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THE BANKRUPTCY BAR ASSOCIATION
Southern District of Florida

Dischargeability of Fines Imposed in Connection with Attorney Discipline

By Grace E. Robson and Timothy R. Bow


Grace E. Robson


Timothy R. Bow

Are fees and costs levied against an attorney by a state disciplinary committee dischargable in bankruptcy? In *The Disciplinary Board of the Supreme Court of Pennsylvania vs. Feingold*,[1] the U.S. Court of Appeals for the Eleventh Circuit answered that question in the negative, holding that a cost judgment imposed as part of an attorney's disciplinary proceeding was non-dischargeable under 11 U.S.C. § 523(a)(7). In doing so, the Court joined an overwhelming majority of courts that have found such cost judgments to be in the nature of a fine or penalty, payable to a governmental unit, and therefore non-dischargeable.

Courts analyzing this issue focus on two components of section 523(a)(7): first, whether a fee or cost judgment is payable to a "governmental unit," and second, whether the fee or cost judgment is in the nature of a "fine, penalty, or forfeiture" and not compensation for an "actual pecuniary loss."

Are disbarment costs payable to a "governmental unit"?

Section 101(27) defines the term "governmental unit" broadly and contains a long list of entities that fall into the definition.[2] While attorney disciplinary committees are not specifically included in the statutory list, the term's legislative history supports a liberal construction and provides that the term be construed in the "broadest sense."[3] Indeed, parties often stipulate that attorney disciplinary committees are governmental units for the purpose of section 523(a)(7).When it has been litigated, courts have almost unanimously held that attorney disciplinary committees that act in a judicial or enforcement capacity are acting as governmental unit for the purpose of determining the dischargeability of the attorney's debt.

The parties in *Feingold* agreed that The Disciplinary Board of the Supreme Court of Pennsylvania was a governmental unit. Likewise, in non-dischargeability cases brought by The Florida Bar, it has also been held that The Florida

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> "If disciplined attorneys file for bankruptcy, they may find that fees and costs levied against them as part of their disciplinary proceedings are not dischargeable."

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And the Hits Just Keep on Coming

By Kit R. Becker

Trustees frequently receive offers to purchase their "right, title and interest" in real property assets of the bankruptcy estate that are subject to secured liens. The Trustee usually receives very little cash for the value of the equity in these properties. For a property that is subject to encumbrances that are in excess of its market value, any cash offer would exceed the trustee's expectation of the estate's share of the proceeds from a sale of the property "free and clear" of encumbrances. While the value is based on the trustee's equity in the property, the sale is actually of the entire property. Bankruptcy Code Section 541 grants the trustee all legal and equitable interests in the debtor's property at the outset of the case. Therefore the transfer by the trustee of "right, title and interest" conveys the entire interest that was previously held by the debtor, not just the equity.

On February 3, 2014, Steven Turner, the Assistant U.S. Trustee for Region 21, advised the panel trustees that if they conduct a sale of any interest of real property, they must ensure that the appropriate documentary stamp tax is collected and paid. Mr. Turner further pointed out that even if the property has negative equity, Florida's Department of Revenue would apply to trustee sales the calculation set forth in the statute and code provisions. The calculation of total consideration for such transfers includes money received, mortgages and other encumbrances,

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THE BANKRUPTCY BAR ASSOCIATION
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Message from the President

By Daniel Gonzalez

Dear Readers,

On behalf of the Board of Directors of the Bankruptcy Bar Association of the Southern District of Florida, I am pleased to present you with this year's Bankruptcy Bar Association Journal. Aside from thanking our contributors and sponsors, I would especially like to thank Editor in Chief, Emily Stone, and her staff who have put together this great edition of the *Journal*.

The BBA has had an exciting year so far. We have co-sponsored numerous events with other bar organizations such as the Dade County Bar Association, the American College of Bankruptcy, the Association of Insolvency and Restructuring Advisors, the Cuban American Bar Association, and the South Florida Chapter of the Association of Corporate Counsel. We have also continued with our successful young lawyers' programs, such as our "Table of 8" dinner series and happy hours. We collected toys at the BBA's annual Holiday Party to benefit the Children's Home Society, hosted courthouse appreciation lunches in all three counties, and held a number of community service events and "Brown Bags" during the course of the last year. In addition, we honored Patricia Redmond for her extraordinary contributions to the BBA, the Bankruptcy Bar Foundation, and the bankruptcy community at a dinner event on March 6th.

If you attended my installation dinner, you will recall that one of my goals as President was to raise funds for the BBA Foundation to ensure the continued success of its *pro bono* initiatives and law school clinical programs for the years to come. I am pleased to report that in conjunction with the March 6th dinner event honoring Ms. Redmond, the BBA Foundation received over $130,000 in pledges for the next five years. I want to thank everyone that made donations and pledges!

In closing, I want to thank everyone who has contributed to the BBA's success over the past year. This is truly a wonderful voluntary bar association, and it has been an honor serving as its President.

Sincerely,
Daniel Gonzalez
President, BBASDFL

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LMM: The Good, The Bad, and The Ugly

By Caroline Lewis

Having recently celebrated its first year of existence on April 1, 2014, the Loss Mitigation Mediation ("LMM") Program in the U.S. Bankruptcy Court for the Southern District of Florida is specifically designed for bankruptcy cases and accounts for the unique circumstances involved therein. Although other loan modification programs exist, the LMM Program, which is administered by our federal judiciary, is tailored to meet the needs of a bankruptcy case and is accordingly far more likely to result in a successful loan modification during a borrower's bankruptcy than any of its state law analogues. While the LMM Program has not yet conquered the myriad challenges that occur after a debtor or lender moves to have the parties participate in LMM, the Program does allow a certain amount of flexibility to better ensure the parties' success. As a result, each LMM proceeding is different despite the fact that the underlying reason behind the commencement of an LMM procedure — usually, a debtor requesting a loan modification — generally remains the same.

> "Even with this good faith mandate, no lender is required to accept a loan modification even if a debtor is clearly able to afford it and challenging such a decision is supremely difficult as the proceedings are confidential."

Further exhibiting the Program's ability to adapt, LMM forms and guidelines were recently amended on December 1, 2013. One such solution was the increasing of the LMM fee. Far too often the lesser amount proved insufficient to adequately account for the tremendous work and effort required to fully complete the LMM process. The reality, however, is that LMM is a process within a bankruptcy proceeding where debtors may barely afford the case fee as it is. The attorney must then make a decision: charge a client potentially more than the client can afford to pay or find themselves providing more representation than anticipated by the flat fee amount. Because attorneys now have greater leeway in setting their LMM-related fees, the issue of cost appears to be among the most easily resolved.

More problematic is the requirement that parties ordered to participate in LMM do so in good faith. The situation becomes particularly difficult when a party, often a lender, indicates its unwillingness to participate in LMM at the outset, but finds itself compelled to participate pursuant to a court order. Although the express language within the standard *Order of Referral to Loss Mitigation Mediation* states the parties must participate in "good faith," a party's actual compliance with the "good faith" requirement is not guaranteed because proof of non-compliance is almost always too costly to pursue.[1]

Even with the good-faith mandate, no lender is required to accept a loan modification even if a debtor is clearly able to afford it. Challenging the lender's decision is supremely difficult as the proceedings are confidential. There is simply no guarantee of success. As a result, the debtor may encounter costly consequences after a failed LMM, including but not limited to curing arrearages incurred while attempting to obtain the modification. The only action available to debtors' counsel in these situations is to have made certain the client was clearly informed of the potential risks and entered into LMM knowingly and willingly in spite of them.

Issues of good faith also arise when a mediation is continued upon the debtor or lender's failure to adequately prepare for the mediation or to provide timely any requested items. Although the Southern District's LMM Program procedures mandate that parties schedule a mediation in advance using a designated online portal, continuation of a mediation occurs far too often. While messages sent during LMM are required to be sent via the portal to promote transparency and open communication between the

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MESSAGE FROM THE CHIEF JUDGE

Report on the Mortgage Modification Summit

By The Honorable Paul G. Hyman

ABOUT THE AUTHOR

The Honorable Paul G. Hyman is Chief Judge of the United States Bankruptcy Court for the Southern District of Florida.

On February 27, 2014, the Middle District of Florida hosted a statewide Chapter 13 Mortgage Modification Mediation Summit in Orlando, Florida. The purpose of the Summit was to provide an open forum for debtors' attorneys, mediators, lenders and chapter 13 trustees to discuss and compare the three mortgage modification mediation programs offered in the Southern, Middle and Northern Districts of Florida, with a focus on what is working well and on possible efficiencies that could be implemented to improve the respective programs.

In preparation for the Summit, our court developed a Mortgage Modification Mediation (MMM) survey that was utilized by all three courts to gauge the successes and failures of each program and to solicit feedback on significant differences between the programs to determine whether there existed a desire to adopt a uniform program throughout the state. The survey results served as a road map for developing the panel discussion topics at the Summit. All bankruptcy judges from the Middle District, Judge Species from the Northern District, and I, as the judicial liaison representative from the Southern District, attended the Summit. After the Summit, the judges met for dinner and agreed to strive for uniformity between the three districts. It was tentatively decided, subject to formal adoption, that:

- MMM should be available in all chapters and for all types of property;
- Motions for MMM should be filed within 90 days of case filing or conversion; motions filed beyond the 90 days will be set for hearing;
- MMM should be concluded within 150 days of the filing or conversion of the case, unless otherwise ordered by the court;
- The address of the subject property and the last four digits of the mortgage loan number should be included in the motion;
- The three districts will work toward a uniform order of referral to MMM;
- Both parties (debtor and lender) should be involved in the mediator selection process;
- Mediator fees should be shared 50/50 between the lender and the debtor;
- The mediator may require an advance deposit of the initial or flat fee component of the mediator's fees;
- Debtors should upload documents to a secure portal before filing the MMM motion;
- The portal should permit access to more than one lender's attorney;
- The parties may communicate outside the portal in any manner;
- A motion for an order approving an MMM agreement should be filed using the respective court's negative notice procedure;
- An order approving an MMM agreement should be recorded by the lender in the public records of the county in which the property that is the subject of the MMM motion is located; and
- The SDFL should join with the other districts in allowing HOA fees to be deducted from the 31% gross income to repayment of any mortgage modification.

> "In preparation for the Summit, our court developed a Mortgage Modification Mediation (MMM) survey that was utilized by all three courts to gauge the successes and failures of each program and to solicit feedback on significant differences between the programs to determine whether there existed a desire to adopt a uniform program throughout the state."

On behalf of the Southern District of Florida, I want to thank Chief Judge Karen Jennemann for her foresight and leadership in creating the MMM summit concept, Middle District of Florida Chapter 13 Trustee, Laurie Weatherford, and the MMM moderator, Liz McLausand, for designing the Summit agenda, and the subject matter panel experts, who did an outstanding job of addressing issues and answering questions raised at the Summit. I think all in attendance would agree that the Summit was a huge success. ■

And the Hits Just Keep on Coming

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whether or not the underlying indebtedness is assumed. He also indicated that the bankruptcy estate could be held liable for the tax even if arrangements had been made for other parties to pay the tax. In sum, the sale by a trustee of his "right, title and interest" is often analyzed as a sale of the equity in the property. The State of Florida's position, however, is that these are sales of the entire interest in the property and that the total consideration includes encumbrances.

The clear meaning of Mr. Turner's advice is that documentary stamp tax paid only on the cash received by the bankruptcy estate could expose the bankruptcy estate to liability that could exceed the benefit of the sale to the estate. However, this is not the only tax problem inherent in selling properties with negative equities that produce very small cash proceeds. There also is an income tax consequence that is often overlooked when the analysis does not include the encumbrances in the total consideration. For federal income tax purposes, selling the "right, title and interest" held by a bankruptcy trustee in a property with negative equity for $10,000, pursuant to Bankruptcy Code Section 363(b), could cause a tax liability to the bankruptcy estate that is far greater than $10,000.

There are several motivations for the buyers of properties with negative equity. These buyers may anticipate an opportunity to rent the property, a hope that the value can be increased with modest improvements, or a belief that the market value will increase if the property can be held for an additional period of time. Such offers are becoming more frequent and trustees are actively soliciting such sales through real estate professionals.

Typically, the trustee will provide a quitclaim deed to make the transfer. Assuming the debtor held good title to the property, that title would have been transferred to the estate upon filing the petition and when that interest was transferred by a quitclaim deed that interest would transfer to the purchaser. The purchaser expects to be the new titleholder and to be able to deal with lien holders and settle any issues regarding title. The basis for income tax purposes for the purchaser is the combined total of cash and the liens on the property. From the perspective of the buyer, this is a purchase of the property subject to any outstanding liens.

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A Health Care Fraud and Bankruptcy Primer

By Soneet Kapila and Melissa Davis

Soneet Kapila

Melissa Davis

Current economic conditions have left the health care industry struggling. Health care fraud also impacts the financial condition of the industry. The inherently highly regulated environment adds to the challenges of any healthcare insolvency proceeding, not to mention the potential of health care fraud adding another dynamic. This has created a highly specialized area within the insolvency practice. This article will discuss types of health care fraud and some of the challenges the insolvency professional will face in health care insolvency matters.

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Health Care Fraud

Health care fraud comes in many shapes and sizes, costing federal, state, and local governments billions of dollars each year. During 2012 the Federal government spent $1.5 billion dollars on health care fraud and abuse activities.[1]

As the largest insurance program in the United States, Medicare is a significant target for fraud. Fraud occurs in the Medicare system at both the provider enrollment stage and at the claims payment stage. Provider fraud includes not only fraudulent or false claims submitted by providers to Medicare for payment, but may also be conducted by parties that unlawfully obtain Medicare provider identification numbers and submit false claims. Acts of fraud committed by insurance companies may include submission of false claims, mismanagement of claims, and failure to pay legitimate claims.

In May 2009, the federal government formed the Health Care Fraud Prevention & Enforcement Action Team ("HEAT") in an effort to curtail health care fraud.[2] HEAT's goal is to marshal government's resources in order to prevent waste, fraud, and abuse in the Medicare programs and crack down on those who abuse the Medicare.[3]

More recently, provisions of The Patient Protection and Affordable Care Act[4] ("PPACA") give the Centers for Medicare & Medicaid Services ("CMS") additional tools to expand efforts to fight fraud.[5] These new rules allow CMS to focus on prevention and detection of fraud before it occurs rather than trying to recover funds from fraudulent acts that have already occurred.

Possible health care fraud has produced several recent bankruptcy and insolvency proceedings with elements of health care fraud:

- **Orlando based Rotech**, a provider of home respiratory products to Medicare subscribers, filed for bankruptcy on April 8, 2013 citing its goal was to cut debt and reorganize.[6] Shortly before the bankruptcy filing government authorities obtained warrants to collect certain billing records in connection with its investigation that may be related to a $6.2 million repayment allegedly related to an overbilling from a computer malfunction that the company disclosed in 2011.[7]
- **Florida ATLS Acquisition, LLC** (Liberty Medical Supply) based in Port St. Lucie, filed for Chapter 11 bankruptcy protection on February 15, 2013.[8] The company cited a dispute with the company's former parent regarding tax liabilities and the assertion of a significant liability for overpayment by Medicare and Medicaid as events that led to the filing.[9]
- **The Federal Bureau of Investigation** raided The Scooter Store headquarters in February 2013 in connection with the Scooter Store's alleged receipt of millions of dollars of Medicare overpayments from 2009 to 2001.[10] The Scooter Store filed for Chapter 11 bankruptcy protection on April 15, 2013 and is in the process of winding down its operations.[11]

Medicare

The Medicare program is a health insurance program that generally provides coverage for Americans sixty-five years of age and older.[12] The program is administered by CMS. It is set up to pay claims quickly, often without verification that the claims were submitted correctly. This system has led to widespread abuse and fraud. In order to receive reimbursement for services provided, health care providers must comply with strict regulations.

Institutional health care providers enter into contracts with CMS known as medical provider agreements. These agreements govern the reimbursement amount that the providers will be given for medical services rendered.[13] Providers are assigned billing numbers that are used to submit their billing statements to CMS. The reimbursement payments Medicare makes to institutional providers are based on billing categories called diagnosis-related groups ("DRGs"). Medicare reimburses providers a pre-determined amount for each service. Doctors, as a general rule, are not encompassed in the DRG reimbursement system.

Medicare provider agreements govern the provider's participation in the Medicare program. CMS administers the medical provider agreements by utilizing Medicare Administrative Contractors ("MACs") or private insurance companies known as fiscal intermediaries.[14] [15] The intermediary essentially serves as the federal government's agent and is responsible for reviewing claims submitted by the providers on a reasonableness of cost basis. The intermediary processes the reimbursements paid to the health care providers by making periodic interim reimbursements payments to the providers based on the estimates.

Cost Reporting

Medicare reimburses institutional providers including hospitals using a prospective payment system. Cost reports are submitted to the

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Case for the Expanded Use of Mediation in Bankruptcy Cases

By James P. S. Leshaw

"Bankruptcy is too expensive, it takes too long, involves too many professionals and the outcome is too uncertain. The bankruptcy laws are complicated, difficult to understand and often make no sense." What bankruptcy professional has not heard this refrain from a client?

The following is a proposal for the expanded use of mediation (which I will call "facilitation") in Chapter 11 cases and complex Chapter 7 cases. First a disclosure: I am now working as a full-time mediator and arbitrator. Some might say (to paraphrase an old cowboy adage) that asking a mediator whether the system needs more mediation is like asking a barber if you need a haircut. I do, however, have twenty-five years of experience working as a bankruptcy lawyer (mostly in complex Chapter 11 cases). I have seen my fair share of cases that have gotten bogged down by warring factions over disputes that should have been resolved quickly or not have been disputes at all, with serious adverse consequences to the overall case, on the amount and timing of distributions to innocent creditors, and on the ability to maintain a viable enterprise for the benefit of employees and suppliers.

"The courts of this country should not be places where resolution of disputes begins. They should be the places where the disputes end after alternative methods of resolving disputes have been considered and tried."[1]

The reality is that most Chapter 11 cases do not have too many professionals (some might dispute this opinion), but rather that there is no professional who is neutral and whose role is to facilitate resolution of disputes for the benefit of all constituencies. The only neutral "parties" in a typical Chapter 11 case who are not hired guns for a particular constituency are the judge and, to a lesser extent, the US Trustee. It is, however, time consuming and expensive to bring disputes before the judge and it is not the job of the US Trustee to help parties resolve their differences.

It is not uncommon for a debtor to seek court approval of one or more neutral parties (typically called mediators) towards the end of a case to help resolve ongoing or threatened litigation—usually avoidance actions. Wouldn't it be helpful to have an experienced professional who is knowledgeable about both the bankruptcy process and the specific facts and issues of the case, whose role it would be to help parties resolve their disputes as they arise during the case in a neutral, confidential, informal and consensual manner, before parties incurred the time and expense of litigation and the uncertainty of bringing a dispute to the judge for resolution?

ABOUT THE AUTHOR

Jim Leshaw is an attorney and mediator in Miami with Leshaw Law where he spends most of his time working as a full-time mediator — helping parties to resolve state and federal litigation.

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"Although there are very few true two-party disputes in a Chapter 11 case, many disputes will have a substantial impact on multiple constituencies."

"An ounce of mediation is worth a pound of litigation" or "Conflict is inevitable but combat is optional"[2]

It is generally accepted that mediation is a highly effective way to resolve disputes. Mediation is loosely defined as use of a neutral third party to help disputants resolve their differences through a formal or informal process. Earmarks of mediation are that mediation is voluntary, the mediator does not have the power to force a given resolution or even any resolution at all, and mediation is generally confidential. The mediation process is flexible and can be done in person or over the telephone. As a general rule, mediation is far less expensive than litigation.

"When elephants fight, it is the grass that suffers"[3]

Bankruptcy is, by definition, a collective process and bankruptcy cases are rarely two-party disputes. Although a cash collateral or DIP financing motion, employee pay dispute, valuation fight, stay relief matter, discovery issue, plan treatment of a particular creditor or class of creditors, or almost any other "contested matter," in theory, might involve only two parties (three if a committee has been appointed), one of which will almost certainly be the debtor, the time, expense and outcome of these disputes will often have a far greater effect on the outcome of a case (defined as what assets are available for distribution to creditors, how quickly those assets will be distributed and whether there will be an ongoing business for the benefit of employees, suppliers and other constituencies) than things such as avoidance actions, which typically are threatened or commenced only at the end of the case. In other words, although there are very few true two-party disputes in a Chapter 11 case, many disputes will have a substantial impact on multiple constituencies.

"You can observe a lot just by watching"[4]

So, why not retain a mediator or facilitator at the commencement of a complex case to help resolve disputes as they arise? Here is a framework for the retention of a neutral problem solver at the commencement of a case.

Who would be retained as facilitator?

The facilitator would be a disinterested person (not firm) experienced with all facets of the bankruptcy process, who has the

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MESSAGE FROM THE CLERK

By Katherine Gould Feldman

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Bankruptcy Case Filing Statistics

For calendar year 2013, Bankruptcy case filings in the Southern District of Florida continued their downward trend to 30,748, a .91% decrease below the 2012 bankruptcy case filing of 31,030. Although our caseload declined in 2013, our court ranked 5th in the nation for bankruptcy filings.

Nationally, there was a 12 percent drop in cases filed in federal bankruptcy courts. During the 12-month period ending December 31, 2013, there were 1,071,932 bankruptcy cases were filed, a decrease from the 1,221,091 bankruptcy cases filed in calendar year 2012. For more information on national bankruptcy filing statistics, visit: http://www.uscourts.gov/Statistics/BankruptcyStatistics/2013-bankruptcy-filings.aspx

Update on Miami Division Move to the C. Clyde Atkins Courthouse

On February 10, 2014, GSA commenced renovation of the clerk's office space in the Atkins Courthouse. This project is on track for completion by the end of the summer and we hope to be moved in before September 30, 2014. The space plan calls for the intake and docketing sections to occupy the former district court clerk's office space on the first floor and our executive offices and IT staff will occupy offices on the 3rd floor. The court will occupy chambers and courtrooms on the 4th floor (Judge Mark), the 7th floor (Judge Cristol) and the 8th floor (Judge Isicoff), and district court magistrates who currently occupy those courtrooms and chambers will be relocated to the James Lawrence King Building. We will keep you posted on further updates as they become available.

Status of Judiciary Budget for Fiscal Year 2014

On January 17, 2014, the House and Senate passed, and the President signed, H.R. 3547, the "Consolidated Appropriations Act of 2014," which provides final fiscal year 2014 funding for the federal government, including the Judiciary. Overall, the Judiciary fared better than expected given this austere budget claimant. The final fiscal year 2014 plan increases the amount of funding by 7.2% over the interim fiscal year plan, and terminates many of the emergency sequestration measures.

While this is an improved financial condition for the courts for the remainder of fiscal year 2014, total court allotments are still significantly below 2012 allotments and are equivalent nationally to fiscal 2008 allotments.

Although bankruptcy court clerk's offices continue to take the brunt of financial plan percentage reductions, the final financial plan reduces salary requirements by only 3.6% instead of the 7.6 % that we anticipated under the interim plan, so our court will not face a budget shortage this year. However, courts are constantly reminded that we must continue to look for new and innovative ways to contain costs and increase efficiencies, in order to deal with future projected budget deficits.

> "Although our caseload declined in 2013, our court ranked 5th in the nation for bankruptcy filings."

Amendments to Federal Bankruptcy Rules, Forms, and Fees

Amendments to federal rules and forms, including amendments to The Federal Rules of Bankruptcy Procedure, Federal Rule of Civil Procedure 45 (which is made applicable in bankruptcy cases by Bankruptcy Rule 9016), Official Bankruptcy Forms and Administrative Office of the U.S. Courts Director's Procedural Forms and the Bankruptcy Court Miscellaneous Fee Schedule were effective December 1, 2013.

In conjunction with the federal rule and form amendments, the court entered Administrative Order 13-2 "Adoption of Certain Interim Local Rules of This Court" and several local forms and other documents have been revised, abrogated, or will remain in effect in lieu of local use of the national version of the form.

Loss Mitigation Mediation

On April 1, 2013, the court adopted a Loss Mitigation Mediation (LMM) Program under Administrative Order 13-01 "Implementation of Loss Mitigation Mediation Program." The program procedures and forms were further revised on December 1, 2013, by publication of a Public Notice re: Amendments to Loss Mitigation Mediation Program. By the close of 2013, 2,723 motions for referral to LMM were filed, 1,972 orders of referral were entered, and 514 final reports of LMM Mediator were filed.

In preparation for the statewide Chapter 13 Mortgage Modification Mediation Summit held on February 27, 2014, in Orlando, the three federal bankruptcy courts in Florida conducted a joint survey on mortgage mitigation mediation programs offered in each of their respective districts. A copy of the response summary can be found at: www.flsb.uscourts.gov/web_folder/mediation/Summary_of_Combined_LMM_Survey_Responses.pdf

Self-Calendaring Expands to Chapter 7 Cases

In January 2014, the court's CM/ECF self-calendaring feature, which is available for scheduling non-emergency matters in all chapter 7 and 13 cases throughout the district, was expanded to chapter 11 cases and adversary proceedings assigned to Judges Hyman and Kimball in the West Palm Beach Division. Please refer to the Guidelines for Self-Calendaring which have been updated to reflect these changes and are posted on the court website.

ECF Training Moves Online

The clerk's office is in the process of developing a CM/ECF Online Training course that we expect to implement on or before October 1, 2014. This is a labor-intensive project composed of a series of electronic learning modules (ELMs) customized for this court which will be available to those seeking to register as Full Attorney and Limited Filers. The support staff in your offices who are involved in the electronic case

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Message from the Clerk

filing process can also take advantage of these on-line tutorials. Each tutorial provides the option for closed captioning and includes a PDF of slide notes. This on-line training will replace the in-person classroom training that has been conducted by the court since we went live on CM/ECF in October 2005.

Digital Audio Recording

In October 2013, the court transitioned to Digital Audio Recording (DAR) in the divisional courtrooms located in Ft. Lauderdale and West Palm Beach. As of October 1, 2013, all court proceedings conducted in these divisions are exclusively digitally recorded and the digital recording constitutes the official record of the court. The Miami division will transition to DAR when the bankruptcy court relocates to the C. Clyde Atkins Federal Building later this yeAar. To request a transcript of proceedings held in Ft. Lauderdale and West Palm Beach, please complete new Local Form "Transcript Request Form," which is posted on the local forms page of the court website. The completed form must be submitted directly to the court transcriber (Ouellette & Mauldin Court Reporters) by email or U.S. mail. The clerk's office will not accept transcript requests. An audio recording of a proceeding can be purchased at a cost of $30.00 for each hearing requested, to do so, complete the new Local Form "Request for Compact Disc (CD) of Audio Recording of Court Proceeding," which is also posted on the court web page. The completed form must be submitted to the clerk's office for processing.

Court Calendar Kiosks

In the coming months, the court will deploy touch screen kiosks outside each of the courtrooms in all three divisions. The kiosks will display that judge's court calendar for the day and will eliminate the need for the courtroom deputy to hang a pre-printed copy of the calendar on a bulletin board outside the courtroom.

CM/ECF Update

- **eFinCert:** One of the federal rule amendments implemented on December 1, 2013, was an amendment to Federal Rule of Bankruptcy Procedure 1007(b)(7), which permits an approved debtor education provider to notify the court directly that the debtor has completed a post-petition instructional course concerning personal financial management. To accommodate this amendment, the court implemented a program that permits approved course providers to electronically file the Certificate of Debtor Education, using the financial management course certificate efiling program (eFinCert) instead of requiring them to register as limited filers in the court's CM/ECF case management system. A link to eFinCert can be located on the court's website.
- **10 MB File Size Increase:** In January 2014, the court increased the data byte file size limit of PDF files from 5MB to 10MB. This increase will reduce the need to split PDF documents into separate PDF files.
- **New Event – Pro Bono Representation of Debtor:** The court implemented a new efiling event "Pro Bono Representation of Debtor [PAPERLESS]" in CM/ECF that will place an entry on the court docket identifying an attorney who is providing pro bono legal services for a debtor. The new paperless event may be entered by the efiling attorney on a voluntary basis when the attorney makes an appearance (filing of a petition or other initial appearance document) on behalf of the debtor, pro bono, in either a bankruptcy or adversary proceeding (sample docket entry below). The event may also be entered in pending cases.

I am proud of what we have accomplished in 2013, and we are grateful for your continued support. As always, I welcome your comments and suggestions on how we can better serve you. ■

And the Hits Just Keep on Coming

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If the trustee believes such sales only create $5,000 or $10,000 of taxable income, he or she would have no reason to reject the offer. The trustee might even believe that since the cash does not exceed the threshold for an income tax return to be filed ($10,000 for 2013) there might be no need to employ an accountant to file such tax returns. If the trustee does not seek assistance from a tax professional to prepare and file the return, there would not be a review of the tax consequences by a qualified tax professional. Unfortunately, as pointed out above, the proper treatment of such transactions for income tax purposes is as a sale of the underlying property with all liens being included in the sales proceeds. For income tax purposes, these are not sales of just the equity. The gain or loss on such sales is the difference between the total consideration including encumbrances and the adjusted tax basis that existed at the time of filing the petition. Frequently in such sales, the tax basis of the equity is assumed to be zero and no inquiry is made to determine the tax basis of the actual property. Gain or loss cannot be calculated until the basis information is determined.

> "For federal income tax purposes, selling the 'right, title and interest' held by a bankruptcy trustee in a property with negative equity for $10,000, pursuant to Bankruptcy Code Section 363(b), could cause a tax liability to the bankruptcy estate that is far greater than $10,000."

To illustrate this point through a Chapter 7 consumer case, a potential investor may offer $10,000 to the trustee for a transfer of his "right, title and interest" to real property listed on the debtor's schedules, without satisfying or removing any liens on the subject real property. Assume the property is a residential rental property with a market value of $400,000 and subject to secured liens of $600,000. The trustee discovers that the debtor acquired the property for $800,000 several years previously and has not used it as his principal residence at any time. The property has depreciated by $90,000. If the property is foreclosed, the trustee knows he will receive nothing, and consequently views the $10,000 as a generous offer which may provide the only distribution to creditors. However, characterizing this sale as a mere transfer of the "right, title and interest" held by the estate and only recognizing $10,000 of income misstates the tax consequences of a sale of the underlying property.

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Dischargeability of Fines Imposed in Connection with Attorney Discipline

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Bar is also a "governmental unit" for the purposes of Section 523(a)(7).[4] Courts in Florida have reasoned that Florida's constitutional framework vests the Supreme Court of Florida with "exclusive jurisdiction to regulate the admission of persons to the practice of law and the discipline of persons admitted."[5] Their reasoning continues that the Supreme Court of Florida then promulgated the Rules Regulating the Florida Bar, which designate the Board of Governors, Grievance Committee, and the Referees as "agencies of the [Florida] Supreme Court."[6] Although in *Feingold*, the Disciplinary Board of the Supreme Court of Pennsylvania was involved, any questioning of this decision's applicability with the Florida Bar's status as a governmental unit has already been answered.

Are disbarment costs in the nature of a "fine or penalty"?

Courts next consider whether disciplinary fees and costs are in the nature of a "fine or "penalty" under 11 U.S.C. § 523(a)(7). Again, the majority of courts addressing the issue have concluded that debts owed by an attorney as a result of disciplinary proceedings are non-dischargeable under § 523(a)(7).

First, according to many courts, the primary purpose for imposing a cost judgment is penal, and not compensatory, "in that an attorney's rehabilitation is encouraged through the condition to reinstatement imposed by the judgment."[7] The "mere fact that a penal sanction is calculated by reference to actual costs does not, in and of itself, transform the penalty into compensation for pecuniary loss."[8] Bolstering this conclusion is the fact that in many instances, the imposition of these costs is discretionary. Courts have concluded that when disciplinary costs are discretionary they function as a sanction rather than as compensation.[9]

In *Feingold*, the Eleventh Circuit found that the Pennsylvania rules regarding attorney discipline and the imposition of disciplinary costs were discretionary.[10] The court noted:

> The Pennsylvania court, in its discretion and in consideration of the circumstances of the particular case before it, may find that the goals furthered by the disciplinary proceedings either do or do not call for the payment of costs by a disciplined attorney. In this way, the imposition of costs is rolled into the overall sanction imposed against an attorney who engages in misconduct. By making the imposition of costs discretionary, the Disciplinary Board has permitted them to be used more like a sanction than like the civil litigation analogue of awarding costs to prevailing parties as a matter of course.[11]

Similarly in Florida, the assessment of costs in an attorney disbarment proceeding in Florida is discretionary.[12] The Supreme Court of Florida has spoken on the issue and held that a discretionary approach should be utilized when awarding costs in attorney disciplinary actions.[13]

In *Kelly v. Robinson*, 479 U.S. 36 (1986), which is often cited as providing an analogous context, the U.S. Supreme Court considered whether a restitution order in a criminal proceeding was dischargeable under 11 U.S.C. § 523(a)(7). The Supreme Court found that section 523(a)(7) creates a "broad exception for all penal sanctions," and concluded that restitution orders were sufficiently penal in nature to fall under section 523(a)(7)'s exception to discharge.[14] After *Kelly*, a number of courts followed the Supreme Court's reasoning and held that cost assessments levied in criminal proceedings are non-dischargeable under section 523(a)(7).

The rationale of *Kelly* and its progeny has been extended and adapted to support the conclusion that debts levied as a result of attorney discipline are non-dischargeable pursuant to section 523(a)(7). For instance, on appeal in *In re Cillo*, the District Court for the Middle District of Florida held that the assessment of costs in an attorney disbarment proceeding closely paralleled costs assessed in criminal proceedings and noted that it would not be a great stretch to compare an assessment of costs in attorney disbarment proceedings to costs assessed in criminal proceedings, nor would the court be alone in this conclusion.[15] Ultimately, the district court affirmed the bankruptcy court and held that a claim by The Florida Bar against a Chapter 7 debtor for costs associated with a proceeding in which the debtor was suspended from the practice of law was non-dischargeable as a claim in the nature of a "fine" or "penalty."[16]

Criminal proceedings can be analogized to attorney disciplinary proceedings because the ultimate goal of both proceedings is to protect the public, deter sanctioned behavior, and rehabilitate the individual.[17] These monetary fines or penalties, whether assessed in an attorney disciplinary proceeding or a criminal proceeding, ultimately promote important state penal and rehabilitative interests.[18] In *Feingold*, the Eleventh Circuit held that it was "persuaded that such cost assessments in attorney disciplinary proceedings are properly viewed as penalties" and noted that "[n]early every other court to have considered this issue has concluded that such cost assessments are fines or penalties within the meaning of § 523(a)(7)."[19]

Second, the money expended by disciplinary committees as they fulfill their governmental function by pursuing disciplinary and remedial actions against attorneys is not an "actual pecuniary loss."[20] The logic is that disciplinary committees will continue to carry out their disciplinary functions regardless of whether or not cost judgments are paid.[21] In a criminal context, the Seventh Circuit's finding in *In re Zarzynski* is informative. In that case, the Seventh Circuit held "[t]here is no county pecuniary loss when the county functions as it should in the furtherance of its public responsibilities…[n]or does the fact that the costs are based on what the county expended in the criminal trial convert the costs into 'compensation for actual pecuniary loss.'"[22]

The minority of courts that find disciplinary costs to be dischargeable almost all do so because the costs assessed in those specific disciplinary proceedings were mandatory and/or compensatory. For example, in *In re Love*, 442 B.R. 868 (Bankr. M.D. Tenn. 2011), the bankruptcy court interpreted Tennessee statutes and rules governing attorney discipline and held that the mandatory assessment of costs against a debtor during disciplinary proceedings was not intended as a fine or penalty but, rather, was compensation for actual pecuniary loss, and was therefore dischargeable. Adopting the *Love* court's analysis, the court in *In re Stasson*, 472 B.R. 748 (Bankr. E.D. Mich. 2012) held that the cost component of an attorney's disciplinary proceeding did not fall within the discharge exception because the disciplinary costs under the Michigan rules were used to fund the pursuit of disciplinary proceedings. As discussed by the Eleventh Circuit in *Feingold*, the fact that a court has discretion to impose costs on a case-by-case basis (versus being a mandatory imposition of costs) is important in determining dischargeability because when the imposition of costs is discretionary, the costs are used as a sanction, as opposed to being awarded as a matter of course.

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Dischargeability of Fines Imposed in Connection with Attorney Discipline

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Conclusion

If disciplined attorneys file for bankruptcy, they may find that fees and costs levied against them as part of their disciplinary proceedings are not dischargeable. However, since the analysis of whether the debt is dischargeable will depend on the statutes and rules of the particular state in which the attorney was disciplined, the disciplined attorney (or counsel for such disciplined attorney), should review the applicable state rules closely. Close attention should be paid to whether the state disciplinary scheme for the assessments of fees and costs is discretionary or mandatory, and also whether it is penal or compensatory in nature. ■

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parties, communication failures continue to exist. At times, parties do not appear for a scheduled mediation as the other participants, including the LMM mediator, sit ready to proceed, only to find it has been for naught.

Other questions of good faith may arise when a lender has already made the decision, for example, to deny a certain type of modification without providing an adequate reason or when a borrower continuously fails to provide current or updated documentation as required by the lender. Both parties have a duty to ensure the process is truly meaningful and this duty continues throughout the duration of the LMM process. However, more commonly encountered by Jean Ryan, a certified LMM mediator and bankruptcy practitioner in the Southern District, is that a lender initially rejects the debtor's request as the borrower's income appears to fail to qualify within the lender's guidelines. Too often the loan modification is rejected because the guidelines do not account for the debtor's ability to pay — specifically in a Chapter 13 bankruptcy case — pursuant to the debtor's Plan, not including other outside potential sources of payment assistance. Ms. Ryan has found that lenders can be difficult to negotiate with by virtue of certain lending restrictions guidelines within which the lender must ever remain "in compliance" and from which the lender cannot deviate. At times there is no way for the debtor to qualify within these guidelines, which may not change or account for the debtor's bankruptcy. Instead of indicating its denial in advance via the portal, the lender often attends mediation solely to relay the making of this determination, thus concluding the mediation in the first few minutes. In these situations, the LMM mediator, a third-party neutral required to facilitate open communication between the parties, may decide to either continue the mediation and not charge if a third mediation occurs or consider this failure as one of the two, one-hour allotted mediations, already limiting the time for mediation before it even truly occurred. This is done even though the LMM mediator has only been paid a flat fee on the basis that two, one-hour mediations will occur. This fee fails to account for a continued third mediation nor does it — in certain cases — adequately reimburse the mediator for his or her constant "supervision" of the parties in the portal, including the extra time and effort necessary to monitor the cases and ensure the parties are communicating as required.

Discussion with Elizabeth McCausland, a certified LMM mediator and bankruptcy practitioner in the Middle and Southern Districts of Florida, and the author's personal experience, confirm that some LMM mediators will not charge or count a "failed" mediation as one of the two, one-hour allotted mediations. This is not required of the LMM mediator and is done purely at the mediator's discretion. Indeed, mediators derive no benefit from doing so. Ms. McCausland's personal practice is not to hold the parties to the one-hour time limit. Instead, she allows two separate mediation sessions to occur without being timed. In light of the difficulties, one positive note in the LMM Program is that it does allow additional hours of mediation to be granted in the event matters cannot be resolved in two hours. Again, while the process is not flawless, the program's provision for further opportunities to negotiate in the face of an initial blanket rejection is a positive development.

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NOTES

[1] 730 F.3d 1268 (11th Cir. 2013).
[2] 11 U.S.C. § 101(27).
[3] H.R.Rep. No. 595, 95th Cong., 1st Sess. 311 (1977), reprinted in 1978 U.S. Code & Cong. News 5787, 6268.
[4] *See In re Cillo*, 159 B.R. 340, 342 (Bankr. M.D. Fla. 1993).
[5] *Id.* (*citing* Art. 5, §15, Fla. Const.).
[6] *Id.* (*citing* R. Regulating Fla. Bar 3-3.1).
[7] *In re Smith*, 317 B.R. 302, 312 (Bankr. D. Md. 2004).
[8] *Id.* (*agreed with by In re Richmond*, 542 F.3d 913 (1st Cir. 2008)).
[9] *In re Bertsche*, 261 B.R. 436, 438 (Bankr. S.D. Ohio 2000).
[10] 730 F.3d at 1274-75.
[11] *Id.*
[12] See Rule 3-7.6(q)(2) and (3), Rules Regulating The Florida Bar.
[13] *The Florida Bar v. Davis*, 419 So.2d 325 (Fla. 1982). *See also The Florida Bar v. Lechtner*, 666 So.2d 892 (Fla. 1996) (holding that the Florida Supreme Court has final discretionary authority to assess costs in attorney disciplinary proceedings).
[14] 479 U.S. at 51.
[15] *In re Cillo*, 165 B.R. 46, 47 (M.D. Fla. 1994).
[16] *Id.*
[17] *In re Smith*, 317 B.R. at 309.
[18] *Id.*
[19] 730 F.3d at 1273.
[20] *Id.*
[21] *Id.*
[22] *In re Zarzynski*, 771 F.2d 304, 306 (7th Cir. 1985).

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experience, expertise and respect necessary to help the parties work towards practical solutions that could benefit the overall case, while permitting the parties to reach mutually acceptable outcomes of their choosing, without judicial resolution of disputes. An experienced facilitator would also be able to contribute ideas or insights based on his or her experience in other cases. Any agreement would, of course, be subject to approval of the bankruptcy court to the extent otherwise required by the Bankruptcy Code or Bankruptcy Rules.

Would parties be required to mediate?

Absolutely not — the parties would not be required to mediate unless the court directed facilitation for a particular dispute. The facilitator would, however, be available as a tool to help parties resolve disputes consensually before the parties spend valuable resources (time and money) preparing an issue for presentation and resolution to the court. Facilitators would get involved only where requested and would not be a mandatory stop on the way to the courthouse.

Would facilitation communications be confidential?

Yes, facilitation communications would be confidential. While the bankruptcy judge may (or may not) be informed that the parties mediated their dispute (successfully or unsuccessfully), all facilitation communications would be privileged as settlement communications pursuant to Federal Rule of Evidence 408 and local rules already enacted in many jurisdictions, including the District of Delaware and the Southern District of New York. It would not be the role of a facilitator to inform the judge who has been naughty or nice, thereby encouraging the use of the facilitator and preserving confidentiality.

Would facilitation be a formal or informal process?

Facilitation of contested matters or other disputes within bankruptcy cases could be formal or informal, depending on the particular circumstance and the desire of the parties. For example, facilitation of a discovery dispute might involve no more than a review of a discovery request and a series of telephone calls with counsel. Facilitation of a perfection or priority issue might involve a slightly more formal process in which counsel provided written documentation and applicable case law to the facilitator, which was followed up by a series of phone calls or meetings. Facilitation of a plan of reorganization might require a more formal process whereas facilitation of the plan treatment of a particular creditor or class of creditors might be less formal. In other words, the facilitation process would be flexible to fit the magnitude and type of dispute at issue. The goal of the facilitation process would always be to help the parties reach a negotiated resolution of the dispute which is acceptable to them and which contains a high likelihood of obtaining bankruptcy court approval to the extent approval is otherwise required, or which will be instrumental in moving the overall case to a successful resolution.

When would a facilitator be retained?

Ideally, a facilitator would be retained at the commencement of a bankruptcy case so that the facilitator's service is available from the outset to help, where requested, resolve issues surrounding first-day motions and second-day motions such as employee pay and benefit issues, professional retention issues, cash collateral issues and DIP financing matters, as well as other appropriate issues that arise throughout the bankruptcy case. The facilitator would not replace the role of the US Trustee but would certainly consider the views and policies of the US Trustee in helping parties reach consensual resolution.

Parties might find it helpful to retain the services of a facilitator before the commencement of the case to help resolve pre-filing or first-day issues with major constituencies, including secured lenders. The facilitator's retention through the bankruptcy case could then be approved and formalized through appropriate court orders.

Wouldn't a facilitator add cost to the bankruptcy process?

An effective facilitator will reduce the overall cost of a complex bankruptcy case, not only for the debtor but for all constituencies. At the same time, an effective facilitator will help to make the bankruptcy process less contentious, reducing the number of disputed matters that need to be resolved by the bankruptcy court, will reduce the uncertainty of outcome that is present whenever a matter is presented to a judge or other person with authority to make a binding decision, and will likely speed up the ultimate resolution of a bankruptcy case while improving outcomes for creditors and other constituencies. Absent extraordinary circumstances, a facilitator will not retain professionals, including his or her own firm.

Why call this person a facilitator rather than a mediator?

I have chosen to refer to this person as a facilitator rather than a mediator because that is the role of the person—to facilitate positive resolutions between parties. Additionally, while mediation can refer to a formal or informal process, most bankruptcy practitioners and judges think of mediation as a more formal process used to resolve adversary proceedings and other distinct pieces of litigation. The facilitation process can be as formal or informal as the parties desire and, as a practical matter, will likely be far less formal than a typical mediation in most instances.

Would use of a facilitator require modification of the Local Rules?

No, use of a facilitator would not require any modifications to the Local Rules, though if use of facilitators becomes widespread within a district, a court might consider amending its local rules, as appropriate. Retention and payment of facilitators would be subject to court oversight and approval like retention of any other court-approved professional in a bankruptcy case.

"Behold the turtle. He makes progress only when he sticks his neck out."[5]

Most experienced bankruptcy professionals will agree that bankruptcy is a highly effective process for reorganizing or liquidating a business, but that disagreements among parties and resulting litigation will often add unnecessarily to the cost of the overall process while reducing the speed, efficiency and desirability of outcome. Use of a facilitator throughout the case could have the effect of improving the process for the benefit of all constituencies. Try it and see if you agree. ■

NOTES

[1] Attributed to Justice Sandra Day O'Connor.
[2] Unknown.
[3] African proverb.
[4] Attributed to Yogi Berra.
[5] My father.

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One aspect of the Program that both Ms. Ryan and Ms. McCausland find advantageous is that the parties are far more *involved*. Compared to state court loan modification proceedings, Ms. Ryan and Ms. McCausland find LMM to be far more effective. The LMM Program certainly does not bring about the typical situation in state court where local counsel are hired solely to attend a mediation with no real incentive for the loan modification to be granted nor to familiarize themselves with the case. Ms. Ryan finds that when involved in LMM, the person reviewing the file and making a determination regarding a potential loan modification is one who has given far more time and attention to the case and who has obtained greater familiarity with the situation. This specific individual is one who can be contacted through the online portal, thus providing a direct avenue of communication. Having this single point of contact provides for a far more meaningful mediation, because it allows the parties to discuss and, hopefully, ultimately resolve case-specific issues.

Ms. McCausland also experiences greatly increased personal attention and involvement with the case upon initiation of LMM where the lender and its counsel are actually "invested" in the case. This investment is an important equalizer in the LMM process, as the parties have a personal stake in the proceeding as per the good faith requirement. If good faith is not exhibited, consequences not limited to the imposition of sanctions may ultimately result. The very language of the *LMM Program Procedures* manual states that the goal of LMM is to "facilitate communication and exchange of information in a confidential setting and encourage the parties to finalize a feasible and beneficial agreement with assistance and supervision of the United States Bankruptcy Court of the Southern District of Florida."[2] As a result, the LMM Program is not shrouded by the same sense of futility that may be found in state court proceedings. While no result is guaranteed, there exists a personalized aspect to LMM that can result in successful loan modifications that would not have been achieved in state court.

Despite its newness, the LMM Program is effective overall and, if the history of similar programs in other federal districts is any guide, will likely grow more successful in the Southern District of Florida over time. For example, since the Middle District of Florida began its own LMM Program in 2010, Ms. McCausland has found LMM success in both outcome and efficiency as the participating attorneys became more familiar with the process. In Orlando alone, over 1500[3] successful loan modifications have been reported, with the number of requests for referral to participation in LMM increasing yearly. As Ms. McCausland stated, "Each of these successful loan modifications is one more debtor and a family who have been able to remain in their home." Importantly, the Southern District's LMM program has proved to be responsive to input from its participants as evidenced by the *Amendments to the LMM Program Procedures* ("Amendments") effective December 1, 2013. One notable change was the allowance of lengthier timeframes and extended deadlines for phases of the LMM process. It is clear by way of these Amendments that the LLM Program recognizes the various obstacles that LMM participants are facing and will adapt as needed.

> "One notable change was the allowing of lengthier timeframes and extended deadlines for phases of the LMM process."

A bit delayed in its implementation, the LMM Program represents the Southern District of Florida's response to the unfortunate inability of many bankrupt debtors to remain in their home by virtue of many lenders' initial unwillingness to consent to a loan modification. While complications remain and the Program remains a work-in-progress, time and continuing input from the bar and bench will flesh out many wrinkles. But even despite its recent birth, the LLM Program has shown an appreciable benefit over its state court analogue and modifications that are attempted by individual borrowers directly with their lenders. In this way, the LMM Program is truly providing a way for debtors to achieve their "fresh start." Despite its imperfections, each time a person remains in his or home, the LMM Program's success and value becomes evident. ■

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[1] *See* LMM-LF-08, page 2.

[2] *See* Loss Mitigation Mediation Program Procedures, p. 1.

[3] An exact number cannot be provided, as successful loan modifications pursuant to LMM are not always reported.

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Fortunately, in this example, the trustee has no tax liability. In fact, there is an ordinary loss on the sale of $100,000. This determination is reached through the following calculation:

Selling Price (Amount of Secured Lien/600,000+Payment for "right, title and interest"/10,000) Less (Cost of 800,000 Less Depreciation of 90,000)=Loss of $100,000

This loss can be carried back to the two preceding tax years and may result in a refund of previously paid income tax by the debtor. The trustee has created an estate of at least $10,000 that may result in a distribution to unsecured creditors. While a desirable result, the outcome is totally unplanned.

A much different outcome would result if the debtor's tax basis in the property is less than the $610,000 secured debt. If the property in the example above has a tax basis of $200,000, the $610,000 realized will result in a gain of $410,000 and a tax liability of over $60,000. With the volatility in the real estate market over the past ten years, it is not uncommon for a bankruptcy estate to include a property that has been refinanced and has a secured lien in excess of the tax basis of the property.

Takeaways

The sale of the estate's "right, title and interest" is a complete sale of the property and not just a transfer of the equity. If the debtor had fee simple title, so does his bankruptcy estate. To the extent that courts enforce the position taken by the U.S. Trustee, the consideration for such sales is not only the cash received, but also includes the amount of any liens that are not satisfied upon closing. It is imperative to have accurate tax basis information to calculate gain or loss for tax purposes. Buyers may have to consider increasing offers for negative equity property in light of the additional transaction costs associated with the sale.

Trustees will need to make sure that appropriate documentary stamp tax is paid for any transfer of interests in real property. Bankruptcy trustees should carefully review the tax liability resulting from the sale of encumbered real property. ■

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fiscal intermediary on an annual basis. Cost reports include data on actual reasonable costs incurred and are used to determine the hospital's DRG rates. The intermediary subsequently reconciles the actual provider costs incurred with the estimated payments already made.16 The intermediary may adjust the amount of allowed claims for various reasons including payment of duplicate claims or payment of a claim at the wrong DRG. This adjustment may result in an overpayment or underpayment.

The False Claims Act prohibits parties from submitting false claims to the government for payment.[17] In order to establish liability a plaintiff must show that defendants (1) made a claim, (2) to the United States government, (3) that is false or fraudulent, (4) knowing of its falsity, and (5) seeking payment from the federal treasury.[18] Submission of costs reports or claims containing false or inaccurate data may result in an overpayment to the institutional provider. If the government determines that a false claim was submitted, Medicare reimbursement payments can be suspended, forcing the provider into bankruptcy.[19]

PPACA amends the Social Security Act for a variety of provisions related to Medicare. Under Section 6402 of the PPACPA, an overpayment must be returned to the Secretary of Health and Human Services with sixty days of when the overpayment was identified.[20]

Recoupment and Offset in Bankruptcy

If an intermediary determines that a provider is subject to an insolvency proceeding either in Federal or State court, the intermediary will adjust the payments made to that provider to ensure that the provider is not overpaid.21 Given the potential impact on cash flow, an institutional health care provider entering into bankruptcy must be aware of any potential overpayments due to Medicare. The government has a right to recover the overpayment and this will have an impact on the provider's continuing cash flow requirements. The government can recover overpayments by either setoff or recoupment.[22]

The ability of one party to offset mutual debt between a creditor and a debtor is discussed in §553(a) of the Bankruptcy Code.[23] A creditor may assert a right to setoff when both the claim and the debt arose before the commencement of the bankruptcy case. A creditor with a setoff right may be considered a secured creditor up to the amount of the setoff.[24]

Recoupment allows a creditor to reduce its pre-petition claim against a debtor by recouping from a post petition amount owed by the creditor to the debtor.[25] Recoupment can only occur if the debts arise out of the same transaction or contract. The initial obligation and the later right to reduce that obligation do not need to arise before the commencement of the bankruptcy case.[26]

The distinction between setoff and recoupment is two-fold. Setoff may only involve pre-petition obligations; recoupment may involve pre and post-petition obligations. Setoff may involve unrelated debts; recoupment must involve related transactions. For example, Medicare may attempt to recoup an overpayment that arose pre-petition from a Debtor's post-petition interim payments if the overpayment and current payment stream are governed by the same contract. Setoff, on the other hand, may occur on unrelated debts but the transactions must occur pre-petition. For example, a creditor may reduce an amount due to a debtor for a pre-petition obligation by the pre-petition amount due from the debtor to the creditor for an unrelated obligation.

The majority of case law favors the government's ability to recoup overpayments of Medicare reimbursements from health care providers in bankruptcy. When the government exercises its right to recoupment, the effect reduces the debtors' current revenues to offset previous overpayments. Unfortunately, this poses a major hurdle for a future purchaser of the healthcare business, due to the successor liability based on recoupment.

Transfer of Medicare Provider Agreements

When a health care provider undergoes a change of ownership (commonly referred to as "CHOW") outside of bankruptcy, its Medicare provider agreement is assigned to the new owner and all of the assets and liabilities associated with that agreement are transferred to the new owner. This means that the new owner assumes any obligations to repay overpayments.

Bankruptcy courts have generally interpreted that Medicare provider agreements are considered executory contracts.[27] However, an issue arises as to whether or not a heath care provider is able to assign its provider agreement free and clear of any liabilities associated with the agreement, or if the agreement is even an executory contract. If it is considered the latter, the party assuming the agreement, either the debtor or a third party purchaser, would also assume any liabilities associated with the Medicare provider agreement, and accordingly, need to "cure" any deficiencies.

Some courts have found that Medicare provider agreements are not typical contracts and are simply form documents that recite Medicare regulations.[28 29]

Medicare Health Maintenance Organizations ("HMO's")

Health Maintenance Organizations provide managed care for health insurance and act as liaisons with health care providers on a prepaid basis. An HMO generally covers services rendered by doctors who have contracted with the HMO to treat patients in accordance with its guidelines and restrictions, in exchange for a steady stream of customers.

Medicare HMO's sell Medicare Advantage Plans whereby CMS makes direct payments to approved Medicare HMO's. Every month the HMO receives a set amount from CMS for every Medicare patient who is an enrolled subscriber to the HMO. The sums received by the HMO are stipulated amounts for Medicare beneficiaries only.

In 2000, CMS implemented a risk adjustment program known as Medicare risk adjustments ("MRA") in an effort to pay the contracted HMO an additional capitation that covers the cost of the increased expenses related to that particular member. The MRA is akin to a premium and is paid in addition to the standard capitation rate. The higher the adjustment levels, the higher the risk score, and the higher the risk score the higher the capitation rate. The members scores are periodically adjusted based on information submitted by the patients' doctors.

Clearly the MRA program offers an opportunity to overstate the clinical data. An HMO may be motivated to overstate the MRA and submit clinical data representing more serious medical needs of patients to increase the amount of risk factors thereby increasing the risk score which result in a higher reimbursement by Medicare. If MRAs are abused and not billed correctly, this can result in an overpayment by Medicare to a Medicare HMO for a capitation payment.

State regulatory agencies invariably act as receivers for insolvent HMO's. When such HMO's are part of a conglomerate, where a parent company may be in bankruptcy, there may be some jurisdictional tension between the applicability of bankruptcy and state laws.

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Some Attempts to Regulate and Prevent Fraud

1. Health Insurance Portability and Accountability Act of 1996 ("HIPPA")[30]

HIPPA established several criminal statutes related to health care fraud and made it illegal for anyone to knowingly and willfully carry out a scheme to defraud any health care benefit program.[31] HIPPA requires the Department of Health and Human Services to regulate the privacy and security of health care information. The regulations have imposed extensive administrative requirements and restrictions on the use and disclosure of health information. Violations of HIPPA may result in civil and criminal penalties.[32]

When health care providers file for bankruptcy, many of the creditors may be patients and thus HIPPA regulations will apply. A high degree of care must be taken to protect patient records. In some cases, it may be appropriate for a patient ombudsman to be appointed if active patient care is ongoing. 11U.S.C. §333(a)(1) of the Bankruptcy Code generally states that the court shall order the appointment of an ombudsman in health care business bankruptcy proceedings to represent the interests of the patients of the health care business.[33]

2. Anti-Kickback Statute[34]

The Anti-Kickback Statute was enacted to deter referral fees amongst health care professionals that are Medicare providers. The statute prohibits anyone to knowingly and willfully offer to pay or receive any consideration to induce, either directly or indirectly, the referral of any good or service that is reimbursable with federal money.[35]

3. The Stark Law[36]

The Stark Law prohibits physicians from referring Medicare or Medicaid patients for services that are covered under the programs to an entity that is owned or controlled by the referring physician, also known as the Physician Self Referring Act. The statute prohibits referrals if a physician or a family member has a financial relationship with the entity to which a patient is being referred. A financial relationship includes an ownership or investment interest in the entity or a compensation arrangement between the physician and the entity.

Conclusion

Health care fraud costs federal and state governments billions of dollars each year. It is obvious that a combination of the reimbursement regulations, HIPPA laws, and the advent of reimbursement abuse and health care frauds lends itself to an intricate web in handling bankruptcy and state court insolvency proceedings involving health care providers. Although recent legislation enacted will result in criminal proceedings for those that commit health care fraud schemes, detection and education is imperative to prevent health care fraud schemes from occurring at the onset. The specialized insolvency issues in health care bankruptcy matters create a need for specialized skills and expertise to add value to these proceedings. ■

NOTES

[1] The Department of Health and Human Services and The Department of Justice Health Care Fraud and Abuse Control Program. *Annual Report for Fiscal Year 2012*; Page 97

[2] www.stopmedicarefraud.gov/aboutfraud/heattaskforce

[3] *Id.*

[4] *Public Law 111-148 Patient Protection and Affordable Care Act.*

[5] http://www.cms.gov/Outreach-and education/Outreach/Partnerships/downloads/BackgrounderFraudPreventionInitiative.pdf.

[6] http://www.dailyfinance.com/2013/03/15/rotech-healthcare-reaches-agreement-in-principle-w/.

[7] *Id.*

[8] http://www.palmbeachpost.com/news/business/liberty-medical-supply-files-chapter-11-bankruptcy/nWQPZ/.

[9] *Id.*

[10] http://www.mysanantonio.com/news/local_news/article/FBI-executes-search-warrant-at-The-Scooter-Store-4293619.php.

[11] http://www.cbsnews.com/news/the-scooter-store-shutting-down-after-federal-scrutiny-cbs-probe/.

[12] Medicare may also provide coverage for individuals with disabilities.

[13] Medicare Part A providers include institutions such as hospitals and skilled nursing facilities. Part B providers include physicians and other professionals. Part B providers are paid on a fee for service basis in the Medicare program.

[14] Prior to 2006, Medicare used private insurance companies known as fiscal intermediaries for this process.

[15] Leslie Ann Berkoff, Timothy Lupinacci, Clifford Zucker, and Bobby Guy, Abi Health Care Insolvency Manual 376 (Virginia: American Bankruptcy Institute 2013).

[16] *Id.* at 420

[17] 31 U.S.C. § 3729

[18] *Id.*

[19] Berkoff, *supra* note 15, at 292.

[20] Patient Protection and Affordable Care Act §6402.

[21] 42 CFR §413.64.

[22] Berkoff, *supra* note 15, at 420.

[23] 11 U.S.C. §553

[24] 11 U.S.C. §506(a)

[25] Berkoff, *supra* note 15, at 432.

[26] Ted A. Berkowitz and Veronique A. Urban, Medicare Issues in Bankruptcies, *AM. BANKR. INST.* J., Aug. 2012

[27] *Id.*

[28] *Id.*

[29] *In re Maximum Care Home Health Agency v. HCFA*, 1998 WL 901642, at *5 (N.D. Tex. 1998).

[30] Public Law 104-191 104th Congress

[31] *18 U.S.C. §1347*

[32] *42 U.S.C. §1320a-7b.*

[33] There is an exception if the court finds that appointment of such an ombudsman is not necessary.

[34] *42 U.S.C. §1320a-7b*

[35] *Id.*

[36] 42 U.S.C. §1395nn

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