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Services and Centers for Medicare and Medicaid Services

11 **UNITED STATES BANKRUPTCY COURT**
12 **CENTRAL DISTRICT OF CALIFORNIA - LOS ANGELES DIVISION**

13 In re
14 VERITY HEALTH SYSTEM OF CALIFORNIA,
INC., *et al.*,
15 Debtors and Debtors In Possession.

Lead Case No. 2:18-bk-20151-ER

Jointly administered with:
Case No. 2:18-bk-20162-ER
Case No. 2:18-bk-20163-ER
Case No. 2:18-bk-20164-ER
Case No. 2:18-bk-20165-ER
Case No. 2:18-bk-20166-ER
Case No. 2:18-bk-20167-ER
Case No. 2:18-bk-20168-ER
Case No. 2:18-bk-20169-ER
Case No. 2:18-bk-20170-ER
Case No. 2:18-bk-20171-ER
Case No. 2:18-bk-20172-ER
Case No. 2:18-bk-20173-ER
Case No. 2:18-bk-20175-ER
Case No. 2:18-bk-20176-ER
Case No. 2:18-bk-20178-ER
Case No. 2:18-bk-20179-ER
Case No. 2:18-bk-20180-ER
Case No. 2:18-bk-20181-ER

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17 Affects All Debtors
18 Affects Verity Health System of
California, Inc.
19 Affects O'Connor Hospital
20 Affects Saint Louise Regional Hospital
21 Affects St. Francis Medical Center
22 Affects St. Vincent Medical Center
23 Affects Seton Medical Center
24 Affects O'Connor Hospital Foundation
25 Affects Saint Louise Regional Hospital
Foundation
26 Affects St. Francis Medical Center of Lynwood
Foundation
27 Affects St. Vincent Foundation
28 Affects St. Vincent Dialysis Center, Inc.
 Affects Seton Medical Center
Foundation
 Affects Verity Business Services
 Affects Verity Medical Foundation
 Affects Verity Holdings, LLC
 Affects De Paul Ventures, LLC

Chapter 11 Cases

Honorable Ernest M. Robles

**OBJECTION OF THE UNITED STATES, ON
BEHALF OF THE U.S. DEPARTMENT OF
HEALTH AND HUMAN SERVICES AND
CENTERS FOR MEDICARE AND
MEDICAID SERVICES TO DISCLOSURE
STATEMENT DESCRIBING AMENDED**



1 Affects De Paul Ventures - San Jose Dialysis, LLC,
2 Debtors and Debtors In
3 Possession.
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**JOINT CHAPTER 11 PLAN OF
LIQUIDATION (DATED JUNE 16, 2020) OF
THE DEBTORS, THE PREPETITION
SECURED CREDITORS, AND THE
COMMITTEE; MEMORANDUM OF POINTS
AND AUTHORITIES IN SUPPORT
THEREOF**

Date: July 2, 2020
Time: 10:00 a.m.
Place: Courtroom 1568
255 E. Temple Street, Los Angeles, CA

8 **TO THE HONORABLE ERNEST M. ROBLES, UNITED STATES BANKRUPTCY JUDGE,**
9 **THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS, THE OFFICE OF THE**
10 **UNITED STATES TRUSTEE, AND OTHER INTERESTED PARTIES:**

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1 The United States, on behalf of the U.S. Department of Health and Human Services (“Dep’t
2 of HHS”) and the Centers for Medicare and Medicaid Services (“CMS”) (collectively, “HHS”),
3 hereby files its Objection to the *Disclosure Statement Describing Amended Joint Chapter 11 Plan of*
4 *Liquidation (Dated June 16, 2020) of the Debtors, the Prepetition Secured Creditors, and the*
5 *Committee* (“Disclosure Statement”) [Docket No. 4880].

6 **MEMORANDUM OF POINTS AND AUTHORITIES**

7 **I. INTRODUCTION AND PROCEDURAL BACKGROUND**

8 On August 31, 2018 (“Petition Date”), the above captioned debtors and debtors in possession
9 (“Debtors”), filed their voluntary petitions for relief under chapter 11 of title 11 of the United States
10 Code (“Bankruptcy Code”). The Debtors’ cases are currently being jointly administered and,
11 pursuant to 11 U.S.C. §§ 1107(a) and 1108, they continue to operate their businesses and manage
12 their affairs as debtors-in-possession.

13 The Disclosure Statement generally describes the comprehensive settlement and compromise
14 between the holders of the Secured 2005 Revenue Bond Claims, the Debtors and the Committee, and
15 for the Plan to become effective in these Chapter 11 Cases immediately after the sale of the Debtors’
16 remaining Hospital assets (as those terms are defined in the Disclosure Statement) (Disclosure
17 Statement at 15.) However, the Disclosure Statement does not describe the status of the proposed
18 transfer of two Medicare Provider Agreements, pursuant to: (a) the Asset Purchase Agreement, dated
19 March 30, 2020 (Docket No. 4360), entered into by and between AHMC
20 Healthcare Inc., a California corporation, as buyer (“AHMC”), and Seton Medical Center (“Seton”)
21 and certain other Debtors, as sellers; and (b) the Asset Purchase Agreement, dated April 3, 2020
22 (“APA”) (Docket No. 4471), entered into by and between Prime Healthcare Services, Inc., as buyer
23 (“Prime”), and St. Francis Medical Center (“St. Francis”) and certain other Debtors, as sellers.

24 In fact, the transfer is the subject of ongoing settlement discussions and negotiations between
25 HHS and the Debtors, as evidenced by various stipulations and orders extending the time to file
26 supplemental briefing and continuing the hearing date thereon. Currently, pursuant to an order
27 approving the parties’ further stipulation entered on June 18, 2020 (Docket No. 4902), the current
28 hearing date on the Medicare Provider Agreements transfer issue is July 15, 2020 at 10:00 a.m.

1 Simply put, the Debtors seek to sell the Medicare Provider Agreements under 11 U.S.C. §
2 363, free and clear of all liens, interests, claims and encumbrances, including successor liability.
3 However, HHS’s position is that the Medicare Provider Agreements may only be assumed and
4 assigned to a successful bidder in conformance with the requirements of 11 U.S.C. § 365. HHS
5 contends that in order to participate in the Medicare program, Debtors must assume the Medicare
6 Provider Agreements, cure all existing defaults and AHMC and Prime must accept assignment of the
7 Medicare Provider Agreements in their entirety, including liability for all amounts due under the
8 Medicare Provider Agreements, as required by the Medicare Statute, 42 U.S.C. § 1395(g)(A) (as
9 further defined and addressed herein). Therefore, HHS’s maintains that the Debtors may not sell,
10 transfer, assume and/or assign the Medicare Provider Agreements unless: (a) the Debtors pay HHS a
11 cure amount, if any, for outstanding Medicare overpayments, subject to further amendment/
12 modification; (b) AHMC and Prime agree to honor all of the Debtors’ obligations under the
13 Medicare Provider Agreements and federal law, including, but not limited to, the obligation to
14 assume liability for any pre-sale Medicare overpayments (including those determined post-closing
15 via audit or otherwise); and (c) cure any and all existing defaults.

16 The Disclosure Statement fails to provide any information, let alone “adequate information”
17 to creditors of this dispute. Accordingly, HHS files this objection because the Disclosure Statement
18 should be denied unless it is amended to describe a proposed resolution of the Medicare Provider
19 Agreement transfer issues and their potential impact upon creditors.

20 **II. HHS’S PROOFS OF CLAIM**

21 On March 20, 2019, HHS filed its general unsecured proofs of claim for Medicare
22 overpayment amounts. Each claim indicated that it was subject to a right of setoff based upon
23 recoupment and setoff of Medicare receivables. *See* St. Francis [Claim No. 3588]; Seton [Claim No.
24 3587]; and St. Vincent Medical [Claim No. 3584] (collectively, the “HHS Claims”). The
25 information presently available to HHS indicates that a final audit must be completed for many of
26 the Debtors’ pre-petition cost-report years, and various cost-reports currently remain open and
27 pending a final audit determination. Therefore, until the Debtors’ cost reports and audits are

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1 completed for all pre-petition periods, HHS will not know the exact amount of its pre-petition claims
2 and reserves the right to amend its proofs of claim accordingly.

3 **III. MEDICARE PROVIDER AGREEMENT STATUTORY AND REGULATORY**
4 **BACKGROUND**

5 As of the Petition Date, the Debtors were parties to Medicare Provider Agreements with the
6 Secretary of HHS, acting through CMS (“Secretary”), under which they receive payment for
7 services provided to Medicare beneficiaries pursuant to Title XVIII of the Social Security Act. *See*
8 42 U.S.C. §§ 1395-1395lll and its implementing regulations (“Medicare Statute”).¹

9 In order to be eligible for reimbursement for services provided to Medicare beneficiaries
10 under Part A of the Medicare program, a health facility, such as a hospital, hospice, skilled nursing
11 facility, or community mental health center must enter into an agreement with the Secretary, called a
12 Health Insurance Benefit Agreement (commonly known as a “Medicare Provider Agreement”). 42
13 U.S.C. § 1395cc; 42 C.F.R. § 400.202 (defining “provider”); *see also* 42 C.F.R. §§ 489.2, 489.3.

14 The transfer of a Medicare Provider Agreement is strictly limited and must be approved by
15 CMS before the transfer is effective. Medicare Provider Agreements may only be assigned upon
16 CMS’s determination that there is a valid “change of ownership.” 42 C.F.R. §§ 489.18, 489.18(c);
17 *United States v. Vernon Home Health, Inc.*, 21 F.3d 693, 696 (5th Cir. 1994), *cert. denied*, 513 U.S.
18 1015 (1994). When an assignment is approved, the new provider becomes subject to all statutory and
19 regulatory terms and conditions under which the Medicare Provider Agreement was originally issued
20 including the original provider’s quality history and adjustment of payments to account for prior
21 overpayments and underpayments. *Vernon*, 21 F. 3d at 696 (citing 42 C.F.R. § 489.18(d)). When
22 CMS approves an assignment, the “new” provider does not have to meet the initial Medicare survey
23 and certification requirements because the “new” provider is merely stepping into the shoes of the
24 “old” provider with the same Medicare Provider Agreement. Importantly, subject to certain
25 requirements, there is no break in Medicare reimbursement for services provided to Medicare

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27 ¹ The Debtors’ Medicare Provider Numbers are as follows: (1) St. Francis: 05-0104; (2) Seton: 05-
28 0289; (3) St. Vincent Medical: 05-0502; and (4) St. Vincent Dialysis: 05-2582.

1 beneficiaries during the change in ownership processing period. *See* CMS Publ. 100-08, Chapter 15,
2 § 15.7.7.1.5.

3 Medicare regulations specifically prohibit the sale or transfer of billing privileges or a
4 Medicare billing number, except pursuant to a valid change of ownership. 42 C.F.R. § 424.550; *see*
5 *also* 42 C.F.R. § 424.535(a)(7) (revocation of Medicare enrollment for knowingly selling Medicare
6 billing number unless exception applies). To obtain CMS approval of a change of ownership of a
7 provider number, the applicant must submit a CMS Form 855A.

8 **IV. THE DISCLOSURE STATEMENT CANNOT BE APPROVED BECAUSE IT DOES**
9 **NOT PROVIDE ADEQUATE INFORMATION REGARDING THE PENDING**
10 **DISPUTE OF THE TRANSFER OF THE MEDICARE PROVIDER AGREEMENTS**

11 The Disclosure Statement also should not be approved because it lacks adequate information.
12 Section 1125(b) of the Bankruptcy Code requires a disclosure statement to provide “adequate
13 information” to be approved. In particular, that statute provides as follows:

14 “An acceptance or rejection of a plan may not be solicited after the
15 commencement of the case under this title from a holder of a claim or
16 interest with respect to such claim or interest, unless, at the time of or
17 before such solicitation, there is transmitted to such holder the plan or a
18 summary of the plan, and a written disclosure statement approved, after
19 notice and a hearing, by the court as containing adequate information. The
20 court may approve a disclosure statement without a valuation of the debtor
21 or an appraisal of the debtor's assets.”

22 11 U.S.C. § 1125(b).

23 “Adequate information” is defined in section 1125(a)(1) of the Bankruptcy Code as:

24 “[I]nformation of a kind, and in sufficient detail, as far as is reasonably
25 practicable in light of the nature and history of the debtor and the
26 condition of the debtor's books and records, including a discussion of the
27 potential material Federal tax consequences of the plan to the debtor, any
28 successor to the debtor, and a hypothetical investor typical of the holders
of claims or interests in the case, that would enable such a hypothetical
investor of the relevant class to make an informed judgment about the
plan, but adequate information need not include such information about
any other possible or proposed plan and in determining whether a
disclosure statement provides adequate information, the court shall
consider the complexity of the case, the benefit of additional information
to creditors and other parties in interest, and the cost of providing
additional information.”

11 U.S.C. § 1125(a).

1 Thus, under section 1125 of the Bankruptcy Code, a disclosure statement must contain
2 adequate information such that a hypothetical reasonable investor may make an informed judgment
3 about acceptance or rejection of a plan. See 11 U.S.C. § 1125(a). Sufficient financial information
4 must be provided so that a creditor can make an informed judgment whether to accept or reject the
5 plan. See *In re McLean Indus., Inc.*, 87 B.R. 830, 834 (Bankr. S.D.N.Y. 1987) (noting that
6 “substantial financial information with respect to the ramifications of any proposed plan will have to
7 be provided to, and digested by, the creditors and other parties in interest in order to arrive at an
8 informed decision concerning the acceptance or rejection of a proposed plan”).

9 As a general rule, a disclosure statement should contain all pertinent information bearing
10 upon the success or failure of the proposals contained in the plan of reorganization and should set
11 forth all material information relating to the risks posed to creditors. See, e.g., *In re Cardinal*
12 *Congregate I*, 121 B.R. 760,765 (Bankr. S.D. Ohio 1990).

13 Here, the Disclosure Statement cannot be approved because it fails to provide adequate
14 information concerning matters that are important to HHS and the Debtors’ creditors in their
15 evaluation of whether to vote for or against the Plan. The issues surrounding the Medicare Provider
16 Agreements transfer dispute must be set forth with enough specificity to enable a reasonable investor
17 to make an informed judgment regarding related assumptions, if any, contained in the Plan.
18 However, the status of the transfer of the Medicare Provider Agreements is not mentioned at all,
19 despite the fact that further governmental approval is necessary before the Medicare Provider
20 Agreements may be transferred to AHMC or Prime. Moreover, no settlement agreements have been
21 reached between HHS and the Debtors, yet the Disclosure Statement fails to provide that status.
22 Accordingly, the Disclosure Statement should be denied for failure to provide sufficient information
23 concerning the potential financial ramifications of the various outcomes of the Medicare Provider
24 Agreements transfer dispute.

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1 **IV. AS OF THE PETITION DATE, THE UNITED STATES' PREPETITION SETOFF**
2 **RIGHTS SECURED THE HHS CLAIMS AGAINST THE DEBTORS.**

3 As stated above, the HHS Claims were filed as general unsecured claims, subject to a right of
4 setoff based upon recoupment and setoff of Medicare receivables. A creditor may set off amounts
5 against payments it otherwise would make to a person in the amount that person owes to the creditor.
6 *See Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 18 (1995) (recognizing the “absurdity of
7 making A pay B when B owes A”). Subject to narrow exceptions, a debtor’s bankruptcy “does not
8 affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose
9 before the commencement of the case under this title against a claim of such creditor against the
10 debtor that arose before the commencement of the
11 case . . .” 11 U.S.C. § 553(a); *see Strumpf*, 516 U.S. at 18.

12 “The doctrine of setoff, as incorporated in Bankruptcy Code section 553, gives a creditor the
13 right ‘to offset a mutual debt owing by such creditor to the debtor,’ provided that both debts arose
14 before commencement of the bankruptcy action and are in fact mutual.” *In re Univ. Med. Ctr.*, 973
15 F.2d 1065, 1079 (3d Cir. 1992) (quoting *In re Davidovich*, 901 F.2d 1533, 1537 (10th Cir. 1990)).
16 *See also 5 Collier on Bankruptcy (Collier)* § 553.01[1] (Alan N. Resnick & Henry J. Sommer eds.,
17 16th ed. rev.)). As of the Petition Date, each of these elements was satisfied. HHS’s Claims arose
18 prior to the Petition Date, and the Debtors had asserted claims against HHS for Medicare services
19 provided prior to the Petition Date. HHS’s and the Debtors’ claims were mutual and both arose
20 under Medicare and the Debtors’ Medicare Provider Agreements.

21 Further, as of the Petition Date, HHS had a right to offset the HHS Claims against any
22 payments for services prior to the Petition Date that the Debtors contend are eligible for
23 reimbursement under Medicare. 42 C.F.R. § 405.371(a) (“Medicare payments to providers and
24 suppliers, as authorized under this subchapter . . . may be . . . (3) [o]ffset or recouped, in whole or in
25 part, by a Medicare contractor if the Medicare contractor or HHS has determined that the provider or
26 supplier to whom payments are to be made has been overpaid”); *see* 42 C.F.R. § 405.373 (describing
27 procedure for offset or recoupment). More generally, the United States enjoys a longstanding

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1 common law right of setoff and may exercise it just like any private entity. *See United States v.*
2 *Munsey Trust Co.*, 332 U.S. 234, 239 (1947).

3 The Bankruptcy Code also recognizes that “[a]n allowed claim of a creditor . . . that is
4 subject to setoff under [Code] section 553 . . . is a secured claim . . . to the extent of the amount
5 subject to setoff . . .” 11 U.S.C. § 506(a)(1). Thus, a creditor’s right of setoff secures the creditor’s
6 claim. “Setoff, in effect, elevates an unsecured claim to secured status, to the extent that the debtor
7 has a mutual, pre-petition claim against the creditor.” *In re Univ. Med. Ctr.*, 973 F.2d at 1079
8 (quoting *Lee v. Schweiker*, 739 F.2d 870, 875 (3d Cir.1984)). Indeed, a creditor holding a right of
9 setoff is said to be “the best secured of creditors” because his “security” is “his own justified refusal
10 to pay.” *United States v. Munsey Trust Co.*, 332 U.S. at 240.

11 The Disclosure Statement fails to include any mention of the HHS Claims or that HHS is a
12 creditor in this case, and it also fails to include the secured nature of the HHS Claims to the extent of
13 its setoff claims. Although HHS is hopeful that it will be able to resolve the HHS Claims through
14 resolution of the Medicare Provider Agreements transfer issue, the Disclosure Statement should
15 make creditors aware of the HHS Claims as secured claims as of the Petition Date to the extent of its
16 setoff rights. Accordingly, the Disclosure Statement should be denied (or amended) for failure to
17 provide sufficient information concerning the secured status of the HHS Claims and the potential
18 impairment of other secured creditors’ claims.

19 **III. RESERVATION OF RIGHTS**

20 The foregoing discussion is not an exhaustive list of the infirmities of the Disclosure
21 Statement. HHS expressly reserves its rights to supplement and amend the Objection, seek discovery
22 with respect to same, and introduce evidence at any hearing to consider confirmation of the Plan,
23 including any amendments thereto.

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1 **IV. CONCLUSION**

2 Based upon the foregoing, HHS respectfully requests that the Court sustain its objection to
3 the Disclosure Statement. HHS further requests all other appropriate relief.

4 Dated: June 23, 2020

Respectfully submitted,

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Attorneys for the United States of America, on behalf
of the U.S. Department of Health and Human Services
and Centers for Medicare and Medicaid Services

PROOF OF SERVICE OF DOCUMENT

I am over the age of 18 and not a party to this bankruptcy case or adversary proceeding. My business address is:
United States Attorney's Office, 300 N. Los Angeles Street, Room 7516, Los Angeles, California 90012

A true and correct copy of the foregoing document entitled **OBJECTION OF THE UNITED STATES, ON BEHALF OF THE U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES AND CENTERS FOR MEDICARE AND MEDICAID SERVICES TO DISCLOSURE STATEMENT DESCRIBING AMENDED JOINT CHAPTER 11 PLAN OF LIQUIDATION (DATED JUNE 16, 2020) OF THE DEBTORS, THE PREPETITION SECURED CREDITORS, AND THE COMMITTEE; MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF** will be served or was served (a) on the judge in chambers in the form and manner required by LBR 5005-2(d); and (b) in the manner stated below:

1. **TO BE SERVED BY THE COURT VIA NOTICE OF ELECTRONIC FILING (NEF):** Pursuant to controlling General Orders and LBR, the foregoing document will be served by the court via NEF and hyperlink to the document. On **June 23, 2020**, I checked the CM/ECF docket for this bankruptcy case or adversary proceeding and determined that the following persons are on the Electronic Mail Notice List to receive NEF transmission at the email addresses stated below:

Service information continued on attached page

2. **SERVED BY UNITED STATES MAIL:**

On **June 23, 2020**, I served the following persons and/or entities at the last known addresses in this bankruptcy case or adversary proceeding by placing a true and correct copy thereof in a sealed envelope in the United States mail, first class, postage prepaid, and addressed as follows. Listing the judge here constitutes a declaration that mailing to the judge will be completed no later than 24 hours after the document is filed.

Service information continued on attached page

3. **SERVED BY PERSONAL DELIVERY, OVERNIGHT MAIL, FACSIMILE TRANSMISSION OR EMAIL** (state method for each person or entity served): Pursuant to F.R.Civ.P. 5 and/or controlling LBR, on **June 23, 2020**, I served the following persons and/or entities by personal delivery, overnight mail service, or (for those who consented in writing to such service method), by facsimile transmission and/or email as follows. Listing the judge here constitutes a declaration that personal delivery on, or overnight mail to, the judge will be completed no later than 24 hours after the document is filed.

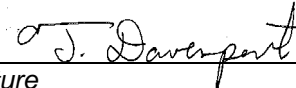
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Service information continued on attached page

I declare under penalty of perjury under the laws of the United States that the foregoing is true and correct.

June 23, 2020
Date

TIFFANY DAVENPORT
Printed Name


Signature

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