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Borrego Adds a New Tool to the Health Care Debtor's Toolbox



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A recent decision from the U.S. Bankruptcy Court for the Southern District of California in the chapter 11 case of *Borrego Community Health Foundation*¹ exemplifies the mounting case law that is slowly eroding health care regulatory authorities' ability to claim that their actions fall within the police and regulatory powers exception to the automatic stay. Building on the *True Health* decision by the U.S. Bankruptcy Court for the District of Delaware that the Centers for Medicare and Medicaid Services (CMS) were prohibited by the automatic stay from suspending payments to a chapter 11 debtor,² the *Borrego* decision strengthens that important protection for health care debtors, giving them key leverage in negotiations with regulatory authorities. Further, *Borrego* is an example of bankruptcy courts' growing willingness to consider public policy and the public's interest in accessing health care in rendering decisions in health care chapter 11 cases.

True Health: Paving the Way

In 2019, THG Holdings LLC and its affiliates (collectively, True Health) filed for voluntary chapter 11 protection due, in part, to CMS suspending certain Medicare reimbursements for services that True Health had performed.³ CMS suspended such payments as a result of True Health's alleged fraudulent billing activities,⁴ and this suspension reduced True Health's revenues by approximately 30 percent.⁵ Soon after filing for chapter 11, True Health commenced an adversary

proceeding to enforce the automatic stay and prevent CMS from continuing to suspend Medicare reimbursements post-petition.⁶

CMS argued that suspending post-petition Medicare reimbursements did not violate the automatic stay because CMS was exercising its police and regulatory powers under 11 U.S.C. § 362(b)(4).⁷ The Delaware Bankruptcy Court disagreed,⁸ explaining that when the government is acting as a creditor, the automatic stay is supposed to apply.⁹ It is only when the government is acting "to enforce such governmental unit's police and regulatory power[s]" that the government is "excepted" from the automatic stay.¹⁰ To determine whether the exception applies, courts must use the pecuniary-interest and public-purpose tests in order to "get to the heart of the reasoning behind the government's actions to avoid relying on unsupported statements of intent."¹¹ If the government is acting to "promote public safety and welfare or to effectuate public policy," then the police and regulatory powers exception to the automatic stay applies.¹² However, if the government is seeking to protect its "pecuniary interest in the debtor's property or primarily to adjudicate private rights," the police and regulatory powers exception does not apply.¹³

The bankruptcy court determined that the payments that CMS owed to True Health were clearly an asset of its bankruptcy estate, and that rather than promoting public safety and welfare or furthering public policy objectives, CMS was attempting to assert its pecuniary interest over other simi-

1 See *Borrego Cmty. Health Found. v. Cal. Dep't of Health Care Servs.*, Case No. 22-02384-LT11, Adv. No. 22-90056-LT, at 1 (Bankr. S.D. Cal. Oct. 6, 2022).

2 See *In re THG Holdings LLC*, 604 B.R. 154, 160-61 (Bankr. D. Del. 2019).

3 *Id.* at 158.

4 *Id.*

5 *Id.*

6 *Id.* at 157.

7 *Id.* at 158.

8 *Id.* at 161-63.

9 *Id.* at 160.

10 *Id.* at 161.

11 *Id.*

12 *Id.* (citing *In re Nortel Networks Inc.*, 669 F.3d 128, 140 (3d Cir. 2011)).

13 *Id.*

larly situated creditors' interests.¹⁴ CMS admitted in its own pleadings that all of the alleged fraud that sparked the payment suspensions took place before True Health filed its bankruptcy petition.¹⁵ Consequently, the bankruptcy court found that the "only reasonable conclusion" for it to reach was that CMS was withholding post-petition payments based on True Health's pre-petition financial missteps, which is "the exact conduct that the pecuniary interest test was designed to prohibit."¹⁶

Borrego: Building Upon True Health's Principles

Borrego is a nonprofit Federally Qualified Health Care Center that serves low-income and rural patients,¹⁷ and it relies on Medi-Cal payments for approximately 44 percent of its revenue.¹⁸ In November 2020, the California Department of Health Care Services (DHCS) suspended Medi-Cal payments to Borrego on account of the dental services provided to its patients.¹⁹ Similarly to *True Health*, DHCS suspended payments for dental claims after discovering fraudulent activities in Borrego's contract dental services.²⁰ However, even after Borrego implemented remedial measures and provided the required documentation, DHCS informed Borrego that it would suspend all Medi-Cal payments as soon as Sept. 29, 2022.²¹ Borrego filed for voluntary chapter 11 protection on Sept. 12, 2022.²²

Borrego commenced an adversary proceeding against DHCS to enforce the automatic stay and prevent the suspension of payments.²³ Borrego argued that if DHCS enforced the suspension, DHCS would violate the automatic stay.²⁴ Moreover, Borrego argued that DHCS could not refuse to pay Borrego for its pre- and post-petition in-house dental services without further violating the automatic stay.²⁵

In response, DHCS argued that its proposed plans would fall under the police and regulatory powers exception to the automatic stay.²⁶ More specifically, its main argument against Borrego's automatic stay defense was that DHCS asserted a public purpose for its actions.²⁷ Rather than explaining how its actions benefited the public, DHCS attempted to shelter behind the mere assertion of a public purpose and assumed that the Southern District of California Bankruptcy Court could not further inquire into any aspect of the alleged benefit to the public.²⁸

Following in *True Health's* footsteps, the bankruptcy court determined that DHCS's threatened suspension and withholding of payment did not qualify as an exception to the automatic stay under either of the two tests that comprise

the police and regulatory powers exception.²⁹ Striking down each of DHCS's arguments, the bankruptcy court first determined that the suspended payments were estate property.³⁰ Next, the court concluded that DHCS failed the pecuniary-interest test because it attempted to protect its own pecuniary interest in post-petition funds for services that Borrego would have continued to properly perform.³¹ The court explained that regardless of any alleged fraud, the suspension was a "classic example" of a creditor trying to assert control over payments to the detriment of all other affected parties.³²

Going beyond mere scrutiny of the government's arguments in favor of the police or regulatory powers exception to the automatic stay, the *Borrego* decision serves as an example of a court's willingness to consider the impact that granting the police and regulatory powers exception could have on the communities that rely on health care debtors for necessary care.

Finally, the bankruptcy court determined that DHCS did not satisfy the public-purpose test because it was clearly attempting to enforce breach-of-contract remedies rather than regulatory remedies.³³ The court explained that if DHCS had been seeking to benefit the public by suspending payments, it would have engaged in such protective actions as requiring other third parties to cease working with Borrego or other similar measures.³⁴ Instead of "revoking [Borrego's] ability to operate as a health care provider," DHCS only sought to "prevent funds from reaching" Borrego.³⁵ The court also noted that DHCS's failure to articulate its arguments in support of the public-purpose test was compounded by the "well-documented risks to the public if DHCS's grab for the purse leaves patients without care."³⁶ In addition, the court stressed that while it may not review the legitimacy of the government's asserted public purpose, it still has the power to determine whether the government's actions actually satisfy the public-purpose test.³⁷

Future Infrastructure: Public Policy and Public Interest Conflict with the Police and Regulatory Powers Exception

In support of its arguments against DHCS's threatened suspension, Borrego highlighted the substantial impact that

¹⁴ *Id.* at 160-61.

¹⁵ *Id.* at 161.

¹⁶ *Id.*

¹⁷ See *Borrego Cmty. Health Found. v. Cal. Dep't of Health Care Servs.*, Ch. 11 Case No. 22-02384-LT11, Adv. No. 22-90056-LT, at 1 (Bankr. S.D. Cal. Oct. 6, 2022). For more on Federally Qualified Health Care Centers, visit transamericainstitute.org/health-wellness/health-care-guides/federally-qualified-health-centers (last visited March 21, 2023).

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.* at 1.

²¹ *Id.*

²² *Id.* at 2.

²³ *Id.* at 1.

²⁴ *Id.* at 6.

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.* at 8.

²⁸ *Id.*

²⁹ *Id.* at 7.

³⁰ *Id.*

³¹ *Id.*

³² *Id.*

³³ *Id.* at 7-8.

³⁴ *Id.* at 8.

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.*

the possible suspensions would have on the public interest.³⁸ Borrego asserted that a suspension would essentially require it to shut down all operations.³⁹ Such a cessation would leave approximately 6,000 creditors with unlikely prospects for repayment, eliminate 700 jobs and force about 94,000 patients to find new sources for health care services.⁴⁰ In addition, employees and patients in remote areas would have to overcome job scarcity, long travel times and limited access to public transportation in response to the suspension.⁴¹ For those individuals who could accommodate the adverse circumstances, they would still have to fight for availability amidst a mass increase in demand for services to which the surrounding health care facilities would be struggling to adjust.⁴²

The Southern District of California Bankruptcy Court premised its analysis of DHCS's arguments for satisfying the public-purpose-test decision partly on the aforementioned public-interest arguments.⁴³ In response to DHCS's argument that the suspension of payments would benefit the public rather than its own financial interests, the court asserted that it could not "fathom" how suspending payments that would eliminate jobs and patients' access to necessary care would amount to a public benefit.⁴⁴ Instead, the court characterized any such arguments as "illusory" and pointed to the public-policy evidence that Borrego presented in opposition.⁴⁵ The court's willingness to consider the public-interest and public-policy objectives in the context of an automatic stay analysis tracks with other bankruptcy courts' willingness to prioritize the public's interest in the continued provision of health care in decisions where the court may have previously only considered the debtor's business judgment or other financially oriented factors.⁴⁶

Conclusion

Cases such as *True Health* and *Borrego* are building on the recent trend that has found bankruptcy courts pushing back on the government's historic assertion of power over health care debtors' bankruptcy cases. Trading in unsupported statements of intent to benefit the public for actual evidence of potential advancements to public policy, courts are beginning to require government actors who walk, talk and look like creditors to be treated as creditors. Going beyond mere scrutiny of the government's arguments in favor of the police or regulatory powers exception to the automatic stay, the *Borrego* decision serves as an example of a court's willingness to consider the impact that granting the police and regulatory powers exception could have on the communities that rely on health care debtors for necessary care.

By requiring the government to fully explain its claims that certain actions are for the benefit of the public, courts are opening the door for debtors to present their own evidence to the contrary.

On March 7, 2023, after DHCS's appeal, the Southern District of California Bankruptcy Court approved a settlement agreement between Borrego and DHCS.⁴⁷ Because of the *Borrego* decision, as similar cases continue to arise and follow in familiar tracks, health care debtors will have a public policy tool to add to their defensive efforts against the government's fight for control over their bankruptcy cases. **abi**

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38 *Id.* at 3.

39 *Id.*

40 *Id.*

41 *Id.*

42 *Id.*

43 *Id.* at 8.

44 *Id.*

45 *Id.*

46 Hearing on Debtors' Emergency Motion for Entry of a Final Order (I) Approving the Sale of Certain of the Debtors' Assets Free and Clear of Liens, Claims, Encumbrances, and Interests, (II) Approving the Assumption and Assignment of Certain Executory Contracts and Unexpired Leases Related Thereto, (III) Dismissing Certain of the Debtors' Chapter 11 Cases, and (IV) Granting Related Relief at 50:11, *In re Pipeline Health Sys. LLC*, Case No. 22-90291 (Nov. 29, 2022) (Docket No. 585) (expanding on the idea to expressly consider bankruptcy process's impact on public interest that Fifth Circuit established in *In re Ultra Petroleum Corp.*, No. 20-20623 (5th Cir. March 14, 2020), and *In re Mirant Corp.*, 378 F.3d 511 (5th Cir. 2004), regarding decisions that directly involved Federal Energy Regulatory Commission).

47 *Borrego Cmty. Health Found. v. Cal. Dep't of Health Care Servs.*, Case No. 22-02384-LT11 (Bankr. S.D. Cal. March 7, 2023).