup>19</sup> See, e.g., *In re Univ. Med. Ctr.*, 973 F.2d at 1072; *United States v. Consumer Health Servs. of Am., Inc.*, 108 F.3d 390 (D.C. Cir. 1997); *In re TLC Hosps., Inc.*, 224 F.3d at 1011; *In re Holyoke Nursing Home, Inc.*, 372 F.3d 1, 4 (1st Cir. 2004); *In re Slater Health Ctr., Inc.*, 398 F.3d 98, 104 (1st Cir. 2005); see also Berkowitz, *supra* note 15.

<sup>20</sup> See ABL, *supra* note 2, at 3.

<sup>21</sup> See *id.*

<sup>22</sup> See *id.*

creditors, another goal is to provide the debtor with a fresh start.<sup>23</sup> Chapter 11 of the Code provides entities with the opportunity to cure their financial issues while staying in business by reorganizing the business and debts.<sup>24</sup> The conflict between health law and bankruptcy is heightened when the government operates as both a regulator of the public health system and a creditor within the bankruptcy system.

### A. Medicare

As one of the largest national healthcare programs, Medicare laws and regulations will frequently affect healthcare entities inside and outside of bankruptcy.<sup>25</sup> Title XVIII of the Social Security Act established the Medicare program to provide health insurance coverage for the elderly.<sup>26</sup> Medicare provides this benefit by paying the cost of certain health services for eligible citizens.<sup>27</sup> Under the Medicare system, healthcare entities enter into “provider agreements” with Medicare’s administrating agency, CMS, to be reimbursed for the cost of services rendered to Medicare-covered patients.<sup>28</sup> The provider agreements require healthcare entities to agree to certain terms and abide by regulations as a condition of participating in the Medicare program.<sup>29</sup> CMS employs a prospective payment system (“PPS”) as a method to reimburse entities prior to incurring the costs for their services.<sup>30</sup> Under the PPS, CMS estimates the costs the healthcare provider will incur based on predetermined amounts for various types of entities.<sup>31</sup>

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<sup>23</sup> See W. HOMER DRAKE & CHRISTOPHER S. STRICKLAND, CHAPTER 11 REORGANIZATIONS § 1.1 (2d ed. 2017).

<sup>24</sup> See *id.*

<sup>25</sup> Harvey L. McCormick, 1 MEDICARE AND MEDICAID CLAIMS AND PROC. § 1:1 (4th ed.).

<sup>26</sup> 42 U.S.C. § 1395 (2012); 6 WILLIAM L. NORTON, JR. & WILLIAM L. NORTON III, NORTON BANKR. L. & PRAC. § 119:5 (3d ed. 2008).

<sup>27</sup> Medicare covers people ages 65 and over, people under age 65 with certain disabilities, and people of all ages with End-Stage Renal Disease. Center for Medicare and Medicaid Services, *Medicare Program - General Information*, CMS.GOV, <https://www.cms.gov/Medicare/Medicare-General-Information/Medicare-GenInfo/index.html> (last modified July 25, 2014). Also, certain individuals may be subject to other eligibility requirements depending on whether they are covered under Part A, B, C, or D. Health services covered depend on whether the individual is under Part A, B, C, or D. See ABI, *supra* note 2, at 3.

<sup>28</sup> Centers for Medicare and Medicaid Services, *Medicare General Information, Eligibility, and Entitlement* § 10.1 CMS.GOV (Sept. 16, 2016), <https://www.cms.gov/Regulations-and-Guidance/Guidance/Manuals/downloads/ge101c05.pdf>; see 42 U.S.C. § 1395g (2012).

<sup>29</sup> *Eligibility and Entitlement*, *supra* note 28.

<sup>30</sup> Centers for Medicare and Medicaid Services, *Prospective Payment Systems – General Information*, CMS.GOV, <https://www.cms.gov/medicare/medicare-fee-for-service-payment/prospmedicarefeesvcpmtgen/index.html> (last modified May 19, 2015).

<sup>31</sup> 42 C.F.R. § 413.64 (2017); *Prospective Payment Systems*, *supra* note 30.

Since these payments are based on estimates, CMS must reconcile the payments with the actual amount due to the provider from actual services rendered and costs accumulated at the end of the accounting period.<sup>32</sup> If CMS determines there has been an overpayment, a fiscal intermediary, acting on behalf of CMS, sends out an initial demand letter to the provider notifying them of the overpayment and requesting repayment or offering the option to enter into a repayment arrangement with reduced or suspended future payments.<sup>33</sup> If the provider does not respond to the demand letter within 15 days, the fiscal intermediary may begin subtracting the amount owed from current or future payments to providers.<sup>34</sup>

In the alternative, the provider may appeal the overpayment demand or request that recovery be waived.<sup>35</sup> This response may temporarily pause the recovery process pending the determination of the appeal or waiver.<sup>36</sup> The appeals process consists of five levels of review, beginning with redetermination by the fiscal intermediary up to judicial review by a federal district court.<sup>37</sup> This lengthy process can lead to years of appeals, and burdens the provider to produce evidence at each stage.<sup>38</sup> If the provider is unable to prove its claim at any point during the appeals process, CMS may resume recovering overpayments.<sup>39</sup> According to the United States Court of Appeals for the Eleventh Circuit in *In re Bayou Shores SNF, LLC*,<sup>40</sup> the healthcare entity must follow CMS's administrative review process before courts are allowed to review the appropriateness of CMS's recovery efforts, even for entities in bankruptcy.<sup>41</sup> CMS only allows limited exceptions for entities who file for bankruptcy.<sup>42</sup>

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<sup>32</sup> 42 C.F.R. § 413.60 (2017); ABI, *supra* note 2, at 15.

<sup>33</sup> Centers for Medicare and Medicaid Services, *Medicare Financial Management Manual*, Ch. 3, § 20.1, CMS.GOV (Nov. 18, 2016), <https://www.cms.gov/Regulations-and-Guidance/Guidance/Manuals/downloads/fin106c03.pdf>.

<sup>34</sup> Centers for Medicare and Medicaid Services, *Medicare Overpayment Fact Sheet*, CMS.GOV (Oct. 2016), <https://www.cms.gov/Outreach-and-Education/Medicare-Learning-Network-MLN/MLNProducts/downloads/OverpaymentBrochure508-09.pdf>.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> Centers for Medicare and Medicaid Services, *Medicare Parts A & B Appeals Process Fact Sheet*, CMS.GOV (May 2016), <https://www.cms.gov/Outreach-and-Education/Medicare-Learning-Network-MLN/MLNProducts/Downloads/MedicareAppealsProcess.pdf>.

<sup>39</sup> *Id.*

<sup>40</sup> *In re Bayou Shores SNF, LLC*, 828 F.3d 1297 (11th Cir. 2016).

<sup>41</sup> *Id.* at 1314.

<sup>42</sup> *See Medicare Financial Management Manual*, *supra* note 33, at Ch. 3, § 140.

When a healthcare entity files for bankruptcy, CMS continues to assert its power to recover overpayments for reimbursements made prior to bankruptcy.<sup>43</sup> Healthcare entities have argued that certain provisions of the Code prohibit CMS's recovery actions after the entity has filed for bankruptcy.<sup>44</sup> Such healthcare entities are willing to fight the government over their Medicare payments because receiving those payments could be the difference between surviving the bankruptcy process or being forced to close its doors.

### B. *Bankruptcy Code*

Though healthcare is a unique industry consisting of both for-profit and non-profit organizations, the majority of these entities file for bankruptcy under chapter 11.<sup>45</sup> Chapter 11 allows the debtor to continue operating the business while developing a plan to reorganize and rehabilitate it.<sup>46</sup> As a general principle, bankruptcy seeks to provide collective creditor relief through staying individual creditor actions.<sup>47</sup> Section 362 of the Code provides that filing a petition for bankruptcy triggers the automatic stay.<sup>48</sup> The automatic stay “gives [the] bankrupt a breathing spell from creditors by stopping all collection efforts, all harassment, and all foreclosure actions.”<sup>49</sup> It also serves the purpose of “permit[ting] [the] bankrupt to attempt a repayment or reorganization plan or simply to be relieved of the financial pressures that drove [it] into bankruptcy.”<sup>50</sup>

Section 362(a) stays all collection efforts, including “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>51</sup> Setoff is further discussed under § 553 of the Code.<sup>52</sup> Setoff is defined as “any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the bankruptcy case against a claim of such creditor against the debtor that arose before the commencement of the bankruptcy case.”<sup>53</sup> Under § 553,

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<sup>43</sup> See, e.g., *In re Univ. Med. Ctr.*, 973 F.2d at 1070; *In re Holyoke Nursing Home, Inc.*, 372 F.3d at 3.

<sup>44</sup> 6 NORTON, *supra* note 26.

<sup>45</sup> Nancy A. Peterman, *Introduction*, 8 AM. BANKR. INST. L. REV. 1, 2 (2000).

<sup>46</sup> 5 WILLIAM L. NORTON, JR. & WILLIAM L. NORTON III, NORTON BANKR. L. & PRAC. § 91:1 (3d ed. 2017).

<sup>47</sup> *Id.*

<sup>48</sup> 11 U.S.C. § 362(a) 2012.

<sup>49</sup> *Mar. Elec. Co. v. United Jersey Bank*, 959 F.2d 1194, 1204 (3d Cir. 1991).

<sup>50</sup> *Id.*

<sup>51</sup> 11 U.S.C. § 362(a)(7) (2012).

<sup>52</sup> *Id.* § 553.

<sup>53</sup> 5 WILLIAM L. NORTON, JR. & WILLIAM L. NORTON III, NORTON BANKR. L. & PRAC. DICT. OF BANKR. TERMS § S90 (3d ed. 2017).



creditors are allowed to offset debts, subject to the limitations given in §§ 553, 362, and 363.<sup>54</sup> Because the automatic stay limits creditors' setoff rights, creditors must seek relief from the automatic stay through the bankruptcy courts before asserting these rights.<sup>55</sup>

Though setoff efforts are not exempt from the automatic stay, subsection (b) of 11 U.S.C. § 362 discusses certain exceptions to the automatic stay.<sup>56</sup> Specifically, § 362(b)(4) provides an exception for actions by a government unit or organization enforcing its police or regulatory power.<sup>57</sup> This exception applies to government agencies like CMS, but courts have concluded that it does not apply when the government agency is seeking to enforce contractual rights, such as those based on obligations under the Medicare provider agreements.<sup>58</sup> According to legislative history, this exception should only apply "where a governmental unit is suing a debtor to prevent or stop violation of fraud, environmental protection, consumer protection, safety, or similar police or regulatory laws, or attempting to fix damages for violation of such law."<sup>59</sup> In *University Medical Center v. Sullivan*,<sup>60</sup> where HHS withheld post-petition Medicare payments from a bankrupt hospital because of past overpayments, the Third Circuit concluded that withholding Medicare payments was not within HHS's regulatory power, and these actions were not exempt from the automatic stay under 11 U.S.C. § 362(b)(4).<sup>61</sup>

Additionally, in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Congress amended § 362(b) to include an additional exception for the Secretary of HHS for actions excluding debtors from Medicare and other federal healthcare programs.<sup>62</sup> This provision was specifically enacted to combat Medicare fraud by providers.<sup>63</sup> Based on the language and underlying legislative history of this exception, it can be understood to only apply to decisions on whether to terminate provider agreements for fraudulent reasons or penalties, but courts have not applied this exception for actions to recover

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<sup>54</sup> 11 U.S.C. § 553(a) (2012).

<sup>55</sup> *United States ex. rel. I.R.S. v. Norton*, 717 F.2d 767, 771 (3d Cir. 1983).

<sup>56</sup> *See* 11 U.S.C. § 362(b) (2012).

<sup>57</sup> *Id.* § 362(b)(4).

<sup>58</sup> *See In re Corporacion de Servicios Medicos Hospitalarios de Fajardo*, 805 F.2d 440, 445 (1st Cir. 1986); *In re Univ. Med. Ctr.*, 973 F.2d at 1075 (3d Cir. 1992).

<sup>59</sup> *In re Corporacion de Servicios Medicos Hospitalarios de Fajardo*, 805 F.2d at 445 (citing H.R. Rep. No. 595, 95th Cong., 1st Sess. 343 (1977)).

<sup>60</sup> *In re Univ. Med. Ctr.*, 973 F.2d 1065.

<sup>61</sup> *In re Univ. Med. Ctr.*, 973 F.2d at 1075.

<sup>62</sup> 11 U.S.C. § 362(b)(28) (2012).

<sup>63</sup> 143 Cong. Rec. E1739-02 (daily ed. Sept. 11, 1997) (statement of Rep. Stark).

overpayments. Even with these changes to § 362 of the Code, none of them have been sufficient to clear up the specific issue healthcare entities face when CMS seeks to elude the automatic stay to recover overpayments.

### C. *Equitable Doctrine of Recoupment*

As an alternative means of offsetting debt, courts have established the equitable doctrine of recoupment.<sup>64</sup> Recoupment is defined as “[a] counterclaim arising out of the same transaction or occurrence as the one on which the original action is based.”<sup>65</sup> While recoupment is not a doctrine solely limited to bankruptcy cases,<sup>66</sup> it allows creditors within the bankruptcy context to assert certain mutual claims that would not be allowed through setoff because of its statutory limitations.<sup>67</sup> Courts allow recoupment when the setoff limitations would lead to inequitable results.<sup>68</sup> A court may also allow a claim for recoupment if the creditor’s claim arises from the same transaction as a debtor’s claim because the creditor’s claim can then be seen as a counterclaim or defense rather than its own, separate debt obligation.<sup>69</sup> This is evidenced by the allowances in the *Federal Rules of Civil Procedure*.

When the *Federal Rules of Civil Procedure* liberalized the process of asserting counterclaims,<sup>70</sup> those changes contributed to some confusion around recoupment. Recoupment seems to fall under the definition of a compulsory counterclaim that the party must plead or waive because the claim would be of the same subject matter as the other party’s claim.<sup>71</sup> In contrast, setoff, which arises from a different transaction, would fall under the definition of a permissive counterclaim and is not required to be plead in the party’s answer.<sup>72</sup> A setoff is limited by the automatic stay, but recoupment is not subject to this

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<sup>64</sup> See *United States ex. rel. U.S. Postal Service v. Dewey Freight System, Inc.*, 31 F.3d 620, 622–23 (8th Cir. 1994).

<sup>65</sup> *Recoupment*, BLACK’S LAW DICTIONARY (10th ed. 2014).

<sup>66</sup> *Dewey Freight System, Inc.*, 31 F.3d at 622.

<sup>67</sup> ROBERT E. GINSBERG, ROBERT D. MARTIN & SUSAN KELLEY, GINSBERG & MARTIN ON BANKR. § 8.07 (5th ed. 2016).

<sup>68</sup> See *id.*

<sup>69</sup> See *Lee v. Schweiker*, 739 F.2d 870, 875 (3d Cir. 1984).

<sup>70</sup> Craig H. Averch & Blake L. Berryman, *Getting Out of the Code: When Equitable Remedies Obtain Priority over General Unsecured Claims*, 5 J. BANKR. L. & PRAC. 285, 290 (1996).

<sup>71</sup> See FED. R. CIV. P. 13(a).

<sup>72</sup> See *In re Monongahela Rye Liquors, Inc.*, 141 F.2d 864, 869 (3d Cir. 1944).

limitation.<sup>73</sup> Based on the courts' discretion, recoupment has been allowed and rejected in various cases.<sup>74</sup>

The primary limitation on recoupment is the requirement that the claims arise from the same transaction.<sup>75</sup> If the claims arise out of the same transaction, the creditor's claims are considered recoupments, and the creditor's post-petition actions are not stayed under 11 U.S.C. § 362.<sup>76</sup> If the claims arise from separate transactions, actions to recover debt are considered setoff and are stayed under 11 U.S.C. § 362(a)(7) unless relief is granted by a bankruptcy court.<sup>77</sup> Since there is no clear indicator of which claims are within the same transaction, debtors and creditors have brought this issue to the courts.

#### *D. Judicial Approaches to the "Same Transactions" Test*

Various circuits have decided that the most important issue in determining whether post-petition recovery efforts for certain claims will be considered setoff or recoupment is whether the claims are part of the same transaction, but these courts have not settled on one test for determining what qualifies as a single transaction.<sup>78</sup> Only five circuits have spoken to this issue, and decisions by bankruptcy and district courts have varied.<sup>79</sup> To determine whether the claims are part of the same transaction, courts have come up with two tests: the single integrated transaction test and the logical relationship test.<sup>80</sup>

##### *1. Single Integrated Transaction Test*

The single integrated transaction test provides a narrow approach for determining what constitutes a single transaction.<sup>81</sup> This approach states that "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

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<sup>73</sup> *In re LaPierre*, 180 B.R. at 100.

<sup>74</sup> *See, e.g., In re Ross*, 104 B.R. 171, 173–74 (E.D. Mo. 1989) (allowing government agency to recoup prepetition overpayments of unemployment benefits from debtor); *Lee*, 739 F.2d at 876 (concluding that government could not recoup prepetition overpayments of Social Security benefits because debt was subject to limits on setoff).

<sup>75</sup> GINSBERG, *supra* note 67.

<sup>76</sup> Palmer, *supra* note 6, at 8.

<sup>77</sup> *See Berkowitz, supra* note 15.

<sup>78</sup> *See, e.g., In re Slater Health Ctr., Inc.*, 398 F.3d at 105; *In re Holyoke Nursing Home, Inc.*, 372 F.3d at 4; *In re TLC Hosps., Inc.*, 224 F.3d at 1011; *United States v. Consumer Health Servs. of Am., Inc.*, 108 F.3d 390; *In re Univ. Med. Ctr.*, 973 F.2d at 1079; *see also 6 WILLIAM, supra* note 26.

<sup>79</sup> 6 WILLIAM, *supra* note 26, at § 119:8.

<sup>80</sup> *See Berkowitz, supra* note 15.

<sup>81</sup> *See In re Univ. Med. Ctr.*, 973 F.2d at 1081.

meeting its obligations.”<sup>82</sup> The Third Circuit discussed this approach in *University Medical Center v. Sullivan*, where HHS withheld Medicare reimbursements from a hospital after discovering previous overpayments.<sup>83</sup> There, University Medical Center (“UMC”) filed for chapter 11 bankruptcy and was sent a demand letter from a fiscal intermediary informing the hospital of Medicare overpayments from three years prior.<sup>84</sup> As a result, HHS began withholding payments from UMC.<sup>85</sup> Although UMC attempted to enter into a repayment plan, their efforts ultimately failed, and HHS resumed withholding the entire amount of UMC’s Medicare reimbursements, forcing the hospital to close.<sup>86</sup>

Prior to the Third Circuit’s holding, the bankruptcy court found for UMC based on § 525(a) of the Code,<sup>87</sup> stating that the government was unlawfully discriminating against the debtor by conditioning future payments on repayment of the past overpayments.<sup>88</sup> In its decision, the bankruptcy court did not state any distinctions between recoupment and setoff, but it concluded that the government’s actions were a violation of the automatic stay.<sup>89</sup> HHS appealed, and the district court affirmed but based on a different rationale. The district court rejected the bankruptcy court’s finding of discrimination,<sup>90</sup> and instead focused on the recoupment argument made by HHS. After assessing whether the prepetition overpayment and post-petition payment arose from the same transaction, the district court ruled that the two were separate transactions.<sup>91</sup> The district court’s decision pointed out that the provider agreement did not enable HHS to enter into one transaction for recoupment purposes. The court also made sure to examine the reconciliation process and other equitable concerns.<sup>92</sup> Following that decision, both parties asked the district court to reconsider the case, and the district court reaffirmed its decision for UMC.<sup>93</sup> Though the district court only reconfirmed its previous decision, it issued another opinion clarifying its rationale. The district court explained the policy considerations behind

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<sup>82</sup> *Id.*

<sup>83</sup> *Id.* at 1070.

<sup>84</sup> *Id.*

<sup>85</sup> *Id.*

<sup>86</sup> *Id.*

<sup>87</sup> 11 U.S.C. § 525(a) (2012).

<sup>88</sup> *Univ. Med. Ctr. v. Sullivan (In re Univ. Med. Ctr.)*, 93 B.R. 412, 416 (Bankr. E.D. Pa. 1988).

<sup>89</sup> *Id.*

<sup>90</sup> *Univ. Med. Ctr. v. Sullivan (In re Univ. Med. Ctr.)*, 122 B.R. 919, 924 (E.D. Pa. 1990).

<sup>91</sup> *Id.* at 929.

<sup>92</sup> *Id.* at 930 (distinguishing *In re B & L Oil Co.*, 782 F.2d 155 (10th Cir. 1986), where the equitable concern was that the creditor mistakenly made a payment that was not required by a contract).

<sup>93</sup> *Univ. Med. Ctr. v. Sullivan (In re Univ. Med. Ctr.)*, 125 B.R. 121, 123 (E.D. Pa. 1991).

disallowing HHS to recoup those overpayments and force hospitals into bankruptcy or closure.<sup>94</sup> The court also discussed the provider agreements being an executory agreement subject to assumption.<sup>95</sup>

Even after three decisions, both parties appealed to the Third Circuit. The Third Circuit, applying its strict single integrated transaction test, concluded that HHS's post-petition recovery actions were setoff efforts and therefore a violation of the automatic stay.<sup>96</sup> The Third Circuit explained that the ongoing relationship between HHS and its Medicare providers did not sufficiently support a finding that the payments and overpayment recovery efforts were one transaction.<sup>97</sup> After reviewing Medicare's statutes and regulations, the Third Circuit found Medicare's reconciliation process, which provided for an annual audit to reconcile the debts, supportive to show that overpayments from a payment three years prior were not within the same transaction, and recoupment was not appropriate.<sup>98</sup>

By using the single integrated transaction test, the Third Circuit stood behind its previously stated belief that the equitable doctrine of recoupment should narrowly construe what constitutes a single transaction.<sup>99</sup> In a previous Third Circuit case on recoupment, *Lee v. Schweiker*,<sup>100</sup> the court articulated the idea that "[t]he fact that the same two parties are involved, and that a similar subject matter gave rise to both claims, however, does not mean that the two arose from the 'same transaction.'"<sup>101</sup> After returning to this same statement in *University Medical Center*, the Third Circuit further explained its rationale for prescribing the single integrated transaction test by stating that exceptions to the automatic stay based on recoupment should be narrowly construed because the doctrine is not stated in the statute.<sup>102</sup> The Third Circuit declined to agree that a "mere logical relationship" is enough to establish that the claims arose from the same transaction.<sup>103</sup>

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<sup>94</sup> See *id.* at 124 ("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 . . . . To allow HHS to recoup this debt by completely withholding interim payments as they accrue, would place the hospital in a stranglehold.")

<sup>95</sup> *Id.*

<sup>96</sup> *In re Univ. Med. Ctr.*, 973 F.2d at 1080.

<sup>97</sup> *Id.* at 1081.

<sup>98</sup> *Id.*

<sup>99</sup> See *Lee*, 739 F.2d at 875 (3d Cir. 1984).

<sup>100</sup> *Lee*, 739 F.2d 870.

<sup>101</sup> *Id.* at 875.

<sup>102</sup> *In re Univ. Med. Ctr.*, 973 F.2d at 1081 (citing *In re B & L Oil Co.*, 782 F.2d at 158).

<sup>103</sup> *Id.*

## 2. *Logical Relationship Test*

A second approach used by courts to determine whether debts fall within the same transaction is the logical relationship test. The logical relationship test implements the broader approach rejected by the Third Circuit. The test states “a ‘transaction’ may include ‘a series of many occurrences, depending not so much upon the immediateness of their connection as upon their logical relationship.’”<sup>104</sup> The United States Courts of Appeals for the First, Seventh, Ninth, and D.C. Circuits have employed this test to generally conclude that post-petition Medicare payments and prepetition overpayments are within the same transaction, allowing the government to recoup these payments without running afoul of the automatic stay.<sup>105</sup>

The United States Court of Appeals for the D.C. Circuit was the first court following *University Medical Center* to prescribe this alternative to the Third Circuit’s test. In *United States v. Consumer Health Service of America*,<sup>106</sup> the D.C. Circuit ruled in favor of allowing the government to recover prepetition Medicare overpayments from a home healthcare provider within bankruptcy.<sup>107</sup> Prior to reaching the D.C. Circuit, the bankruptcy court ruled against HHS, citing to the Third Circuit’s decision in *University Medical Center*.<sup>108</sup>

In the D.C. Circuit’s opinion, it never defined the “logical relationship test” nor explicitly rejected the Third Circuit’s test.<sup>109</sup> The D.C. Circuit explained its belief that the overpayments and post-petition Medicare payments were part of the same transaction based on its understanding of the Medicare statute, which the D.C. Circuit felt the Third Circuit neglected to consider carefully.<sup>110</sup> The D.C. Circuit disagreed with the use of the healthcare entity’s annual audit as an indicator because, in its view, timing is irrelevant to the determination.<sup>111</sup>

The court reasoned that even under the Third Circuit’s strict test, the Medicare payments should be considered part of the same transaction because the statute describes the Medicare reimbursements as one payment subject to

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<sup>104</sup> *In re TLC Hosps., Inc.*, 224 F.3d at 1013 (quoting *Moore v. N.Y. Cotton Exch.*, 270 U.S. 593, 610 (1926)).

<sup>105</sup> *See In re Slater Health Ctr., Inc.*, 398 F.3d at 104; *In re TLC Hosps., Inc.*, 224 F.3d at 1013; *Consumer Health Servs. of Am., Inc.*, 108 F.3d at 395.

<sup>106</sup> *Consumer Health Servs. of Am., Inc.*, 108 F.3d 390.

<sup>107</sup> *Id.* at 396.

<sup>108</sup> *United States v. Consumer Health Servs. of Am., Inc.*, 171 B.R. 917, 922 (Bankr. D.D.C. 1994).

<sup>109</sup> *See Consumer Health Servs. of Am., Inc.*, 108 F.3d 390 (D.C. Cir. 1997).

<sup>110</sup> *See Consumer Health Servs. of Am., Inc.*, 108 F.3d at 394; *see also* 42 U.S.C. § 1395g (2012).

<sup>111</sup> *Consumer Health Servs. of Am., Inc.*, 108 F.3d at 395.

“necessary” deductions.<sup>112</sup> Since the statute stated that the debtor could be paid for its post-petition services minus “necessary” adjustments, the D.C. Circuit sought to determine what Congress intended those adjustments to include.<sup>113</sup> The D.C. Circuit recognized that “necessary” deductions could have meant those sufficient to repay HHS for some overpayments without forcing the debtor into financial difficulties.<sup>114</sup> However, without finding any guidance from Congress, the D.C. Circuit remanded to the bankruptcy court to determine the amount that should be paid to Consumer Health.<sup>115</sup> The D.C. Circuit’s statements on what are considered “necessary” deductions brought even more ambiguity to the confusing issue of recoupment of overpayments by rejecting HHS’s interpretation of the term only to leave the lower courts to come up with their own interpretation.

Following *Consumer Health Services*, the United States Court of Appeals for the Ninth Circuit joined the D.C. Circuit in embracing the broader approach to defining whether Medicare payments were within a single transaction. In *In re TLC Hospitals, Inc.*, the Ninth Circuit articulated its standard for what is now known as the logical relationship test.<sup>116</sup> In *In re TLC Hospitals, Inc.*, HHS attempted to deduct prepetition overpayments from post-petition underpayments.<sup>117</sup> At the bankruptcy court, the court allowed HHS to offset its prepetition overpayments from the underpayments it owed the hospital but not from the post-petition payments.<sup>118</sup> The district court reversed, allowing HHS to recover its prepetition overpayments from post-petition reimbursement payments under recoupment.<sup>119</sup> The Ninth Circuit affirmed, recognizing that recovery of prepetition overpayments would not be allowed under the setoff provisions of the Code but concluded that the overpayments and underpayments could be recouped because they were within the “same transaction.”<sup>120</sup> The Ninth Circuit took a similar approach as the D.C. Circuit by reading the Medicare statute and regulations as creating a billing system of payments that “logically relate” to the same transaction.<sup>121</sup> The Ninth Circuit also attempted to make clear that this logical relationship test should be subject to some limits and

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<sup>112</sup> *Id.*

<sup>113</sup> *Id.* at 396.

<sup>114</sup> *Id.*

<sup>115</sup> *Id.*

<sup>116</sup> *In re TLC Hosps., Inc.*, 224 F.3d 1008.

<sup>117</sup> *Id.* at 1010.

<sup>118</sup> *Id.*

<sup>119</sup> *Sims v. U.S. Dep’t of Health & Human Servs.*, 225 B.R. 709, 715 (N.D. Cal. 1998).

<sup>120</sup> *In re TLC Hosps., Inc.*, 224 F.3d at 1011.

<sup>121</sup> *Id.* at 1012.

not so loosely applied that it would expand to cover “multiple occurrences in any continuous commercial relationship.”<sup>122</sup>

In *In re TLC Hospitals, Inc.*, the Ninth Circuit recognized a split between the circuits by clearly stating that it joined the D.C. Circuit in its opinion and disagreed with the Third Circuit.<sup>123</sup> Similarly, the United States Court of Appeals for the First Circuit’s decisions in *In re Holyoke Nursing Home*<sup>124</sup> and *In re Slater Health Center*<sup>125</sup> confirmed the First Circuit’s choice to follow the D.C. and Ninth Circuit’s approach to interpreting “same transaction” under the recoupment doctrine. In *Holyoke*, the Health Care Financing Administration (“HCFA”)<sup>126</sup> began withholding Medicare payments from Holyoke Nursing Home after it filed for chapter 11 bankruptcy.<sup>127</sup> Holyoke commenced an adversary proceeding against HCFA for violating the automatic stay.<sup>128</sup> The bankruptcy court and district court both found that HCFA’s actions were permissible based on recoupment.<sup>129</sup>

A year later in *Slater*, the First Circuit again faced a case where Medicare began withholding a portion of the bankrupt nursing home’s payments to recover prepetition overpayments.<sup>130</sup> In both *Holyoke* and *Slater*, the First Circuit held that Medicare overpayments may be recouped without violating the automatic stay.<sup>131</sup> In *Slater*, the First Circuit cited to its decision in *Holyoke* as controlling precedent and stated its decision to follow other circuits, such as the D.C. Circuit and Ninth Circuit, in holding that recoupment is permissible in Medicare overpayment cases.<sup>132</sup> In *Slater* and *Holyoke*, the First Circuit explained that the payments were part of a single transaction based on the continuous relationship established by the Medicare provider agreements.<sup>133</sup>

The circuits that have addressed this issue seem to focus their decisions on whether the government’s recovery actions will be stayed around the doctrines

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<sup>122</sup> *Id.*

<sup>123</sup> *See id.* at 1013.

<sup>124</sup> *In re Holyoke Nursing Home, Inc.*, 372 F.3d 1.

<sup>125</sup> *In re Slater Health Ctr., Inc.*, 398 F.3d at 105.

<sup>126</sup> The Health Care Financing Administration (HCFA) was the prior title of the Department of Health and Human Services’ (HHS) Medicare division. *Health Care Finance Administration*, FEDERAL REGISTER, <https://www.federalregister.gov/agencies/health-care-finance-administration> (last visited Nov. 1, 2017).

<sup>127</sup> *In re Holyoke Nursing Home, Inc.*, 372 F.3d at 2.

<sup>128</sup> *Id.* at 3.

<sup>129</sup> *Id.*

<sup>130</sup> *In re Slater Health Ctr., Inc.*, 398 F.3d at 99.

<sup>131</sup> *See In re Holyoke Nursing Home, Inc.*, 372 F.3d at 4; *In re Slater Health Center, Inc.*, 398 F.3d at 105.

<sup>132</sup> *In re Slater Health Ctr., Inc.*, 398 F.3d at 103.

<sup>133</sup> *In re Holyoke Nursing Home, Inc.*, 372 F.3d at 4; *In re Slater Health Ctr., Inc.*, 398 F.3d at 105.



of setoff and recoupment. Courts attempt to employ recoupment as an equitable means of allowing creditors to recover counterclaims.<sup>134</sup> However, few courts consider that setoff and recoupment essentially allow certain creditors to rise above others, thereby disrupting bankruptcy's goal of equal distribution to creditors.<sup>135</sup> The unique nature of healthcare entities in bankruptcy demands that courts reconsider this doctrine.

## II. DISCUSSION

This Comment will argue that courts should follow the minority approach in *University Medical Center v. Sullivan* when determining whether government actions to recover Medicare overpayments are subject to the automatic stay. Following the single integrated transaction test to determine whether Medicare payments and overpayments fall within the same transaction properly limits the non-statutory doctrine of recoupment. This test also allows courts to consider the unique nature of bankruptcy cases for healthcare entities and treats the government equal to any other creditor when seeking to recover contractual obligations.

### A. *Limitations on Recoupment*

In *University Medical Center*, the court defines “recoupment” as “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.”<sup>136</sup> Recoupment is not a doctrine discussed in the Code, but courts recognize it as an equitable alternative to setoff.<sup>137</sup> Recoupment began as a doctrine that allowed parties to bring separate claims but adjudicate them together.<sup>138</sup> This doctrine held importance in many contexts, but modernly it is most important in bankruptcy law.<sup>139</sup>

As discussed above, in bankruptcy, courts make determinations about whether claims fall within the doctrine of recoupment by determining whether

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<sup>134</sup> See GINSBERG, *supra* note 67, at § 8.07.

<sup>135</sup> See Lee, 739 F.2d at 875.

<sup>136</sup> *In re Univ. Med. Ctr.*, 973 F.2d at 1079 (citing 4 COLLIER ON BANKRUPTCY 553.03, at 553-15-17 (L. King, ed. 15th ed. 1991)).

<sup>137</sup> See Lee, 739 F.2d at 875 (stating that recoupment may be utilized when applying setoff limitations would be inequitable).

<sup>138</sup> *In re B & L Oil Co.*, 782 F.2d at 157 (describing the original doctrine of recoupment as “an equitable rule of joinder.”).

<sup>139</sup> See, e.g., *id.*

they arise from the same transaction.<sup>140</sup> While there are statutory limitations on setoff,<sup>141</sup> the “same transaction” requirement seems to be the only limitation recognized for recoupment.<sup>142</sup> Because equitable recoupment may allow creditors to circumvent the automatic stay, the doctrine must be narrowly construed to prevent abuse.<sup>143</sup> It has been argued that recoupment, like setoff, violates bankruptcy’s goal of fair and equal treatment of creditors,<sup>144</sup> but courts seem to continue allowing recoupment because of equity.<sup>145</sup>

### 1. Ambiguity of “Same Transaction”

The ambiguity around recoupment in bankruptcy contexts arises from a lack of clarity on what constitutes the “same transaction.” The definition of setoff discusses “mutual debts,” but these debts arise from different transactions.<sup>146</sup> On the other hand, the definition of recoupment requires that the claims arise from the “same transaction.”<sup>147</sup> Because of the similarities between setoff and recoupment, courts may not specifically distinguish which of these remedies the party is entitled to outside of the bankruptcy context.<sup>148</sup> Often courts discuss applying a test to determine whether claims arise from the same transaction, but never state how such a test operates.<sup>149</sup> The seemingly simple distinction between the doctrines has sparked debate over the definition of the phrase “same transaction” to determine when recoupment is applicable in bankruptcy cases.<sup>150</sup>

Prior to a specific statement of the doctrine of recoupment, the Supreme Court discussed the definition of “transaction” in the context of counterclaims in *Moore v. New York Cotton Exchange*.<sup>151</sup> The Supreme Court stated that transaction has a flexible meaning and that “[i]t may comprehend a series of many occurrences, depending not so much upon the immediateness of their

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<sup>140</sup> See Palmer, *supra* note 6, at 8.

<sup>141</sup> See 11 U.S.C. § 553 (2012).

<sup>142</sup> GINSBERG, *supra* note 67, at § 8.07.

<sup>143</sup> James H. Wynn, *Freeze and Recoupment: Methods for Circumventing the Automatic Stay?*, 5 BANKR. DEV. J. 85, 103 (1988).

<sup>144</sup> See *Cty. of Orange v. Cty. of Orange (In re Cty. of Orange)*, 183 B.R. 609, 615 (Bankr. C.D. Cal. 1995).

<sup>145</sup> See *BNY Fin. Corp. v. Masterwear Corp. (In re Masterwear Corp.)*, 229 B.R. 301, 311 (Bankr. S.D.N.Y. 1999).

<sup>146</sup> See David G. Epstein & Jonathan A. Nockels, *Recoupment: Apples, Oranges and Fruit Basket Turnover*, 58 SMU L. REV. 51, 54 (2005).

<sup>147</sup> See generally *id.*

<sup>148</sup> *Id.* at 54.

<sup>149</sup> See, e.g., *Frederick v. United States*, 386 F.2d 481, 488 (5th Cir. 1967).

<sup>150</sup> GINSBERG, *supra* note 67, at § 8.07.

<sup>151</sup> *Moore v. N.Y. Cotton Exch.*, 270 U.S. 593, 610 (1926).

connection as upon their logical relationship.”<sup>152</sup> With the Court only addressing the definition of “transaction” in the context of general counterclaims and not “same transaction” for the purpose of recoupment, it is unclear whether the same definition should apply to a more specific doctrine like recoupment.<sup>153</sup>

In one of the earlier cases to mention recoupment, *Bull v. United States*,<sup>154</sup> the Supreme Court gave a similarly vague definition of recoupment.<sup>155</sup> The Court stated recoupment as “a defense arising out of some feature of the transaction upon which the plaintiff’s action is grounded.”<sup>156</sup> In a later Supreme Court case discussing recoupment of a tax claim, the Court described a single transaction for tax cases as “the taxable event claimed upon and the one considered in recoupment.”<sup>157</sup> Though the Court gives an unclear definition of “single transaction,” it goes on to criticize the lower court for its broad application of recoupment.<sup>158</sup> The Court stated that the same transaction requirement should be narrowly construed and limited recoupment in tax cases to situations similar to the facts in *Bull*.<sup>159</sup> The Second Circuit later stated that recoupment should be even further limited in bankruptcy cases because of its tendency to clash with bankruptcy’s goal of providing equal treatment for creditors.<sup>160</sup>

The first time recoupment was applied in conjunction with bankruptcy law was in *Stanolind Oil & Gas Co. v. Logan*.<sup>161</sup> In *Stanolind Oil & Gas*, the district court addressed a bankrupt oil company in an involuntary proceeding.<sup>162</sup> The bankruptcy proceedings involved a number of mineral leases on land in the company’s estate, but the initial trustee found that these leases were unsalable.<sup>163</sup> The estate was closed, but the debtor did not receive a discharge.<sup>164</sup> Later, the bankrupt company discovered oil on the land under these leases, and the bankruptcy proceedings were reopened. The debtor had transferred a portion of the lease to Stanolind, and Stanolind sought to stop the trustee from obtaining

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<sup>152</sup> *Id.*

<sup>153</sup> Epstein, *supra* note 146, at 64–65.

<sup>154</sup> *Bull v. United States*, 295 U.S. 247 (1935).

<sup>155</sup> *See id.* at 262.

<sup>156</sup> *Id.*

<sup>157</sup> *Rothensies v. Elec. Storage Battery Co.*, 329 U.S. 296, 299 (1946).

<sup>158</sup> *Id.* at 301.

<sup>159</sup> *Id.* at 300–01.

<sup>160</sup> *See N.Y. State Elec. & Gas Corp. v. McMahon (In re McMahon)*, 129 F.3d 93, 97 (2d Cir. 1997).

<sup>161</sup> *Stanolind Oil & Gas Co. v. Logan*, 92 F.2d 28 (5th Cir. 1937).

<sup>162</sup> *Id.* at 29.

<sup>163</sup> *Id.*

<sup>164</sup> *Id.* at 30.

possession of these leases and recovery of expenses Stanolind incurred from developing the lease by arguing that the property had been abandoned.<sup>165</sup>

The Fifth Circuit disagreed with Stanolind's abandonment argument but agreed that Stanolind may offset their expenses against the value of the oil.<sup>166</sup> The Fifth Circuit stated that the reimbursements Stanolind sought were a debt due to the estate, and by seeking these expenses from the proceeds of the leases and oil, Stanolind had a right to offset those debts.<sup>167</sup> The Fifth Circuit found these actions permissible under the Bankruptcy Act of 1898 through the equitable doctrines of setoff and recoupment.<sup>168</sup> Once again, instead of explaining each doctrine, the court stated setoff and recoupment as one doctrine that courts may utilize to further equitable principles in bankruptcy cases.<sup>169</sup> The Fifth Circuit's opinion in *Stanolind* set a tone for other decisions that failed to distinguish or set a standard for setoff and recoupment as separate doctrines.

Some courts and commentators argue that recoupment can be reconciled with bankruptcy goals because the property the creditor seeks is not property of the estate due to someone else holding an interest in the property.<sup>170</sup> The Code helps to resolve this ambiguity through its clear definitions of "claim" and "property of the estate." The Code defines "claim" as a "(A) right to payment" or "(B) right to an equitable remedy."<sup>171</sup> Under § 541 of the Code, "property of the estate" is described as "all legal or equitable interests of the debtor in property as of the commencement of the case."<sup>172</sup> Section 541 also makes clear that "any interest in property that the estate acquires after the commencement of the case" is also property of the estate.<sup>173</sup> This section was included to make clear that the debtor is still entitled to payment or benefits for the property and services a debtor renders during the time after the bankruptcy case is commenced.<sup>174</sup> A decision by a New York bankruptcy court also confirmed the

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<sup>165</sup> *Id.*

<sup>166</sup> *Id.* at 31–32.

<sup>167</sup> *Id.* at 32.

<sup>168</sup> *Id.*

<sup>169</sup> *Id.*

<sup>170</sup> See *In re Monongahela Rye Liquors, Inc.*, 141 F.2d at 869; *In re Career Consultants, Inc.*, 84 B.R. 419, 426 (Bankr. E.D. Va. 1988); Epstein, *supra* note 146, at 75.

<sup>171</sup> 11 U.S.C. § 101(5) (2012).

<sup>172</sup> *Id.* § 541(a)(1).

<sup>173</sup> *Id.* § 541(a)(7).

<sup>174</sup> See Peter R. Roest, *Recovery of Medicare and Medicaid Overpayments in Bankruptcy*, 10 ANNALS HEALTH L. 1, 7 (2001).

idea that a right to recover an overpayment could be considered a “dischargeable, contingent claim.”<sup>175</sup>

No one argues that setoff claims are not an attempt by the creditor to satisfy a claim by obtaining property of the estate, which is covered by the automatic stay.<sup>176</sup> Since recoupment is such a similar doctrine, only distinguished by whether the claims are from the same transaction, that minor difference should not negate the claim as an equitable interest in the debtor’s property. Though provisions of the Code speak to setoff and similar definitions, it does not change that recoupment is not mentioned in the Code, and the non-statutory doctrine must be interpreted by combining various sources.

## 2. *Interpreting a Non-Statutory Doctrine*

When considering an ambiguous term within a statute, courts may typically consider congressional intent to determine its meaning.<sup>177</sup> Unlike setoff, recoupment is not addressed in the bankruptcy statute, and courts do not have congressional guidance on this doctrine. While recoupment was discussed in the bankruptcy context as early as the 1930s,<sup>178</sup> Congress did not include recoupment in the Bankruptcy Code of 1978, or the BAPCPA.<sup>179</sup> The Bankruptcy Code of 1898 solely discussed “set-off” and did not mention recoupment.<sup>180</sup> In describing setoff, § 68 stated that “[i]n all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid.”<sup>181</sup> As the Fifth Circuit stated in *Stanolind* when interpreting this provision, setoff was viewed as a privilege based on the discretion of the court depending on equitable principles,<sup>182</sup> but that was the only restriction on the provision. In the Bankruptcy Act of 1898, Congress did not limit setoff as later statutes would, and courts did not see a need to provide other equitable principles to supplement this privilege.

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<sup>175</sup> *Kings Terrace Nursing Home v. N.Y. Dep’t of Soc. Servs. (In re Kings Terrace Nursing Home)*, 1995 Bankr. LEXIS 157, at \*12 (S.D.N.Y. Jan. 26, 1995), *aff’d*, 184 B.R. 200 (S.D.N.Y. 1995).

<sup>176</sup> 11 U.S.C. § 362(a)(3) (2012).

<sup>177</sup> See The Honorable Thomas F. Waldron, Neil M. Berman, *Principled Principles of Statutory Interpretation: A Judicial Perspective After Two Years of BAPCPA*, 81 AM. BANKR. L.J. 195, 214–15 (2007).

<sup>178</sup> See *Stanolind Oil & Gas Co.*, 92 F.2d 28.

<sup>179</sup> Epstein, *supra* note 146, at 63.

<sup>180</sup> Act of July 1, 1898, ch. 541, § 68, 30 Stat. 544, 565 (repealed 1978) (superseded by 11 U.S.C. §§ 101–1532).

<sup>181</sup> *Id.*

<sup>182</sup> *Stanolind Oil & Gas Co.*, 92 F.2d at 32.

The Bankruptcy Code of 1978 altered ideas about setoff by stating in § 553 that setoff is a right, not solely a privilege.<sup>183</sup> Section 553 does not mention recoupment. The right of setoff described in this section applied to mutual debts that arose before the bankruptcy case commenced, and the Code does not mention a difference between “mutual debts” and those that arise from the “same transaction.”<sup>184</sup> The Code also changed the previous law on setoff by including a provision discussing it in § 362. Currently, § 362 places a limitation on the right of setoff while the automatic stay is in place, but it does not mention the possibility of subverting this limitation by utilizing recoupment instead.<sup>185</sup> There was also no mention of recoupment in the Code’s legislative history to guide courts.<sup>186</sup> Even when Congress amended the Code in 2005 through the BAPCPA, there was no amendment that addressed recoupment. Since Congress did not codify recoupment when it amended the Code, courts could conclude that Congress intended to allow courts to prescribe recoupment’s parameters. However, courts must also be aware of the idea that the non-statutory doctrines must be narrowly construed with provisions of the Code.<sup>187</sup>

The bankruptcy system is known as a statutory system that prescribes clear and standard rules for bankruptcy proceedings, but courts also have jurisdiction in some cases to protect equity. These two ideas can clash when attempting to provide some debtors with more flexible tools for reorganization than the Code strictly allows.<sup>188</sup> By allowing broad judicial discretion for non-statutory doctrines, it becomes a separation of powers issue because the unelected judiciary is changing the laws made by the elected legislature.<sup>189</sup> While all judicial activism cannot be considered a violation of separation of powers, judicial interpretation of non-statutory doctrines should, at least, be narrowly limited to preserve the goals of the bankruptcy process.<sup>190</sup>

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<sup>183</sup> Bankruptcy Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, § 553 (1978); *see also* 11 U.S.C. § 553 (2012).

<sup>184</sup> *See* 11 U.S.C. § 553 (1978). The “same transaction” distinction for debts arose from the common law, not statute. *See* Lee, 739 F.2d at 875.

<sup>185</sup> *See* Bankruptcy Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, § 362 (1978); *see also* 11 U.S.C. § 362 (2012).

<sup>186</sup> *See* H. R. Rep. No. 95-595, at 340 (1977); 151 Cong. Rec. S1726-01 (2005).

<sup>187</sup> *See In re McMahon*, 129 F.3d at 97; *In re Univ. Med. Ctr.*, 973 F.2d at 1081.

<sup>188</sup> *See* Adam J. Levitin, *Toward A Federal Common Law of Bankruptcy: Judicial Lawmaking in a Statutory Regime*, 80 AM. BANKR. L.J. 1, 2 (2006).

<sup>189</sup> *See id.* at 15.

<sup>190</sup> *Contra id.* at 4 (advocating for broader judicial discretion to create a federal common law that expands on the Code).

Even if courts determine that recoupment is a separate equitable doctrine from setoff, there may be cause for distinguishing recoupment's use in bankruptcy cases.<sup>191</sup> In *In re Malinowski*,<sup>192</sup> the Second Circuit seemed to imply that recoupment should be applied differently in bankruptcy cases than in other types of cases to protect bankruptcy's goal of equal distribution among creditors.<sup>193</sup> In that case, the New York Department of Labor withheld unemployment insurance benefits from a debtor who filed bankruptcy to recover prepetition overpayments of unemployment benefits.<sup>194</sup> After the debtor filed for bankruptcy, the Department of Labor determined the debtor was eligible for benefits, but withheld those benefits to recover payments that had previously been overpaid to the debtor without filing a claim in the bankruptcy case or seeking relief from the automatic stay.<sup>195</sup>

While the bankruptcy court and district court held that the Department's actions were permissible under recoupment, the Second Circuit reversed, holding that recoupment could not be allowed because the prepetition payments and post-petition payments were not part of the same transaction.<sup>196</sup> The Second Circuit described setoff according to the Code's definition, but acknowledged that recoupment was not subject to the same limitations as setoff and described the doctrine instead as "a defense, the purpose of which is to do justice viewing one transaction as a whole."<sup>197</sup>

In defining "transaction," the Second Circuit rejected the broad definitions used by other courts and instead explained that recoupment and "transaction" in bankruptcy should be "given a more restricted definition."<sup>198</sup> The court rejected the Department's arguments that there was a contractual relationship that allowed it to withhold these payments when the payments came from separate periods of unemployment.<sup>199</sup> In *Malinowski*, the Second Circuit presented a good argument for limiting the non-statutory doctrine of recoupment in bankruptcy cases that focused on providing an equitable remedy based on the facts of the case and upholding Congress's goals for the Code.<sup>200</sup>

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<sup>191</sup> See Epstein, *supra* note 146, at 64.

<sup>192</sup> *Malinowski v. N.Y. Sate DOL (In re Malinowski)*, 156 F.3d 131 (2d Cir. 1998).

<sup>193</sup> *Id.* at 133.

<sup>194</sup> *Id.* at 132.

<sup>195</sup> *Id.*

<sup>196</sup> *Id.* at 134–35.

<sup>197</sup> *Id.* at 133.

<sup>198</sup> *Id.*

<sup>199</sup> *Id.* at 134.

<sup>200</sup> See *id.* (holding that the goals behind the Code be maintained to limit recoupment).

It remains unclear whether the Supreme Court's decision in *Reiter v. Cooper*<sup>201</sup> did anything to clarify this argument on whether bankruptcy cases for recoupment should be treated differently than those outside of bankruptcy. In *Reiter*, the bankruptcy trustee brought an action against the bankrupt company's shipping partner to recover freight shipping undercharges.<sup>202</sup> The issue in *Reiter* focused on the procedure for bringing counterclaims and recoupment claims.<sup>203</sup> The Court explained that the debtor can utilize recoupment to satisfy counterclaims and used a footnote to inform that recoupment in this case was not distinguishable because it was a bankruptcy case.<sup>204</sup> This footnote has been considered as the Court's way of rejecting the Second Circuit's opinion in *Malinowski* regarding treating recoupment differently within bankruptcy.<sup>205</sup> Others argue that the Supreme Court did not explain its reasoning enough to come to that conclusion.<sup>206</sup> In *Reiter*, the Supreme Court pointed to *Bankruptcy Rule 7013*<sup>207</sup> and its incorporation of *Federal Rule of Civil Procedure 13*<sup>208</sup> for support.<sup>209</sup> However, the issue with using *Bankruptcy Rule 7013* is that the Court did not consider the exception in the rule for claims that arise after the entry of an order for relief or filing of a petition.<sup>210</sup> The exception is supposed to distinguish post-petition claims that should not be considered counterclaims from the prepetition claims that can.<sup>211</sup> Because the Supreme Court did not discuss this exception, some argue the opinion left room for distinguishing claims within bankruptcy from those outside due to the important distinction between prepetition and post-petition claims within bankruptcy proceedings.<sup>212</sup> There is also a possibility that *Reiter* has no substantive significance for the topic of recoupment in bankruptcy. The Court's statement could have solely been about the insignificance of the procedural background of the case, where the defendant attempted to assert recoupment as a defense instead of a counterclaim.<sup>213</sup> What is clear is that the Supreme Court did not go further to rule on the definition of "same transaction."

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<sup>201</sup> *Reiter v. Cooper*, 507 U.S. 258 (1993).

<sup>202</sup> *Id.* at 261.

<sup>203</sup> *See id.* (determining that there was an issue of time within the procedure).

<sup>204</sup> *Id.* at 265 n.2.

<sup>205</sup> *See In re Malinowski*, 156 F.3d at 134 (2d Cir. 1998); Epstein, *supra* note 146, at 54.

<sup>206</sup> *See Averch*, *supra* note 70, at 300.

<sup>207</sup> FED. R. BANKR. P. 7013.

<sup>208</sup> FED. R. CIV. P. 13.

<sup>209</sup> *Reiter*, 507 U.S. at 265 n.2.

<sup>210</sup> FED. R. BANKR. P. 7013; 11 U.S.C. § 301(b) (2012) ("The commencement of a voluntary case under a chapter of this title constitutes an order for relief under such a chapter.")

<sup>211</sup> *Averch*, *supra* note 70, at 300.

<sup>212</sup> *See id.* at 300.

<sup>213</sup> *See Roest*, *supra* note 174, at 41.



In *University Medical Center*, the Third Circuit stated that recoupment was a non-statutory doctrine that should be narrowly construed.<sup>214</sup> Narrowly construing recoupment must also be balanced with the pre-Code practices doctrine. In *Cohen v. de la Cruz*,<sup>215</sup> the Supreme Court explained the pre-Code practices doctrine by stating that the Court does not interpret the Code as “erod[ing] past bankruptcy practice absent a clear indication that Congress intended such a departure.”<sup>216</sup> The pre-Code practices doctrine represents the Court’s belief that Congress legislated the Code knowing certain pre-Code practices existed, and Congress could have clearly changed those practices through the Code.<sup>217</sup> Since Congress only discussed setoff in the Code and not recoupment, courts are able to utilize the doctrine for equitable purposes, but recoupment should not be expanded too broadly.

Although the pre-Code practices doctrine may be helpful when determining whether Congress intended to displace a non-statutory practice, such as recoupment, such an assumption would not prohibit courts from imposing limitations on the doctrine. In *United States v. Texas*,<sup>218</sup> the Supreme Court stated “[s]tatutes which invade the common law . . . are to be read with a presumption favoring the retention of long-established and familiar principles, except when a statutory purpose to the contrary is evident.”<sup>219</sup> Here, the State of Texas asserted that the United States Department of Agriculture attempted to recover a debt along with prejudgment interest from the State for loss of food stamp coupons.<sup>220</sup> The State argued that the Debt Collection Act of 1982 precluded the federal government from recovering prejudgment interest from states.<sup>221</sup> The Supreme Court ruled against Texas and held that the common law principle of prejudgment interest must still be in place because the statute had not spoken directly to abrogating it.<sup>222</sup> Some commentators use this case to claim that a statute cannot modify any area of common law unless it speaks to it directly.<sup>223</sup> This idea is then imported to how one analyzes the Code and the common law doctrine of recoupment. The issue with using the pre-Code

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<sup>214</sup> *In re Univ. Med. Ctr.*, 973 F.2d at 1081.

<sup>215</sup> *Cohen v. de la Cruz*, 523 U.S. 213 (1998).

<sup>216</sup> *Cohen v. de la Cruz*, 523 U.S. at 221 (1998) (quoting *Pa. Dep’t of Pub. Welfare v. Davenport*, 495 U.S. 552, 563 (1990)).

<sup>217</sup> Levitin, *supra* note 188, at 59.

<sup>218</sup> *United States v. Texas*, 507 U.S. 529 (1993).

<sup>219</sup> *Id.* at 534.

<sup>220</sup> *Id.* at 530–31.

<sup>221</sup> *Id.* at 530.

<sup>222</sup> *See id.* at 536.

<sup>223</sup> See Elizabeth Swinton Schoen & Samuel R. Maizel, *The Medicare Contract in Bankruptcy: In Which Direction Does University Medical Center Lead?*, 11 BANKR. DEV. J. 405, 421 (1995).

practices doctrine in the context of recoupment is that the Code is not seeking to abrogate it. The goals of the Code may have implications that limit the doctrine of recoupment, but *United States v. Texas* does not provide any instructions on how this type of conflict should be resolved.

The common law also never discussed the appropriate way to construe a common law doctrine whose practical significance is diminishing in the areas it was originally intended to be utilized. Recoupment was significant outside of bankruptcy for procedural reasons when distinguishing counterclaims from defenses.<sup>224</sup> Currently, most of those requirements for pleadings are no longer useful inside or outside of bankruptcy.<sup>225</sup> Recoupment's lingering significance is determining whether a claim will be subject to the automatic stay, but it is not clear whether the doctrine was intended for this purpose. In *Norwest Bank Worthington v. Ahlers*,<sup>226</sup> the Supreme Court stated that the equitable powers bankruptcy courts possess are limited by the provisions in the text of the Code.<sup>227</sup> By using the single integrated transaction test to determine which claims arise within the same transaction, courts allow recoupment as a pre-Code practice without expanding the doctrine so far that it becomes inequitable in some situations.<sup>228</sup>

Additionally, limiting recoupment by using the single integrated transaction test would not harm these creditors as much as many would like to believe. If a court denies a creditor the ability to recoup its debt because the transactions are not connected enough to fall within the definition of "same transaction," the creditor will simply have a right to setoff instead of recoupment. Under setoff, creditors may realize they do not have immediate access to the claimed property, but setoff simply places them in the same or better position than other creditors. A creditor's right to setoff would be stayed under § 362 of the Code but within the bankruptcy process, the creditor may be treated like a secured creditor.<sup>229</sup> As a secured creditor, the creditor may not be able to get their property before everyone else, but the creditor does have more say in the chapter 11 plan process

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<sup>224</sup> Roest, *supra* note 174, at 46.

<sup>225</sup> *See id.* at 73.

<sup>226</sup> *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988).

<sup>227</sup> *Id.* at 206 ("[W]hatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code.").

<sup>228</sup> *See, e.g., In re Univ. Med. Ctr.*, 973 F.2d at 1081.

<sup>229</sup> 11 U.S.C. § 506(a) (2012).

than a general unsecured creditor.<sup>230</sup> Alternatively, the creditor could petition a court for relief from the automatic stay under § 362(d) of the Code.<sup>231</sup>

### *B. Using the Single Integrated Transaction Test in Healthcare Cases*

The minority test, or single integrated transactions test, limits the doctrine of recoupment enough to allow equitable relief in appropriate circumstances while furthering the public policy goals of bankruptcy and healthcare laws. In contrast, the logical relationship test embraced by the majority, which only requires claims be connected by a “logical relationship,” expands recoupment too broadly.<sup>232</sup> Under the logical relationship test, the court in *In re TLC Hospitals, Inc.* admitted that the test could be construed to encompass numerous claims solely linked by one commercial relationship.<sup>233</sup> The court cautioned against allowing the doctrine to expand this far but failed to prescribe any additional guidelines to stop this from occurring.<sup>234</sup> If recoupment is allowed to expand too broadly, the doctrine may displace the Code’s provisions regarding setoff and disturb the equality of the chapter 11 process.

#### *1. Cases from Other Industries*

Alternatively, the single integrated transactions test will not drown out recoupment or the goals of bankruptcy, but similar approaches have been used in a manner that allows certain debtors the fresh start bankruptcy intends to provide them. In *In re B & L Oil Co.*,<sup>235</sup> the Tenth Circuit allowed a buyer to recoup overpayments from the payments it owed a supplier prior to bankruptcy.<sup>236</sup> In this case, the Tenth Circuit stated its belief that recoupment should apply in narrow situations, but here, the court found this situation to be sufficiently narrow.<sup>237</sup> The court in *In re B & L Oil Co.* dealt with a clear contract

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<sup>230</sup> “To obtain confirmation, or ‘cramdown,’ of a [c]hapter 11 plan over the dissent of a secured creditor, the debtor generally has to provide for a stream of payments (such as through a promissory note) such that (1) the present value of the payment stream is at least equal to the value of the collateral and (2) the total payments will at least equal the amount of the secured claim. 11 U.S.C. § 1129(b)(2)(A)(i).” See Averch, *supra* note 70, at 292.

<sup>231</sup> A creditor may be granted relief from the automatic stay if able to show (1) cause, “including the lack of adequate protection of an interest in property of such party in interest” or (2) showing the debtor does not have an equity in the property, and it is not needed for reorganization. 11 U.S.C. § 362(d) (2012).

<sup>232</sup> *In re TLC Hosps., Inc.*, 224 F.3d at 1012.

<sup>233</sup> *Id.*

<sup>234</sup> *See id.*

<sup>235</sup> *In re B & L Oil Co.*, 782 F.2d 155.

<sup>236</sup> *Id.* at 159.

<sup>237</sup> *Id.* at 157.

that the parties entered for a product, and the buyer sought to recoup amounts from the previous month's exchange.<sup>238</sup> The Tenth Circuit allowed recoupment because it believed allowing the debtor to keep those amounts would be unjust enrichment.<sup>239</sup>

Also, in *In re Beeche Systems Corp.*,<sup>240</sup> a bankruptcy court allowed recoupment even after accepting the narrow "single integrated transactions" approach.<sup>241</sup> In this case, the buyer and seller had a contract prior to the seller filing bankruptcy.<sup>242</sup> The buyer deducted the amount it owed the seller from the amount the seller owed the buyer for repurchasing equipment.<sup>243</sup> The bankruptcy court allowed recoupment in this situation because it was clear from the terms of the contract that each party's claim was from one transaction regarding the same equipment.<sup>244</sup> Courts are able to utilize narrow tests, like the single integrated transactions test, to determine when recoupment is equitable without broadening the doctrine.

Recoupment in healthcare and the Medicare industry is substantially different from these examples because of the contractual relationships. Arguably, Medicare provider agreements create contractual relationships between the government and the healthcare provider.<sup>245</sup> Though a contractual relationship could make healthcare cases similar to cases like *In re B & L Oil Co.*, the courts that allow recoupment under the logical relationship test based their opinions on the Medicare statute language that allows HHS to determine payments subject to pre-petition overpayment claims.<sup>246</sup> Not only are courts unclear on whether the relationship is contractual or statutory, but they also do not take into account the nature of the agreements. Medicare provider agreements also are unique because CMS does not allow contractual negotiations on whether HHS will attempt to recoup from the provider during bankruptcy, and if recoupment is not limited in other bankruptcy cases (though it should be) the single integrated transaction test should especially be used in healthcare cases.

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<sup>238</sup> See *id.* at 158.

<sup>239</sup> *Id.* at 159.

<sup>240</sup> *In re Beeche Sys. Corp.*, 164 B.R. 12 (N.D.N.Y. 1994).

<sup>241</sup> See *id.* at 18.

<sup>242</sup> See *id.* at 15.

<sup>243</sup> *Id.* at 18.

<sup>244</sup> See *id.*

<sup>245</sup> See Schoen, *supra* note 223, at 409; see also 42 U.S.C. § 1395h (1988); *In re TLC Hosps., Inc.*, 224 F.3d at 1013.

<sup>246</sup> See *In re TLC Hosps., Inc.*, 224 F.3d at 1013; *Consumer Health Servs. of Am., Inc.*, 108 F.3d at 395.

2. *The Single Integrated Transaction Test is the Best Method for Healthcare and Government Cases*

Healthcare entities and their provider agreements with CMS are substantively different from commercial contracts. This is because these entities are not only involved in providing important health services to the public, but Medicare reimbursements are also made based on a prospective payment system CMS designed.<sup>247</sup> The single integrated transaction test is the best method for determining whether Medicare overpayment claims should be considered recoupment. In *University Medical Center*, the Third Circuit did not allow CMS to recoup overpayments from a medical provider because the claims arose from different transactions for different services and products.<sup>248</sup> The Third Circuit believed CMS's overpayment claim was distinct from the reimbursements because the overpayments were only within the same transaction as the reimbursements in the same year, and CMS could not recoup overpayments from reimbursements from the following year.<sup>249</sup>

In a previous case decided by the Third Circuit, *Lee v. Schweiker*, the court also denied a government entity the right to recoup pre-petition overpayments.<sup>250</sup> In *Lee*, the Social Security Administration ("SSA") overpaid elderly benefits to an individual, but the individual filed for bankruptcy during the time SSA was attempting to recover the overpayments by reducing the individual's monthly benefits.<sup>251</sup> The Third Circuit decided that these benefits could not be recouped from an individual because they were similar to the individual's income, unlike a claim or contractual right.<sup>252</sup> The court held that SSA could keep the payment it recouped prior to the individual filing for bankruptcy, but by withholding post-petition benefits, SSA violated the automatic stay because its actions were not recoupment.<sup>253</sup>

In *University Medical Center*, the Third Circuit based its decision on whether the Medicare payments and overpayments were within the same transaction by examining the Medicare reimbursement process. Medicare's unique reimbursement process for healthcare entities should be considered because Medicare established the reimbursement procedures, and courts should

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<sup>247</sup> See generally *Prospective Payment Systems*, *supra* note 30.

<sup>248</sup> *In re Univ. Med. Ctr.*, 973 F.2d at 1081.

<sup>249</sup> *Id.* at 1081–82.

<sup>250</sup> See *Lee*, 739 F.2d at 876.

<sup>251</sup> *Id.* at 872.

<sup>252</sup> See *id.* at 876.

<sup>253</sup> *Id.*

enforce those procedures. Medicare uses cost reporting to help determine the amount of Medicare funds the healthcare entity should receive.<sup>254</sup> Cost reporting requires the healthcare provider to submit a standard CMS cost report form annually for each fiscal year.<sup>255</sup> The cost report requests various information on the facilities' operations, costs, and financial statement data.<sup>256</sup> CMS also gives providers certain reporting principles to follow when completing these forms, such as requiring use of generally accepted accounting principles, unless an alternative policy is given.<sup>257</sup>

Medicare specifically requires that cost reporting periods align with the facility's twelve-month fiscal year.<sup>258</sup> Medicare holds healthcare entities to these policies and their cost reports by only allowing limited amendments to submitted reports under certain circumstances.<sup>259</sup> When submitting the cost reports, an entity's administrator or chief financial officer must certify that the report is accurate and in compliance with applicable laws and regulations.<sup>260</sup> Then, Medicare turns the cost report file over to a Medicare Administrative Contractor ("MAC") to review and audit it.<sup>261</sup> CMS tasks various MACs with performing audits at the site of the healthcare entity or as a "desk review," and following the audit they must reconcile and settle the reimbursements for the period.<sup>262</sup>

The courts in *University Medical Center* and *Lee v. Schweiker* made their decisions about whether the claims arose out of the same transaction by examining the facts and characteristics of the claims presented.<sup>263</sup> The single integrated transaction test's narrow interpretation of "same transaction" is necessary in bankruptcy cases that involve long, complex transactions, like those in healthcare and other cases involving the government. Courts should also

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<sup>254</sup> See 42 C.F.R. § 413.20 (2017).

<sup>255</sup> *Id.* § 413.20.

<sup>256</sup> *Id.* § 413.24.

<sup>257</sup> *Id.* § 413.20.

<sup>258</sup> *Id.* § 413.24.

<sup>259</sup> *Id.* § 413.24; see also CENTERS FOR MEDICARE AND MEDICAID SERVICES, PROVIDER REIMBURSEMENT MANUAL—PART I (PUB. 15-1), CH. 29, § 2931.2(A), <https://www.cms.gov/Regulations-and-Guidance/Guidance/Manuals/Paper-Based-Manuals-Items/CMS021929.html?DLPage=1&DLEntries=10&DLSort=0&DLSortDir=ascending> ("Ordinarily, a cost report filed in a manner consistent with regulations and policy governing its preparation is intended to be final when settlement has been made or following an audit when determined to be necessary by the intermediary . . . . However, a cost report may also be considered final when initially delivered to the intermediary although the intermediary may not have performed its desk review and, if necessary, its audit.")

<sup>260</sup> 42 C.F.R. § 413.24 (2017).

<sup>261</sup> *Id.*

<sup>262</sup> *Id.*

<sup>263</sup> *In re Univ. Med. Ctr.*, 973 F.2d at 1080–82; *Lee*, 739 F.2d at 876.

narrowly construe “same transaction” in cases with government agencies because the Bankruptcy Code has already provided special provisions for these agencies.<sup>264</sup> The automatic stay provision of the Bankruptcy Code provides an exception for governmental agencies to enforce their police and regulatory power.<sup>265</sup> When these agencies attempt to enforce contractual rights, they remove themselves from the protection of this exception, allowing the courts to treat them as all other creditors.<sup>266</sup>

The Third Circuit in *University Medical Center* held that Medicare’s claim to recover overpayments did not arise out of the same transaction because of the Medicare payment process.<sup>267</sup> The court examined the Medicare payment system and its process of reconciling its records on an annual basis.<sup>268</sup> The Third Circuit was able to conduct this type of examination because CMS and other regulatory agencies have manuals and rules that prescribe how the agency must handle certain actions.<sup>269</sup> If agencies are going to promulgate specific regulations, the agency must also expect courts to hold them to those standards when interpreting other doctrines.

The Third Circuit’s decision in *University Medical Center* was focused around the audit system, but it also referred to the services from the period when the overpayments were made and those services from the post-petition period when the reimbursements were held as distinctly different services.<sup>270</sup> HHS argued the reporting and auditing period centered around the fiscal year was used for administrative convenience.<sup>271</sup> In *Consumer Health Services*, the D.C. Circuit agreed with that argument and described the audit only as a “snapshot in time,”<sup>272</sup> but this statement contradicts the strictness of CMS’s policies on cost reporting for the fiscal year. By embracing this idea, the D.C. Circuit and other courts make the entire term of the Medicare provider agreement one transaction.<sup>273</sup> This distinction is too broad because CMS’s recoupment actions can never be checked by the courts, despite the D.C. Circuit’s statements

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<sup>264</sup> See 11 U.S.C. § 362(b)(4) (2012).

<sup>265</sup> See *id.*

<sup>266</sup> See *In re Coporacion de Servicios Medicos Hospitalarios de Fajardo*, 805 F.2d at 445; *In re Univ. Med. Ctr.*, 973 F.2d at 1075.

<sup>267</sup> *Id.* at 1081.

<sup>268</sup> *Id.*

<sup>269</sup> See, e.g., *Eligibility, and Entitlement*, *supra* note 28, at § 10.1; *Medicare Financial Management Manual*, *supra* note 33, at Ch. 3, § 20.1.

<sup>270</sup> *In re Univ. Med. Ctr.*, 973 F.2d at 1081.

<sup>271</sup> *Id.* at 1080.

<sup>272</sup> *Consumer Health Servs. of Am., Inc.*, 108 F.3d at 395.

<sup>273</sup> Roest, *supra* note 174, at 73.

otherwise.<sup>274</sup> When the bankruptcy court examined the Medicare provider agreement in *University Medical Centers*,<sup>275</sup> it pointed to the provision that stated HHS's reimbursements were for each eligible patient that the hospital treated.<sup>276</sup> When the Third Circuit reviewed the bankruptcy court's decision, it took into account that each patient may have different services provided to them, but HHS chose to keep track of the services rendered within a certain transaction through the reporting and auditing procedure.

### C. *Effects on Healthcare Entities*

In the healthcare industry, efficient reorganization can have a significant effect on public health.<sup>277</sup> When healthcare entities are not given the adequate resources to reorganize, they may be forced to close their doors to patients.<sup>278</sup> Medicare reimbursements are a necessary tool of reorganization for many healthcare providers. Courts and the government should also consider how limits placed on recoupment can assist the goals of health law.<sup>279</sup> In *Lee v. Schweiker*, the Third Circuit acknowledged the argument that government benefits to individuals may warrant a special consideration when deciding whether a government agency may recoup overpayments during bankruptcy.<sup>280</sup> The single integrated transactions test, as used in *Lee* and *University Medical Center*, takes into account the special circumstances of healthcare and government agency cases when determining how broadly the courts should define "same transaction."<sup>281</sup>

A unique issue for healthcare entities is their obligation to continue servicing a patient once their staff begins treating him.<sup>282</sup> Under the Emergency Medical Treatment and Active Labor Act ("EMTALA"), if a patient enters the emergency department of a hospital with an emergency medical condition, the hospital is required to at least screen and stabilize the patient.<sup>283</sup> EMTALA prohibits hospitals from "dumping" patients on other emergency departments

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<sup>274</sup> *Consumer Health Servs. of Am., Inc.*, 108 F.3d at 396 ("We do not hold, however, that all Medicare claims for prior overpayments avoid the automatic stay. A provider that is no longer providing Medicare services, whether or not it is in [c]hapter 11, is subject to a collection remedy defined by statute and regulation.")

<sup>275</sup> *In re Univ. Med. Ctr.*, 122 B.R. at 930.

<sup>276</sup> *Id.*

<sup>277</sup> *See Palmer, supra* note 6.

<sup>278</sup> *See, e.g., In re Univ. Med. Ctr.*, 973 F.2d at 1071; *In re Bayou Shores SNF, LLC*, 525 B.R. at 164.

<sup>279</sup> *See Palmer, supra* note 6.

<sup>280</sup> *See Lee*, 739 F.2d at 876.

<sup>281</sup> *See In re Univ. Med. Ctr.*, 973 F.2d at 1081; *Lee*, 739 F.2d at 876.

<sup>282</sup> *See Emergency Medical Treatment and Active Labor Act*, 42 U.S.C. § 1395dd (2011).

<sup>283</sup> *Id.*



for discriminatory reasons, such as race, sexual orientation, or lack of insurance.<sup>284</sup> Physicians are also prohibited from discontinuing service to their patients without going through a proper procedure to terminate the physician-patient relationship and assist the patient in finding other services.<sup>285</sup> Though the costs for these services are supposed to be factored into Medicare's payment system, these special obligations could be a reason why in previous years Medicare underpayments have totaled over \$20 billion.<sup>286</sup>

It seems inequitable that one party may be allowed to recoup payments, but the other party cannot discontinue services if the government breaches its contractual obligation. After *University Medical Center*, the Third Circuit's decision could be read broadly enough to allow an entity to enforce a provider agreement against the government but not perform its obligations.<sup>287</sup> Under § 365 of the Code, an executory contract may be temporarily unenforceable against the debtor in the time period before plan confirmation and assumption or rejection of the contract.<sup>288</sup> In those situations where the debtor could try to take advantage of the creditor, creditors are also given a remedy under § 365(d) to petition courts to require that the debtor assume or reject the contract.<sup>289</sup> There may also be other options for debtors attempting to hold the government accountable for its actions. In *Cosgrove v. Bowen*,<sup>290</sup> where individuals attempted to recover interest for underpaid reimbursements, the Second Circuit ruled that HHS acted arbitrarily and capriciously by not adjusting reimbursement rates for some physician services, causing underpayments.<sup>291</sup>

#### D. Jurisdictional and Other Potential Issues

By prescribing such a broad test for determining the definition of "same transaction," the majority approach enables CMS to recoup Medicare overpayments from healthcare entities despite the circumstances the entity may be facing. CMS then has the right to recoup Medicare overpayments without

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<sup>284</sup> See *id.*; Thomas A Gionis, *The International Tort of Patient Dumping: A New State Cause of Action to Address the Shortcomings of the Federal Emergency Medical Treatment Act (EMTALA)*, 52 AM. U. L. REV. 173, 181 (2002).

<sup>285</sup> AMERICAN HEALTH LAWYERS ASSOCIATION, REPRESENTING HOSPITALS AND HEALTH SYSTEMS HANDBOOK, § 21.2.1 (Dinetia Newman & Robert G. Homchick, eds., 1st ed. 2016).

<sup>286</sup> American Hospital Association, *Underpayment by Medicare and Medicaid Fact Sheet*, AHA (November 2009), <http://www.aha.org/content/00-10/09/medicunderpayment.pdf>.

<sup>287</sup> See Schoen, *supra* note 223, at 436–40.

<sup>288</sup> 11 U.S.C. § 365 (2012); *Dewey Freight Sys., Inc.*, 31 F.3d at 623.

<sup>289</sup> 11 U.S.C. § 365(d) (2012).

<sup>290</sup> *Cosgrove v. Bowen*, 898 F.2d 332 (2d Cir. 1990).

<sup>291</sup> *Id.* at 334.

seeking relief from the automatic stay or coming to the bankruptcy courts.<sup>292</sup> Without the automatic stay as a defense, a healthcare entity's remedy is limited, due to jurisdiction issues, to following through with the Medicare appeals process.<sup>293</sup> The same jurisdictional issue appeared in *University Medical Center* when the case was brought to the court of appeals.<sup>294</sup>

In *University Medical Center*, HHS asserted that neither the court of appeals, district court, or bankruptcy court had jurisdiction to rule on the claims.<sup>295</sup> HHS argued that those courts did not have jurisdiction to hear claims "arising under the Medicare statute prior to exhaustion of administrative remedies" based on language in the Medicare statute.<sup>296</sup> The Third Circuit found that the administrative channels were not exhausted, but it had jurisdiction under the Code instead because the claim did not "arise under the Medicare statute."<sup>297</sup> The Third Circuit interpreted the statute to only implicate a jurisdictional issue if the claim was over a disputed final reimbursement determination and if any amounts were in dispute, unlike the facts in the case.<sup>298</sup> Despite the court's somewhat shaky rationale, other circuits continued to rule on these claims based on the same idea that they held jurisdiction.<sup>299</sup> Most commentators believe that *University Medical Center* left open whether courts may hear overpayment claims prior to the provider exhausting its administrative remedies.<sup>300</sup>

Although *University Medical Center* did not start the confusion around 42 U.S.C. § 405(h) and its jurisdictional limitations for Medicare case, the Third Circuit's decision did not help clear things up. In 1984, when Congress amended 42 U.S.C. § 405(h), the amended statute was read to only limit district courts from hearing claims arising under 28 U.S.C. §§ 1331 and 1346.<sup>301</sup> This amendment sparked questions on whether § 405(h) also precluded bankruptcy courts from hearing Medicare claims if the party has not exhausted all administrative processes.<sup>302</sup> Then, in *Bodimetric Health Servs., Inc. v. Aetna Life*

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<sup>292</sup> *In re B & L Oil Co.*, 782 F.2d at 159.

<sup>293</sup> *In re Bayou Shores SNF, LLC*, 828 F.3d at 1326–27.

<sup>294</sup> *See In re Univ. Med. Ctr.*, 973 F.2d 1065.

<sup>295</sup> *Id.* at 1072.

<sup>296</sup> 42 U.S.C. §§ 405(h), 1395ii (2012); *In re Univ. Med. Ctr.*, 973 F.2d at 1072.

<sup>297</sup> *In re Univ. Med. Ctr.*, 973 F.2d at 1072.

<sup>298</sup> *Id.* at 1073.

<sup>299</sup> *See, e.g.*, *Consumer Health Servs. of Am., Inc.*, 108 F.3d 390; *In re TLC Hosps., Inc.*, 224 F.3d at 1013.

<sup>300</sup> *See Roest, supra* note 174, at 56.

<sup>301</sup> *Id.* at 57. 28 U.S.C. § 1331 addresses federal question jurisdiction, and 28 U.S.C. § 1346 grants federal district courts concurrent jurisdiction with the U.S. Court of Federal Claims for certain cases in which the United States is the defendant.

<sup>302</sup> *Roest, supra* note 174, at 58–60.

& Cas.,<sup>303</sup> a home health agency (“HHA”) brought an action against its fiscal intermediary for causing it to lose HHA claims, leading to the loss of a substantial amount of funds.<sup>304</sup>

The lower court, in *Bodimetric Health Servs., Inc.*, granted the fiscal intermediary’s motion to dismiss, but the HHA appealed.<sup>305</sup> The Seventh Circuit ruled that 42 U.S.C. § 405(h) precluded the courts from jurisdiction over an action brought by HHA against a fiscal intermediary.<sup>306</sup> The court ruled that it was precluded from jurisdiction, subject to the exhaustion of administrative remedies because “Congress clearly expressed its intent not to alter the substantive scope of section 405(h).”<sup>307</sup> Here, the Seventh Circuit utilized congressional intent to determine the implications of the statute because the plain meaning presented some ambiguity,<sup>308</sup> but this decision did not do enough to clear the ambiguity behind the jurisdictional issue.

In 2014, the jurisdictional issue reappeared in *In re Bayou Shores*,<sup>309</sup> a case in which CMS terminated the provider agreement of a skilled nursing facility due to compliance problems.<sup>310</sup> The nursing facility later filed bankruptcy, and the bankruptcy court stayed CMS’s actions to terminate the provider agreement.<sup>311</sup> At the bankruptcy court, there were numerous issues raised about whether the Medicare provider agreements could be assumed and recovery actions stayed. When the jurisdictional issue was raised, the bankruptcy court held that it had subject matter jurisdiction, despite the Medicare statute, under 28 U.S.C. § 1334, which gives bankruptcy courts jurisdiction over “all civil proceedings arising under title 11.”<sup>312</sup>

By the time the case made its way up to the Eleventh Circuit, it was clear that the jurisdictional issue had become more contentious. The Eleventh Circuit held that courts do not have jurisdiction over cases regarding CMS and Medicare claims before the party has completed the agency’s administrative appeals process.<sup>313</sup> In *Bayou Shores*, the Eleventh Circuit explained that claims arising

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<sup>303</sup> *Bodimetric Health Servs., Inc. v. Aetna Life & Cas.*, 903 F.2d 480 (7th Cir. 1990).

<sup>304</sup> *Id.* at 483.

<sup>305</sup> *Id.*

<sup>306</sup> *Id.* at 488.

<sup>307</sup> *Id.* at 489.

<sup>308</sup> Roest, *supra* note 174, at 59.

<sup>309</sup> *In re Bayou Shores, SNF, LLC*, 525 B.R. 160.

<sup>310</sup> *Id.* at 168–69.

<sup>311</sup> *Id.* at 165.

<sup>312</sup> *Id.* at 166.

<sup>313</sup> *In re Bayou Shores SNF, LLC*, 828 F.3d at 1326.

under the Medicare Act are no longer limited to those claims based on monetary disputes.<sup>314</sup> The Eleventh Circuit based its decision on the language in the Medicare statute, without also considering the results to healthcare entities.<sup>315</sup> Restricting a debtor's access to bankruptcy courts to stop Medicare overpayment recovery actions will likely affect healthcare entities in bankruptcy, given that healthcare entities have reported that these administrative proceedings can take years to complete, which ties up funds needed during reorganization.<sup>316</sup>

Healthcare entities do not have many other options, outside of leaving the Medicare system, which would also cause the entity's financial demise. In the Ninth Circuit's decision in *In re TLC Hospitals*, the Ninth Circuit stated that health providers that do not want to be subject to HHS's recoupment actions have the option to not provide Medicare services and leave the system.<sup>317</sup> Here, it does not seem the court considered the equities and circumstances of the case. Medicare payments cover such a large percentage of payments to hospitals that many cannot survive without them.<sup>318</sup> In 2010, HHS data showed that Medicare patients accounted for around thirty-five percent of patients in urban hospitals and around forty-five percent of patients in rural hospitals.<sup>319</sup>

The survival of these entities hinges on whether Medicare decides to demand repayment of all its overpayments at any particular point in time.<sup>320</sup> As the district court in *University Medical Center* pointed out, these providers rely on Medicare for support and ultimately find themselves indebted to HHS for thousands of dollars at no fault of their own.<sup>321</sup> From HHS's own data, it is normal for healthcare providers to rely on Medicare for a large portion of its funds,<sup>322</sup> but when Medicare makes a mistake, the entity will suffer if Medicare decides to demand payments from one of these providers. Without some of these necessary tools, the goal of chapter 11 bankruptcy that seeks to allow debtors to stay in business while attempting to reorganize will not be met. This means the underlying idea that these businesses are better for society alive than dead will not be followed for one of the most important industries in the nation.

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<sup>314</sup> *Id.* at 1329.

<sup>315</sup> *See id.* at 1326

<sup>316</sup> *See, e.g., In re Bayou Shores SNF, LLC*, 828 F.3d 1297; *Medicare Parts A & B Appeals Process Fact Sheet*, *supra* note 35.

<sup>317</sup> *In re TLC Hosps., Inc.*, 224 F.3d at 1014.

<sup>318</sup> James Markus & John Young, *Ninth Circuit Weighs in on Recoupment of Medicare Overpayments*, 19 AM. BANKR. INST. J. 16, 16 (Nov. 2000).

<sup>319</sup> U.S. Dept. of Health & Human Servs., *supra* note 13.

<sup>320</sup> Markus, *supra* note 318, at 16.

<sup>321</sup> *In re Univ. Med. Ctr.*, 125 B.R. at 124.

<sup>322</sup> U.S. Dept. of Health & Human Services, *supra* note 13.

If these providers do not have the resources to reorganize, many of them will be forced to close. While new healthcare regulations may prompt some closures, hospitals especially needed in rural areas will be harmed the most because more of their patients' services are reimbursed through Medicare.<sup>323</sup> One example is the Nye Regional Medical Center closure in Tonopah, Nevada.<sup>324</sup> The closure of this medical center left the residents of this rural area over an hour's drive away from the closest emergency department.<sup>325</sup> Without any facilities to handle emergency situations, the health of residents may be jeopardized. Similar stories were seen throughout the country in 2015, and these closures affect patients, employees, and the entire public health.<sup>326</sup>

### CONCLUSION

For over ten years, courts have been split on whether government actions that seek to recover Medicare overpayments from bankrupt healthcare entities will be stayed under 11 U.S.C. § 362. Courts have sought to resolve this issue by defining recoupment as “[a] counterclaim arising out of the same transaction or occurrence as the one on which the original action is based,”<sup>327</sup> but this definition has only led to further confusion over the phrase “same transaction.” Out of the two tests used to determine whether claims arise out of the same transaction, the single integrated transaction test is the most suitable for the healthcare industry and Medicare claims.

The single integrated transaction test narrowly construes the doctrine of recoupment, which restricts certain creditors from advancing their claim before others and disrupts bankruptcy's goal of providing equal treatment of all creditors. The healthcare and Medicare industries are unique and important to our nation in providing citizens with efficient, affordable, and widely available healthcare resources. CMS should not be able to recover overpayments during bankruptcy without seeking relief from the automatic stay. This issue regarding Medicare claims must be resolved to provide those healthcare entities in bankruptcy with more tools for reorganization.

Though this issue has long been debated, the need for answers is becoming increasingly urgent due to new court decisions on the procedures healthcare

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<sup>323</sup> *Id.*

<sup>324</sup> Value Healthcare Services, *Nye Regional Medical Center Closes*, <http://valuehealthcareservices.com/education/nye-regional-medical-center-closes/> (last visited Mar. 4, 2017).

<sup>325</sup> *Id.*

<sup>326</sup> *See, e.g., id.*

<sup>327</sup> *Recoupment, supra* note 65.

entities must follow to get their claims heard. In *In re Bayou Shores SNF*, the Eleventh Circuit held that a healthcare facility must adjudicate its complaints about Medicare through the agency's administrative process prior to bringing the claim to the courts, including bankruptcy courts.<sup>328</sup> This means that healthcare entities will have a more difficult time getting a court to hear its claims before it is too late for the entity to survive.

By allowing the government agency to jump other creditors in the bankruptcy process and restricting courts from reviewing their actions for numerous months, it gives HHS too much control. These procedures ignore the importance of the automatic stay and giving the debtor the necessary "breathing room" to reorganize. Under the ACA, future healthcare plans, and other healthcare regulations, assistance from the courts will be needed to achieve the legislature's goal of increasing public health and efficient care.

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<sup>328</sup> *In re Bayou Shores SNF, LLC*, 828 F.3d at 1330.

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