United States Bankruptcy Court
District of New Mexico

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW MEXICO

In re:
ALLIANCE HOSPITAL OF SANTA TERESA,
Debtor. No. 11-98-12111 SL

ALLIANCE HOSPITAL OF SANTA TERESA,
Plaintiff,
v. Adv. No. 99-1140 S

NEW MEXICO HUMAN SERVICES DEPT.,
Defendant.

PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW ON DEFENDANT'S MOTION TO DISMISS OR ABSTAIN

This matter came before the Court for hearing on the Motion to Dismiss or for Abstention filed by Defendant New Mexico Human Services Department ("HSD"). HSD appeared through its attorneys Gail Gottlieb and SuAnn Hendren. Plaintiff Alliance Hospital of Santa Teresa ("Alliance") appeared through its attorney James Brewer. These proposed findings of fact and conclusions of law are submitted to the United States District Court pursuant to Federal Bankruptcy Rule 9033.[1]

PROPOSED FACTS

1. Alliance is an adolescent psychiatric hospital located in Santa Teresa, New Mexico.

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[1] Pursuant to Federal Bankruptcy Rule 9033(b), parties must serve and file written objections to these Proposed Findings of Fact and Conclusions of Law within 10 days after being served with this document.

2. HSD is an agency of the State of New Mexico and has the jurisdiction to regulate health related matters within the state, including the Medicaid program[2].
3. Alliance is an approved Medicaid provider.
4. HSD reimburses providers different compensation rates for patients in psychiatric facilities depending on whether the patient is in "acute care" or in "days awaiting placement" ("DAP") status. Patients that do not need or no longer need the more extensive acute care, but have not yet been transferred to facilities that offer a lower level of care are considered to be in DAP. HSD reimburses for DAP at a lower rate than for acute care.
5. Under the regulations, providers receive interim payments during the year that are subject to approval of a cost report at year end. HSD audits the cost report and determines any amount due to or from the provider and sends a Notice of Program Reimbursement to the provider.
6. Alliance filed its Chapter 11 petition on April 3, 1998.
7. On August 25, 1998, HSD filed a proof of claim in Alliance's bankruptcy proceeding for "overpayment for

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[2] The Medicaid Act requires participating states to designate or establish a state agency to administer the state's Medicaid plan. 42 U.S.C. § 1396a(a)(5). In New Mexico, the HSD is that single agency. See Medicaid Provider Act, § 27-11-1 to -5 NMSA 1978.

services allegedly rendered to medicaid recipients" for the time period of December 9, 1994 to October 25, 1995, in the amount of $306,906.21. Attachments to the proof of claim indicate that the Medicaid Program made reimbursement to Alliance for claims submitted for inpatient services at the rate allowed for acute days instead of the rate allowed for days awaiting placement.

8. Alliance's monetary claim against HSD is from alleged underpayments from the years 1995, 1996 and 1997, and an alleged embezzlement loss in 1996. Alliance also seeks a declaratory judgment that HSD's regulation which resulted in the alleged underpayments is in violation of federal law.

9. HSD has moved to dismiss the complaint or abstain alleging 1) Eleventh Amendment immunity[3], 2) lack of

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[3] The Eleventh Amendment to the United States Constitution provides:

> The Judicial Power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

U.S. Const. amend. XI. The amendment also bars suits against a state initiated by that state's own citizens, Florida Association of Rehabilitation Facilities, Inc. v. State of Florida Department of Health and Rehabilitative Services, 225 F.3d 1208, 1219 (11th Cir. 2000)(citing Edelman v. Jordan, 415 U.S. 651, 663 (1974)), as does the federal structure of the republic. Hans v. Louisiana, 134 U.S. 1 (1890).

jurisdiction over HSD’s legislative process, 3) failure to exhaust administrative remedies, 4) Burford and Pullman abstention, and 5) failure to state a claim.

10. The parties stipulated at the hearing that Alliance had not exhausted its administrative remedies.

11. The parties stipulated at the hearing that the filing of the proof of claim was properly authorized.

12. Exhibits 10, 12 and 14 are Notices of Program Reimbursement (dated July 6, 1998, June 30, 1998, and July 6, 1998) that resulted from audits of Alliance for fiscal years ending June 30, 1995, 1996 and 1997 respectively. The 1995 Notice indicated $292,242 due to Alliance. The 1996 and 1997 Notices indicated amounts of $336,275 and $544,491 due to HSD. Exhibits 11, 13 and 15 are written Requests for Reconsideration of the 1995, 1996 and 1997 audits (dated August 5, 1998, July 29, 1998, and August 5, 1998). Each of these Requests contends that the DAP payment provisions are contrary to 42 U.S.C. § 1396a(a)(13)(A), the Boren Amendment[4]. Exhibits 16, 17 and 18 are written responses dated

[4] See Kansas Health Care Association, Inc. v. Kansas Department of Social and rehabilitation Services, 31 F.3d 1536, 1539 n.3 (10th Cir. 1994) for a brief discussion of the Boren Amendment.

September 2, 1998, from the New Mexico Medicaid Audit Contractor to HSD regarding the Requests for Reconsideration for 1995, 1996 and 1997. These responses state that the adjustments proposed in the audits were proper and in accordance with HSD regulations.

13. The Requests for Reconsideration did not go through the entire reconsideration process. The parties commenced settlement discussions regarding the 1995, 1996 and 1997 Notices and Requests for Reconsideration. The parties eventually did settle, but reserved the issue of the DAP rate.
14. There is no evidence in the record that the audit agent's responses, Exhibits 16, 17 and 18, were forwarded to Alliance or, if they were, on what date.
15. HSD could and would complete the administrative appeals process timely by complying with the regulations' timelines.

PROPOSED CONCLUSIONS OF LAW

When deciding a motion to dismiss, all well-pleaded factual allegations in the complaint are accepted as true and viewed in the light most favorable to the nonmoving party. Sutton v. Utah State School for the Deaf and Blind, 173 F.3d 1226, 1236 (10th Cir. 1999)(citation omitted.) "A 12(b)(6)

motion should not be granted 'unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.'" Id. (quoting Conley v. Gibson, 335 U.S. 41, 45-46 (1957)). "The court's function on a Rule 12(b)(6) motion is not to weigh potential evidence that the parties might present at trial, but to assess whether the plaintiff's complaint alone is legally sufficient to state a claim for which relief may be granted." Id. (quoting Miller v. Glanz, 948 F.2d 1562, 1565 (10th Cir. 1991)).

1. BANKRUPTCY COURT JURISDICTION

Bankruptcy Court jurisdiction is established by 28 U.S.C. § 1334, which lists four types of matters over which the district court has bankruptcy jurisdiction: 1) cases "under" title 11 (which are the bankruptcy cases themselves, initiated by the filing of a Chapter 7, Chapter 11, etc. petition), 2) proceedings "arising under" title 11 (such as a preference recovery action under §547), 3) proceedings "arising in" a case under title 11 (such as plan confirmation), and 4) proceedings "related to" a case under title 11 (such as a collection action against a third party). Wood v. Wood (In re Wood), 825 F.2d 90, 92 (5th Cir. 1987). In the District of New Mexico, all four types have been referred to the bankruptcy

court. See 28 U.S.C. § 157(a); Administrative Order, Misc. No. 84-0324 (D. N.M. March 19, 1992).

Jurisdiction is then further broken down by 28 U.S.C. § 157, which grants full judicial power to bankruptcy courts not only over cases "under" title 11 but also over "core" proceedings, §157(b)(1), but grants only limited judicial power over "related" or "non-core" proceedings, §157(c)(1). Wood, 825 F.2d at 91; Personette v. Kennedy (In re Midgard Corporation), 204 B.R. 764, 771 (10th Cir. B.A.P. 1997). This core/non-core distinction is important, because it defines the extent of the Bankruptcy Court's jurisdiction and the standard by which the District Court reviews the factual findings. Halper v. Halper, 164 F.3d 830, 836 (3rd Cir. 1999).

"Core" proceedings are matters "arising under" and "arising in" cases under title 11. Wood, 825 F.2d at 96; Midgard, 204 B.R. at 771. Matters "arise under" title 11 if they involve a cause of action created or determined by a statutory provision of title 11. Wood, 825 F.2d at 96; Midgard, 204 B.R. at 771. Matters "arise in" a bankruptcy if they concern the administration of the bankruptcy case and have no existence outside of the bankruptcy. Wood, 825 F.2d at 97; Midgard, 204 B.R. at 771. Bankruptcy judges may hear and determine core proceedings and enter final orders and

judgments. 28 U.S.C. § 157(b)(1). 28 U.S.C. § 157(b)(2) contains a nonexclusive list of 15 types of core proceedings.

"Non-core" proceedings are those that do not depend on the bankruptcy laws for their existence and that could proceed in another court even in the absence of bankruptcy. Wood, 825 F.2d at 96; Midgard, 204 B.R. at 771. "Proceedings 'related to' the bankruptcy include (1) causes of action owned by the debtor which become property of the estate pursuant to 11 U.S.C. § 541, and (2) suits between third parties which have an effect on the bankruptcy estate." Celotex Corporation v. Edwards, 514 U.S. 300, 307 n.5 (1995).

Bankruptcy courts have jurisdiction over non-core proceedings if they are at least "related to" a case under title 11. 28 U.S.C. § 157(c)(1)("A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11.") However, unless all parties consent otherwise, 28 U.S.C. § 157(c)(2), bankruptcy judges do not enter final orders or judgments in non-core proceedings.[5] Rather, they submit proposed findings

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[5] Paragraph 1 of the Complaint recites in part that "This adversary proceeding is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(F)." HSD, in ¶9 of its Motion to Dismiss or to Abstain, doc. 6, states "This is not a core proceeding, and HSD does not consent to the entry of final orders or judgments by the Bankruptcy Court." Section 157(b)(2)(F) deals with preference actions, not at issue in this case. The

of fact and conclusions of law to the district court, which enters final orders and judgments after de novo review. 28 U.S.C. § 157(c)(1); Federal Bankruptcy Rule 9033. See also Orion Pictures Corporation v. Showtime Networks, Inc. (In re Orion Pictures Corporation), 4 F.3d 1095, 1100-01 (2nd Cir. 1993)(discussing Section 157's classification scheme).

28 U.S.C. § 157(b)(2) gives a nonexclusive list of 15 "core proceedings." The fact that a matter is listed among the "core proceedings" of 28 U.S.C. § 157(b)(2) cannot end the inquiry, however. In Northern Pipeline Construction Co. v. Marathon Pipe Line Company, 458 U.S. 50, 76 (1982), the United States Supreme Court ruled that Article III of the Constitution "bars Congress from establishing legislative courts to exercise jurisdiction over all matters related to those arising under the bankruptcy laws." In Marathon, the debtor sought damages for alleged breaches of contract and warranty, misrepresentation, coercion, and duress. Id. at 56. The Supreme Court distinguished this adjudication of "state-created private rights" from the "restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power." Id. at 71. The Court found that the broad

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Court will treat Plaintiff's reference as one to 157(b)(2) in general.

grant of jurisdiction to the bankruptcy courts found in 28 U.S.C. § 1471 (1976 ed., Supp.IV) was unconstitutional because it "impermissibly removed most, if not all, of the 'essential attributes of the judicial power' from the Art. III district court" and vested those attributes in the bankruptcy court. Id. at 87. Congress responded with the current jurisdictional scheme which categorizes matters as either core or non-core. Any determination by the Bankruptcy Court of the core status of a matter should be done with the dictates of Marathon in mind. See Adams v. Grand Traverse Band of Ottawa and Chippewa Indians Economic Development Authority (In re Adams), 133 B.R. 191, 196 (Bankr. W.D. Mi. 1991)("[Section] 157(b)(2)(A) [matters concerning the administration of the estate] was not meant to confer core status on all proceedings having some effect on the estate. If that was the intent behind § 157(b)(2)(A), then there would be no distinction between 'related to' and 'core' proceedings.")

The Court of Appeals for the Tenth Circuit has not specifically addressed the treatment of cases when they involve both core and noncore matters. In Halper v. Halper, 164 F.3d 830, the Court of Appeals for the Third Circuit addressed this issue. Some Bankruptcy Courts determine the extent of their jurisdiction on a claim by claim basis. Id.

at 838. Others look to whether the core aspects heavily predominate the whole case, and if they do then they treat the entire proceeding as core. Id. at 839. The Halper court adopted the claim-by-claim approach as "the only one consistent with the teachings of Marathon [Northern Pipeline Construction Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982)]". Id. See also Hudgins v. Shah (In re Systems Engineering & Energy Management Associates, Inc.), 252 B.R. 635, 643 n. 3 & 4 (Bankr. E.D. Va. 2000)(listing cases that have applied the predominant approach and the claim-by-claim approach, and adopting the latter.) This Court also believes that the claim-by-claim approach is most consistent with Marathon. Therefore, the next step is to apply the core/non-core tests to each count of the complaint.

Before determining whether each count is core, however, the Court must address Alliance's claim that because all of its counts are brought as a counterclaim to a proof of claim, by definition each count is core under 28 U.S.C. § 157(b)(2)(C).[6] The Court does not read 28 U.S.C. §

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[6] Core proceedings include ... (C) counterclaims by the estate against persons filing claims against the estate. 28 U.S.C. § 157(b)(2)(C). (Emphasis added.)

157(b)(2)(C) so broadly.[7] 28 U.S.C. § 157(b)(1) says that Bankruptcy Courts "may hear and determine all cases under

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[7] HSD also argues that it is not a "person" pursuant to 11 U.S.C. § 101(41), so 28 U.S.C. § 157(b)(2)(C) does not apply. This appears correct. Compare 65 B.R. 278, 279 (Bankr. S.D. Fl. 1986)(Government unit not a "person" and therefore ineligible to serve on unsecured creditors committee pursuant to 11 U.S.C. § 1102(b)(1).) See also 1 U.S.C. § 1 ("In determining the meaning of any Act of Congress, unless the context indicates otherwise- ... the words "person" and "whoever" includes corporations, companies, associations, firms, partnerships, societies and joint stock companies, as well as individuals." I.e., not government.); United States v. United Mine Workers of America, 330 U.S. 258, 275 (1947)(The absence of any provision in 1 U.S.C. 1 extending the term "person" to sovereign governments implies that Congress did not desire the term to extend to them.)

When Congress intends to include a governmental agency within the definition of person, it does so explicitly. See e.g., 49 U.S.C. § 40102(a)(33) ("'person', in addition to its meaning under section 1 of title 1, includes a governmental authority..."); 49 U.S.C. § 60101(a)(17) ("'person', in addition to its meaning under section 1 of title 1 (except as to societies), includes a State, a municipality..."); Vermont Agency of Natural Resources v. United States ex rel. Stevens, 529 U.S. 765, 783-84 (2000)(31 U.S.C. § 3733 defines person "for the purposes of this section" to include states. 31 U.S.C. § 3729 lacks the definitional section, suggesting that states are not "persons" for the purposes of that section.)

Furthermore, in common usage the term "person" does not include the sovereign, and statutes employing the word "person" are ordinarily construed to exclude it. Will v. Michigan Dept. of State Police, 491 U.S. 58, 64 (1989). If Congress intends to alter the constitutional balance between the states and the federal government, it must make its intention "unmistakably clear in the language of the statute." Id. at 65 (quoting Atascadero State Hospital v. Scanlon, 4873 U.S. 234, 242 (1985)).

Why Congress apparently decided that a counterclaim asserted against a governmental unit should not be treated as a core proceeding is not necessary to explore in this decision.

title 11 and all core proceedings arising under title 11, or arising in a case under title 11 ..." (Emphasis added.) Section 157(b)(1) limits the Bankruptcy Court to entering final orders in matters "arising under" or "arising in". See Intellitek Computer Corporation v. Kollmorgen Corporation (In re Nanodata Computer Corporation), 74 B.R. 766, 769 (W.D. N.Y. 1987)("[L]isted categories [in 157(b)(2)] must be read in light of the definition of core proceedings in subsection 157(b)(1).") See also 1 Norton Bankr. L. & Prac. 2d § 4.30 (West 2000):

> If a debtor's or trustee's counterclaim involves the assertion of a claim based upon a traditional state law contract claim, then the counterclaim should be treated as a 'related to' proceeding. Absent consent of the parties, such a counterclaim should be determined by an Article III judge at its final order stage in order to avoid the interdiction of Article III and Northern Pipeline.

To adopt Alliance's argument that all counterclaims must be core proceedings would short circuit the holding in Marathon by allowing the Bankruptcy Courts to enter final judgments in, for example, breach of contract cases asserted as counterclaims. See also Burger King Corporation v. B-K of Kansas, Inc., 64 B.R. 728, 732 (D. Ks. 1986)("This court strongly questions whether a non-Code federal law claim can avoid the dictates of the Marathon case simply by being

brought as a counterclaim."); In re Nanodata Computer Corporation), 74 B.R. at 771:

> The crux of the matter which should not be forgotten is that bankruptcy jurisdiction as such is not intended as a method of bringing state claims into a federal forum. Rather, and recognizing the significant interplay between state law and bankruptcy issues, federal courts acting in the bankruptcy context should deal with state law only to the extent such is necessarily and directly implicated by the bankruptcy issues.

(Emphasis in original). Compare Republic Reader's Service, Inc. v. Magazine Service Bureau, Inc. (In re Republic Reader's Service, Inc.), 81 B.R. 422, 427-28 (Bankr. S.D. Tx. 1987)(Court should not construe every attempted recovery of a money judgment by a debtor-in-possession as a core proceeding.)

The complaint in this case seeks A) to recover damages for breach of contract for time periods predating the bankruptcy, B) alternatively, to recover in quantum meruit for services it provided for time periods predating the bankruptcy, C) for a declaration that HSD has failed to comply with the Boren Amendment[8], 42 U.S.C. § 1396a(a)(13)(A), a

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[8] The Boren Amendment was repealed effective October 1, 1997. See Balanced Budget Act of 1997, Pub.L. 105-33, § 4711(a)(1), 111 Stat. 251, 507-08 (1997). The legislation explicitly states that the repeal has only prospective effect and that Boren Amendment rate standards continue to apply to payment for items and services provided on or before October 1, 1997. Pub.L. 105-33, § 4711(d). Florida Association of

declaration[9] of the proper procedure to be applied under the Boren Amendment and a declaration of the amount due to Alliance under the Boren Amendment for services rendered for time periods predating the bankruptcy, D) an order denying HSD's claim, and E) attorneys fees. Upon review of the complaint, the Court finds that Counts A, B, and C are alternative claims (based on a single set of facts) to extract additional Medicaid funds from the State.

Counts A, B, and C - Breach of Contract, Quantum Meruit, Declaratory Judgment

The relief requested in these counts are not among those listed in 28 U.S.C. § 157(b)(2) as being "core". These counts do not seek to enforce any right granted by the bankruptcy

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Rehabilitation Facilities, Inc. v. State of Florida Department of Health and Rehabilitative Services, 225 F.3d at 1213. HSD's argument that the repeal eliminated Alliance's cause of action is not well taken. Id. at 1217.

[9] Although set out as a request for declaratory judgment, this count seeks a declaration that the reimbursement rate is inadequate and seeks a declaration of the total amount that should be paid to Alliance. This count resembles the "declaratory" relief that the Court, in Sacred Heart Hospital of Norristown v. Commonwealth of Pennsylvania, 204 B.R. 132, 139-40 (E.D. Pa. 1997), aff'd 133 F.3d 237 (1998), found to be a request for a money judgment. See also Mid-Delta Health Systems, Inc. v. Shalala (In re Mid-Delta Health Systems, Inc.), 251 B.R. 811, 812 (Bankr. N.D. Ms. 1999)("[T]he 'bottom line' of the complaint centers on what is actually owed by the plaintiffs. [The auditor's] audit procedures are simply the mechanism utilized by the defendants to ascertain their version of the overpayment amount.")

code, nor does bankruptcy law determine their outcome. They therefore do not "arise under" Title 11. The claims exist independently of the bankruptcy and do not impact on the administration of the estate. They therefore do not "arise in" a case under Title 11. They are, however, related to the bankruptcy case because their outcome impacts on the ability to reorganize and on the amount of property in the estate available for distribution to creditors. Counts A, B, and C are non-core. See also Humboldt Express, Incorporated v. The Wise Company, Incorporated (In re Apex Express Corporation), 190 F.3d 624, 631-32 (4th Cir. 1999) ("[Accounts receivable] claims, at least when grounded in state law and arising prepetition, must be treated as non-core.... The primary reason for our holding is that such claims fall squarely within the dictates of Northern Pipeline."); St. George Island, Ltd. v. Pelham, 104 B.R. 429, 431-32 (Bankr. N.D. Fl. 1989)(collecting cases and noting that actions to collect pre-petition debts are generally treated as non-core proceedings).

HSD has moved to dismiss Counts A, B, and C for failure to state a claim. Given the waiver of immunity that the Court finds below, the Court finds that Alliance has stated a claim for relief. Compare Amisub v. State of Colorado Department of Social Services, 879 F.2d 789, 793 (10th Cir. 1989), cert.

denied 496 U.S. 935 (1990)(Boren Amendment creates enforceable rights in health care providers and implies a private right of action under 42 U.S.C. § 1983. Case is dismissed as to the State of Colorado, however, because it had not waived sovereign immunity.) See also Connecticut Hospital Association v. Weicker, 46 F.3d 211, 217 (2nd Cir. 1995):

> Although the district court took time to analyze and discuss the findings [as required by Boren Amendment]- or lack thereof- in various past years, we conclude that, because the Eleventh Amendment bars retrospective monetary relief from the state, the findings with respect to any year other than the current year are irrelevant.

In this case, New Mexico has waived its sovereign immunity and Alliance has stated a cause of action; the motion to dismiss counts A, B, and C should be denied.

Count D - Objection to Claim

Count D is listed as a core proceeding by 28 U.S.C. § 157(b)(2)(A), (B), and/or (O). Furthermore, it is a matter "arising in" a case under title 11 that has no existence outside of bankruptcy. Count D is a core matter. Count D also states a valid cause of action such that the motion to dismiss should be denied as to Count D.

Count E - Attorneys Fees

Count E seeks attorney fees but does not cite the grounds for the claim. Debtor would be entitled to attorney fees only

if they could be awarded as part of Counts A through D. Count D is an objection to the proof of claim. There is no provision in the Bankruptcy Code to award attorney fees for successful objection to a proof of claim. See 11 U.S.C. § 502(b). Compare 11 U.S.C. §§ 303(i)(1), 362(h) and 523(d) (all providing specifically for awards of attorney fees.) Therefore, the fees requested must be awardable, if at all, under Counts A through C. They are non-core proceedings. Count E should therefore also be considered a non-core matter.

In summary, this adversary proceeding is a mixture of core and non-core "related to" proceedings. The bankruptcy court has jurisdiction over the adversary proceeding by virtue of 28 U.S.C. 1334(b), but final orders and judgments for Counts A, B, C, and E must be entered by the United States District Court. Count D is a core proceeding for which the Bankruptcy Court can enter final judgment, but the outcome of Count D depends directly on the results of Counts A, B, C, and E. Count D should therefore be stayed pending the outcome of those counts.

2. SOVEREIGN IMMUNITY

In Wyoming Department of Transportation v. Straight (In re Straight), 143 F.3d 1387 (10th Cir.), cert. denied, 525 U.S. 982 (1998) the Court of Appeals for the Tenth Circuit

addressed the issue of waiver of sovereign immunity under 11 U.S.C. § 106(b)[10]. The Court of Appeals cited Gardner v. New Jersey, 329 U.S. 565, 574 (1947) for the proposition that once a state files a claim in a bankruptcy, it waives any immunity respecting adjudication of the claim. Straight focuses on a state's voluntary waiver of immunity by filing proofs of claim in a case:

> [Section] 106(b) does not pretend to abrogate a state's immunity, it merely codifies an existing equitable circumstance under which a state can choose to preserve its immunity by not participating in a bankruptcy proceeding or to partially waive that immunity by filing a claim. The choice is left to the state.

143 F.3d at 1392. See also Sutton v. Utah State School for the Deaf and Blind, 173 F.3d 1226, 1236 (10th Cir. 1999):

> The Supreme Court has held that waiver of the Eleventh Amendment occurred where a state filed a claim for taxes in a bankruptcy reorganization proceeding ... 'When the State becomes the actor and files a claim against the fund, it waives any immunity it otherwise might have had respecting the adjudication of the claims.' Gardner v. New Jersey, 329 U.S. 565 (1947).

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[10] 11 U.S.C. § 106(b) provides:

> A governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and arose out of the same transaction or occurrence out of which the claim of such governmental unit arose.

In Straight, the Tenth Circuit noted that the 1994 amendments to the Bankruptcy Code codified the Gardner rule, but narrowed that case's applicability by permitting a debtor to proceed only against claims asserted by the state that arose out of the same transaction or occurrence as the proof of claim. Straight, 143 F.3d at 1390.

The Court believes that Straight was wrongly decided, in that it construed the state's waiver too broadly, for the reasons that follow.[11] In Gardner v. New Jersey, 329 U.S. 565, the Supreme Court dealt with a claim filed in a reorganization case by the state of New Jersey for taxes owed by the debtor railroad company. Id. at 570. When the trustee sought an adjudication by the reorganization court of the claim (both as to amount and as to the status of the lien securing the claim), the New Jersey attorney general argued that the court's adjudication of the claim would constitute a prohibited suit against the state. Id. at 571. The Supreme Court held "only...that the reorganization court could properly entertain all objections to the claim except those involving the valuations underlying the assessments and the

[11] Of course, this Court is bound to follow the ruling in Straight, and does so in this decision.

validity of those assessments."[12] Id. at 584. It was in that context that the Supreme Court ruled that "the reorganization court had jurisdiction over the proof and allowance of the tax claims and that the exercise of that power was not a suit against the State," id. at 572, and that "[w]hen the State becomes the actor and files a claim against the fund it waives any immunity which it otherwise might have had respecting the adjudication of the claim." Id. at 574. (Citations omitted.) It was this latter language that the Tenth Circuit quoted in support of its ruling in Straight. 143 F.3d 1389-90.

But the language used by Justice Douglas in Gardner makes clear that the Supreme Court was limiting its ruling to the property that was in the custody of the reorganization court.

> It is traditional bankruptcy law that he who invokes the aid of the bankruptcy court by offering a proof of claim and demanding its allowance must abide by the consequences of that procedure. Wiswall v. Campbell, 93 U.S. 347, 351, 23 L.Ed. 923. If the claimant is a State, the procedure of proof and allowance is not transmitted into a suit against the State because the court entertains objections to the claim. The State is seeking something from the debtor. No judgment is sought against the State. The whole process of proof, allowance, and distribution is, shortly speaking, an adjudication

[12] These two limitations arose from the fact that the valuations underlying the assessments and the validity of the assessments under state law had already been litigated between the parties, and should not be litigated again. Id. at 578. This part of the court's ruling had nothing to do with immunity issues.

> of interests claimed in a res. It is none the less such because the claim is rejected in toto, reduced in part, given a priority inferior to that claimed, or satisfied in some way other than payment in cash. When the State becomes the actor and files a claim against the fund it waives any immunity which it otherwise might have had respecting the adjudication of the claim.

329 U.S. at 573-74. (Citations omitted; emphasis added.)

> Through the appropriate exercise of [the broad authority granted the reorganization court], the court may authorize the trustee to compromise claims, secured or unsecured, and may approve equitable adjustments of them, and so reduce or otherwise affect the participation that the claimant, whether a State or another, may have in the res which is in custodia legis.

Id. at 581-82. (Emphasis added.) See also Arecibo Community Health Care, Inc. v. Commonwealth of Puerto Rico, 244 F.3d 241, 245 (1st Cir. 2001).

In Straight, the Tenth Circuit upheld the imposition of a monetary sanction against the state of Wyoming for violating the automatic stay. The amount of the fine was certainly not a res in the custody of the bankruptcy (or district) court, and the motion for sanctions against the state certainly had the effect, if not the specific form, of a suit against the state. See Gardner, 329 U.S. at 574.

In College Savings Bank v. Florida Prepaid Postsecondary Educ. Expense Board, 527 U.S. 666 (1999), Justice Scalia, writing for the court, characterized the court's holding in

Gardner as standing "for the unremarkable proposition that a State waives its sovereign immunity by voluntarily invoking the jurisdiction of the federal courts." Id. at 681 n. 3. The Tenth Circuit seized on this language to affirm its holding in Sutton v. Utah State School for the Deaf and Blind, 173 F.3d at 1234, that the state's removal of an action to the United States District Court constituted a waiver of its Eleventh Amendment immunity from the suit against it. "[College Savings Bank] expressly distinguished cases in which a state affirmatively invokes the jurisdiction of a federal court or makes a clear declaration of its intent to submit to a federal court's jurisdiction." McLaughlin v. Board of Trustees of State Colleges of Colorado, 215 F.3d 1168, 1170 (10th Cir. 2000). McLaughlin was another case in which the state (specifically, the Board of Trustees) removed an action from state court to the United States District Court. Id. at 1169.

But in this instance, HSD has done nothing more than file a proof of claim, seeking a portion of the assets of the estate in the custody of the Court. And the language of footnote 3 in College Savings Bank, 527 U.S. at 681, while admittedly ambiguous on this specific issue, should not be construed to open states up to liability of the kind permitted

by the Tenth Circuit in Straight.[13] An examination of the exact issues addressed and language used in Gardner, set out above, provides the context for a narrow interpretation of Justice Scalia's wording. Indeed, given the tone and trend of the recent Supreme Court decisions on sovereign immunity and the Eleventh Amendment, from Seminole Tribe of Florida v. Florida, 517 U.S. 44 (1996) coming forward, the better assumption would be that the Supreme Court would construe instances of waiver by a state more narrowly than broadly.

And further albeit oblique support for such a narrow reading derives from a consideration of the facts of the College Savings Bank case, which arose when the Board, a Florida state entity, 527 U.S. at 671, in essence (allegedly) stole plaintiff's idea for college savings to use for itself and then lied about the college savings program it had set up. Id. It is difficult to imagine more inequitable conduct (at least as bad as decertifying the debtor for business contracts in violation of the automatic stay) that calls for the

[13] The relevant language from the footnote is as follows: "The last case, Gardner v. New Jersey, 329 U.S. 565, 67 S.Ct. 467, 91 L.Ed. 504 (1947), which held that a bankruptcy court can entertain a trustee's objections to a claim filed by a State, stands for the unremarkable proposition that a State waives its sovereign immunity by voluntarily invoking the jurisdiction of the federal courts."

exercise of jurisdiction, yet the Supreme Court found no waiver of sovereign immunity.[14]

Finally, removing an action to a United States District Court, as occurred in both Sutton and McLaughlin, is certainly a much more comprehensive invocation of federal jurisdiction and waiver of immunity than merely seeking a portion of estate property, the res in the custody of the court. And while Straight limits the waiver of immunity to claims against the state arising out of the same transaction or claim previously filed by the state in the bankruptcy estate, 143 F.3d at 1390 (in this case, the state was required to pay attorney fees and costs), that holding is based on the statute, 11 U.S.C. §106(b), and on equity. Id. at 1392. College Savings Bank makes clear that Congress does not have the power to compel such a waiver merely by passing legislation, and both Gardner and College Savings Bank make clear that "equity" by itself does not compel the waiver of immunity merely by a state's participation in the bankruptcy process. In short, the filing of a proof of claim by a state, without more, should subject the state to a challenge to its proof of claim, including by

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[14] The specific issue in College Savings Bank was whether the Trademark Remedy Clarification Act abrogated state sovereign immunity or whether the state waived its sovereign immunity by engaging in the designated activities. 527 U.S. at 669.

offset or recoupment, but to no further liability. Arecibo Community Health Care, Inc. v. Commonwealth of Puerto Rico, 244 F.3d at 245.

Nevertheless, notwithstanding the foregoing analysis, and applying the currently existing law in the Tenth Circuit as explicated in Straight, the Court finds that HSD has waived its sovereign immunity and is subject to an adjudication in this court or the District Court of any claims against it arising out of the same transaction or occurrence, based on the following analysis.

HSD argues that Straight has no continuing vitality after College Savings Bank v. Florida Prepaid Postsecondary Education Expense Board, 527 U.S. 666. In College Savings, the Supreme Court recognized only two circumstances in which an individual may sue a state: 1) if Congress acted pursuant to the 14th Amendment to allow the suit, or 2) if the state waived its sovereign immunity. Id. at 670. The Court would find waiver either 1) if the State voluntarily invoked federal jurisdiction, or 2) if the state made a "clear declaration" that it intended to submit to federal jurisdiction. Id. at 675-76. However, College Savings reaffirmed the validity of Gardner. Id. at 681 n.3 (Gardner "stands for the unremarkable

proposition that a State waives its sovereign immunity by voluntarily invoking the jurisdiction of the federal courts.")

Similarly, the Tenth Circuit has reaffirmed Sutton (which dealt with removal of an action to United States district court) after College Savings. "[College Savings Bank] expressly distinguished cases in which a state affirmatively invokes the jurisdiction of a federal court or makes a clear declaration of its intent to submit to a federal court's jurisdiction." McLaughlin v. Board of Trustees of State Colleges of Colorado, 215 F.3d 1168, 1170 (10th Cir. 2000). Straight would appear to be one of those cases "expressly distinguished" by College Savings because it is based upon the state's affirmative invocation of federal jurisdiction from the voluntary filing of a proof of claim. See Gardner, 329 U.S. at 574. See also Sutton, 173 F.3d at 1234 (citing Gardner for the proposition that "'State waives Eleventh Amendment immunity by voluntarily appearing in bankruptcy court to file a proof of claim.'"). Accord State of Georgia Department of Revenue v. Burke (In re Burke), 146 F.3d 1313, 1317 n.8 and 1318 (11th Cir. 1998) cert. denied, 527 U.S. 1043 (1999)(Court relied on Gardner rather than 11 U.S.C. § 106(b) and found that state waived its sovereign immunity by filing a

proof of claim.) But see Arecibo Community Health Care, Inc. v. Commonwealth of Puerto Rico, 244 F.3d at 245:

> The validity of Section 106(b), already under serious doubt after Seminole Tribe ... is clearly undermined by the holding in College Savings Bank. Section 106(b) of the Bankruptcy Code is Congress's attempt, under its Article I powers, to construe a State's commercial activity as a waiver of its sovereign immunity. This is precisely that which is prohibited by College Savings Bank.[15]

In addition to the proof of claim, section 106(b) requires that the debtor's claim be property of the estate and arise from the same transaction or occurrence as the proof of claim. The parties do not dispute that debtor's claim is property of the estate. See generally 11 U.S.C. § 541.[16] The issue then is whether HSD's claim and this adversary arise from the "same transaction or occurrence."

The Straight Court noted that the same "transaction or occurrence" language of § 106(b) also appears in Federal Rule of Civil Procedure 13(a), thereby suggesting that cases

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[15] The Commonwealth had filed a proof of claim for $1.65 million but otherwise asserted its sovereign immunity. The trustee responded with a claim against the Commonwealth for $8.2 million. 244 F.3d at 243. The Court of Appeals ruled that the trustee was limited to defending against the proof of claim. Id. at 245.

[16] That a cause of action is property of the estate does not mean that the moneys sought by the debtor for the estate constitute part of a res in the custody of the court.

interpreting Rule 13(a)[17] would be relevant to determinations under 11 U.S.C. § 106(b). Straight, 143 F.3d at 1391. See also United States v. Nordic Village, Inc., 503 U.S. 30, 34 (1992)(describing former § 106(a) as encompassing compulsory counterclaims and former § 106(b) as encompassing permissive counterclaims.[18])

In Federal Rule of Civil Procedure 13(a) the terms "transaction" and "occurrence" are given flexible and realistic constructions to effect judicial economy by trying all related controversies between the parties in one action.

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[17]Federal Rule of Civil Procedure 13(a) provides in part: "**Compulsory Counterclaims**. A pleading shall state as a counterclaim any claim which at the time of serving the pleading the pleader has against any opposing party, if it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim...."

[18]In 1994, Congress amended § 106 in response to the Supreme Court's conclusion that § 106(c) did not explicitly abrogate states' sovereign immunity. See Hoffman v. Connecticut Dep't of Income Maintenance, 492 U.S. 96, 109 S.Ct. 2818, 106 L.Ed.2d 76 (1989). In the pre-amendment version of § 106, subsection (a) was identical to present-day § 106(b); subsection (b) was identical to present-day § 106(c); and subsection (c) purported to govern abrogation of sovereign immunity. After those amendments recodified § 106, section (a) governed abrogation.
Sacred Heart Hospital of Norristown v. Commonwealth of Pennsylvania, Department of Public Welfare (In re Sacred Heart Hospital of Norristown), 204 B.R. 132, 141 n.10 (E.D. Pa.), aff'd 133 F.3d 237 (1998).

Pipeliners Local Union No. 798, Tulsa, Oklahoma v. Ellerd, 503 F.2d 1193, 1198 (10th Cir. 1974). This issue usually arises in the context of determining whether a counterclaim is compulsory or merely permissive. Courts have used various standards to determine if a counterclaim is compulsory or permissive:

> (1) Are the issues of fact and law raised by the claim and counterclaim largely the same? (2) Would res judicata bar a subsequent suit on defendants' claim absent the compulsory counterclaim rule? (3) Will substantially the same evidence support or refute plaintiff's claim as well as defendants' counterclaim? and (4) Is there any logical relation between the claim and the counterclaim?

Id. See also 6 Wright & Miller, Federal Practice and Procedure, Civil § 1410 (characterizing the 4 "standards" listed above as separate tests and noting that the "logical relation test" has by far the widest acceptance among the Courts.)

Applying the tests, the Court finds that the claims raised by Plaintiff in this adversary proceeding would be compulsory counterclaims under Federal Rule of Civil Procedure 13(a) to HSD's proof of claim. See, e.g., Bank of Lafayette v. Baudoin (In re Baudoin), 981 F.2d 736, 741 and 744 (5th Cir. 1993)(Lender liability claim should have been asserted as an objection to Bank's proof of claim; failure to object was res judicata as to the lender liability claim.) That is,

Alliance's claims arise from the same transaction or occurrence as HSD's proof of claim. HSD's proof of claim (Exhibit 21) presents a claim for "overpayment for services allegedly rendered to medicaid recipients" for the time period December 9, 1994 to October 25, 1995, pursuant to the Provider Participation Application (Exhibit 1)("Contract"). Alliance's Count A alleges breach of the Contract for 1994 through 1997. Count B seeks relief in quantum meruit for the same time period for the value of the services rendered pursuant to the Contract. Count C seeks declaratory relief that the procedures used by HSD in determining amounts due under the Contract violated the Boren Amendment. Count D objects to HSD's proof of claim based on Counts A, B, and C. Count E seeks attorney fees. Therefore, both the claim and this adversary proceeding result from the same Contract and for an overlapping time period. Alliance's claims will require the same evidence as HSD's claim. The Court finds that there is a logical relationship between the claims such that Alliance's claims arise from the same "transaction or occurrence" and are compulsory counterclaims to HSD's proof of claim. See Sims v. United States (In re TLC Hospitals, Inc.), 224 F.3d 1008, 1012 (9th Cir. 2000)("[W]e conclude that the distinctive Medicare system of estimated payments and later adjustments

does qualify as a single transaction for purposes of recoupment.”); WJM, Inc. v. Massachusetts Department of Public Welfare, 840 F.2d 996, 1005 (1st Cir. 1988)(Offsets of medicare payments were preferential transfers arising from same transaction as state’s proof of claim for overpayments; the “transaction” was the course of dealings between the state and the providers under the provider contracts.); United States v. Aquavella, 615 F.2d 12, 22 (2nd Cir. 1980)(Government claims for recovery of excess interim payments and advances paid to provider under the Medicare Act were compulsory counterclaims to provider’s claims for an injunction and money damages.) Being compulsory counterclaims, the adversary proceeding meets the same transaction or occurrence test of § 106(b).

In summary, HSD waived its immunity either under Gardner or 11 U.S.C. § 106(b)[19], and with respect to the issue of sovereign immunity, the motion to dismiss should be denied.

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[19] During argument, HSD orally moved for leave to file an immediate appeal if the Court denied the Motion to Dismiss on 11th Amendment grounds. See Puerto Rico Aqueduct and Sewer Authority v. Metcalf & Eddy, Inc., 506 U.S. 139, 147 (1993)(State entities may take advantage of collateral order doctrine to appeal a district court order denying a claim of 11th Amendment immunity.) Because these proposed finding and conclusions, constituting as they do a recommendation to the District Court, are going immediately to the District Court anyway, the issue of an immediate appeal is probably best argued (if needed) to the District Court, rather than this Court.

3. EXHAUSTION OF ADMINISTRATIVE REMEDIES

First, the Court will review the administrative remedies available to Medicaid providers. Section 27-11-5 NMSA 1978 (1999 Repl.) directs the Secretary of Human Services to promulgate rules to enforce the Medicaid Provider Act. Section 27-2-12 NMSA 1978 (1999 Repl.) directs the Medical Assistance Division ("MAD") of HSD to promulgate regulations for medical assistance. Section 27-2-9(A) NMSA 1978 (1999 Repl.) directs HSD to adopt regulations establishing rates for hospital services consistent with the federal Social Security Act and directs HSD to apply that formula to determine the amount a hospital is entitled to receive as reimbursement. "Any hospital entitled to reimbursement for in-patient hospital services shall be entitled to a hearing, pursuant to regulations of the board [HSD] consistent with applicable state law, if the hospital disagrees with the department's determination of the reimbursement the hospital is to receive." Section 27-2-9(C) NMSA 1978 (1999 Repl.). "To be eligible for Medicaid reimbursement, providers are bound by MAD policies, procedures, billing instruction, reimbursement rates, and all audit, recoupment and withholding provisions unless superceded by federal law, federal regulation or by specific written approval by the MAD director." 8 NMAC

4.701.1. Regulations regarding "Awaiting Placement Days" are set out in 8 NMAC 4.MAD.721.52. General reimbursement policies and methods are set out in 8 NMAC 4.721.D.

8 NMAC 4.MAD.955 specifically deals with reconsideration of audit settlements. 955.1 states:

> Medicaid providers who disagree with an audit settlement can submit a written request for a reconsideration to the New Mexico Medical Assistance Division (MAD) within thirty (30) days of the date on the notice of final settlement. Filing of a request for reconsideration does not affect the imposition of the final settlement.

The written request must identify each point on which it takes issue and include documentation, citations of authority, and arguments. 955.11. Any matter not raised in the written request "may not" be raised later. Id. The written request and supporting materials are forwarded to the auditor, who must file a response with MAD within 30 days. 955.12. MAD forwards the auditor's response to the provider, who then has 15 days to submit additional material. 955.13. All of these documents are then submitted to the MAD Director for final decision. Id. The Director then makes a determination and submits a written copy of his/her findings to each party within 30 days of the delivery of the documents. 955.14. The MAD Director's decision is final. Id.

In addition to conducting audits, HSD is required to recover overpayments made to Medicaid providers. 8 NMAC 4.MAD.960. When HSD seeks this recovery, written notice is sent to the provider and must include:

> 1. ...
> 3. Provider's right to a hearing, right to be represented by counsel at the hearing proceeding, and method of requesting a hearing;
> 4. Statement notifying the provider that if he/she does not request a hearing, the action proposed by HSD will be deemed final for purposes of collection of overpayment and imposition of sanctions; and 5. Statement that provider has thirty (30) calendar days from the date of the notice to request a hearing.

8 NMAC 4.MAD.965.1. Requests for a hearing must be made within 30 days, and if a provider fails to request a hearing the provider waives its right to an appeal. 8 NMAC 4.MAD.966.

8 NMAC 4.MAD.980 describes the hearing process and a provider's hearing rights on (administrative) appeal. 4.MAD.966 (second paragraph.) 8 NMAC 4.MAD.981.2 provides that "Hearings are conducted and a written decision is issued to the provider within 120 calendar days from the date HSD receives the hearing request, unless the parties otherwise agrees [sic] to an extension."

Judicial review of final administrative hearing decisions is provided for by 8 NMAC 4.MAD.987:

> 987.1 Right of Appeal

> If a final hearing decision upholds HSD's original action or proposed action, the provider has the right to pursue judicial review of the decision and is so notified of that right in the decision.
>
> 987.2 Timeliness
>
> The provider has thirty (30) calendar days from the date of the hearing decision to appeal that decision by filing an appropriate action for judicial review with the clerk of the First Judicial District Court and sending a copy of the notice of action to HSD and/or the hearing officer.
>
> 987.3 Jurisdiction and Standard
>
> All appeals to the District Court are based on a review of the record made at the hearing. The Office of General Counsel files one copy of the hearing record with the clerk of the First Judicial District Court and furnishes one copy to the provider within twenty (20) calendar days after receipt of the notice of appeal.

The Court reads 4.MAD.987 to apply to the final decisions from both reimbursement audits (4.MAD.955) and payment recoveries (4.MAD.980).

HSD is correct in its argument that one must, in general, exhaust administrative remedies before taking judicial action in the federal courts[20]. See e.g., Mercy Hospital of Laredo v. Heckler, 777 F.2d 1028, 1039 (5th Cir. 1985)(Failure to exhaust specifically available remedies precludes Medicare provider hospitals from attacking validity of administrative scheme or

[20] This is also true under state law. See Mitchell-Carr v. McLendon, 127 N.M. 282, 286, 980 P.2d 65, 69 (1999)(exhaustion of remedies required under New Mexico Human Rights Act.); Neff v. State of New Mexico, 116 N.M. 240, 244, 861 P.2d 281, 285 (Ct. App. 1993)(exhaustion of remedies required under Tax Administration Act).

its standards.); Bartlett v. Schweiker, 719 F.2d 1059, 1062-63 (10th Cir. 1983)(Individual must pursue social security remedies before seeking judicial review.); Home Comp Care, Inc. v. United States Department of Health and Human Services (In re Home Comp Care, Inc.), 221 B.R. 202, 206 (N.D. Il. 1998)(A plaintiff must exhaust its administrative remedies prior to obtaining judicial review.); In re St. Johns Home Health Agency, Inc., 173 B.R. 238, 242-43 (Bankr. S.D. Fl. 1994)(While Medicaid Act would not divest court of jurisdiction over a motion to assume the Medicaid provider agreement, it would prevent court from determining amounts due under the agreement until exhaustion of remedies.).[21]

Alliance argues in its Memorandum in Support of Response (document 13) that in the bankruptcy context exhaustion requirements are negated, citing Cunningham v. U.S., 165 B.R. 599, 604 (N.D. Tx. 1993) and In re Healthback, L.L.C., 226 B.R. 464, 473 (Bankr. W.D. Ok. 1998). The law is not settled

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[21] But see, e.g. University Medical Center v. Sullivan (In re University Medical Center), 973 F.2d 1065, 1073 (3rd Cir. 1992), holding that exhaustion of Medicare's administrative review procedures is not required when complaint is for violation of the automatic stay that resulted from post-petition withholding of pre-petition overpayments. However, the parties did not dispute the amounts at issue, so that the administrative process designated for resolving disputes about amounts owed served no purpose. The heart of this adversary proceeding, on the other hand, is a determination of what sums are owed by whom.

on this issue, however. Cunningham recognized that courts have divided on the issue of exhaustion, but ruled that § 106 was an express waiver of sovereign immunity that negated the exhaustion requirement of the Internal Revenue Code. 165 B.R. at 604. Healthback reached the same result in the Medicare/bankruptcy context on three grounds. First, it found that the plain language of 28 U.S.C. § 1334 allowed jurisdiction over matters involving Medicare. 226 B.R. at 469. Second, it found that the bankruptcy issues were not a "judicial review" of an administrative decision, but were an application of bankruptcy law to the exercise of jurisdiction over property of the estate. Id. at 469-70. Finally, the Court found that there were no disputed facts involved. Id. at 470-71. Therefore, there would be no purpose in administrative review. Id.

The Court disagrees with the reasoning in Cunningham and, in part, Healthback. First, the Bankruptcy Code's silence on the issue of exhaustion of remedies does not determine the matter one way or the other[22]. On one hand, the silence could

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[22] See, e.g. Lindh v. Murphy, 521 U.S. 320, 337-39 (1997)(Rehnquist, J., dissenting):

> The Court's opinion rests almost entirely on the negative inference that can be drawn from the fact that Congress expressly made chapter 154, pertaining to capital cases, applicable to pending cases, but did not make the same express provision in regards

mean that the broad jurisdictional grant of 28 U.S.C. § 1334 implicitly repeals all other exhaustion requirements. On the other hand, the silence could mean that existing law on exhaustion is unchanged[23]. Generally, repeal by implication is not favored. Morton v. Mancari, 417 U.S. 535, 549-50 (1974). The "only permissible justification" for repeal by implication is when an earlier and a later statute are irreconcilable. Id. at 550. In interpreting two statutes that deal with the same subject, the Court should first attempt to harmonize them. Id. at 551:

> The courts are not at liberty to pick and choose among congressional enactments, and when two statutes are capable of co-existence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective.

> to chapter 153. That inference, however, is by no means necessary, nor is it even clearly the best inference possible. Certainly, Congress might have intended that omission to signal its intent that chapter 153 not apply to pending cases. But there are other, equally plausible, alternatives.
> ...
> If Congress wanted to make chapter 153 inapplicable to pending cases, the simplest way to do so would be to say so.

[23] Furthermore, the legislative history does not address exhaustion. If Congress had intended to abrogate, for bankruptcy cases, the voluminous and longstanding body of law that provides such benefits to all the parties involved, including the courts and the administrative agencies, it most likely would have said so in the statute or the legislative history.

"Where the powers or directions under several acts are such as may well subsist together, an implication of repeal cannot be allowed." Henderson's Tobacco, 78 U.S. 652, 657 (1870).

The Court does not find that the statutes in this case are irreconcilable. The admittedly broad grant of jurisdiction over estates and their assets and liabilities does not conflict with the requirement of exhaustion of administrative remedies. Exhaustion serves "the twin purposes of protecting administrative agency authority and promoting judicial efficiency." McCarthy v. Madigan, 503 U.S. 140, 145 (1992). The exhaustion requirement does not foreclose judicial review in the Bankruptcy Court; it merely postpones it and allows an agency to reach a decision in its area of expertise. See Board of Governors of the Federal Reserve System v. Mcorp Financial, Inc., 502 U.S. 32, 41 (1991) ("If and when the Board's proceedings culminate in a final order, and if and when judicial proceedings are commenced to enforce such an order, then it may well be proper for the Bankruptcy Court to exercise its concurrent jurisdiction under 28 U.S.C. § 1334(b).") By interpreting the Bankruptcy Code in this manner, the policies behind exhaustion of remedies and full jurisdiction of the Bankruptcy Court are both met. Viewed from another perspective, 4.MAD § 987.1 essentially says that

a party does not have a lawsuit until certain conditions are met, i.e., when remedies are exhausted. There is nothing offensive to the Bankruptcy Code in requiring a party to meet the conditions precedent to a lawsuit before filing it.

At oral argument, Alliance also claimed that there is no mandatory exhaustion process in 8 NMAC 4.MAD.955. It is true that 955.1 states that a provider who disagrees with an audit settlement "can submit" a written request for a reconsideration; it does not say "shall submit". The New Mexico Court of Appeals addressed a similar issue in Jaramillo v. J.C. Penney Co., Inc., 102 N.M. 272, 694 P.2d 528 (Ct. App. 1985). Section 28-1-10(A) NMSA 1978 provides that "Any person claiming to be aggrieved by an unlawful discriminatory practice ... may file with the commission a written complaint." The issue presented was whether compliance with the grievance procedures of the Human Rights Act was a prerequisite to suit under the Act, i.e. should "may file" be read as "shall file". Id. The Court of Appeals noted that the Act provided a right, the procedure, and the remedy. Id. This comprehensive scheme indicated that the legislature intended the grievance procedure to be mandatory when discrimination was alleged. Id. at 273, 694 P.2d at 529. See also Sabella v. Manor Care, Inc., 121 N.M. 596, 598, 915 P.2d

901, 903 (1996)(Grievance procedures under New Mexico Human Rights Act prerequisite to filing suit in district court.)[24]

The Medicaid statutes also provide rights, procedures, and remedies as part of a comprehensive administrative scheme. The Court finds that a Medicaid provider must exhaust the administrative remedies set out in New Mexico's administrative code before taking judicial action.

The Courts have recognized an exception to the requirement that administrative remedies be exhausted in certain situations. Harline v. Drug Enforcement Administration, 148 F.3d 1199, 1202-03 (10th Cir. 1998), cert. denied, 525 U.S. 1068 (1999). For example, an agency could waive the exhaustion requirement if further proceedings would serve no purpose. Id. at 1202. We do not have waiver in this case. The Court can deem that waiver has been improperly withheld if (1) plaintiff asserts a colorable constitutional claim that is collateral to the substantive issues of the administrative proceeding, (2) exhaustion would result in irreparable harm, and (3) exhaustion would be futile. Id. at 1202-03. The plaintiff has the burden of establishing these three elements. Id. at 1203. The Bankruptcy Court recommends

[24] And it is not unreasonable to read the language of the regulation to say, in effect, that an aggrieved provider "may" request a reconsideration if it wishes to change the result.

that exhaustion not be deemed waived in this case. Alliance did not establish that exhaustion would result in irreparable harm; in fact, HSD's uncontroverted testimony was that the administrative process could be completed in a timely fashion. Nor has Alliance demonstrated that exhaustion would be futile. In summary, the Bankruptcy Court recommends that Counts A, B, C, and E be dismissed without prejudice pending exhaustion of administrative remedies.

4. Doctrine of Primary Jurisdiction

Primary jurisdiction is a doctrine under which the court may decline jurisdiction over a case involving issues that an administrative agency has the expertise and opportunity to evaluate. Rucker v. St. Louis Southwestern Railway Company, 917 F.2d 1233, 1237 (10th Cir. 1990). It applies when both a court and an administrative agency are vested with initial jurisdiction over a matter. In re Mountain View Coach Line, Inc., 99 B.R. 555, 559 (Bankr. S.D. N.Y. 1989). It requires the court to enable a "referral" to the agency while staying further proceedings to give the parties an opportunity to seek an administrative ruling. Reiter v. Cooper, 507 U.S. 258, 268 (1993). The referral (or deferral) is made "in order to preserve uniformity and consistency in the regulation of the business entrusted to the agency." Mountain View Coach Line,

Inc., 99 B.R. at 559 (citing Far East Conference v. United States, 342 U.S. 570 (1952)). "Referral of the issue to the administrative agency does not deprive the court of jurisdiction; it has discretion either to retain jurisdiction or, if the parties would not be unfairly disadvantaged, to dismiss the case without prejudice[25]." Reiter v. Cooper, 507 U.S. at 268-69. Where a matter has been entrusted to an administrative agency by Congress, a bankruptcy court normally should stay the proceedings pending an administrative decision. Nathanson v. National Labor Relations Board, 344 U.S. 25, 30 (1952).

The doctrine of primary jurisdiction has been applied in bankruptcy/medicare cases. See Mid-Delta Health Systems, 251 B.R. at 815-16 and Gingold v. United States (In re Shelby County Healthcare Services of Al, Inc.), 80 B.R. 555, 562 (Bankr. N.D. Ga. 1987). In both of these cases the Bankruptcy Court deferred to the administrative agencies for their expertise and specialized knowledge. In the Mid-Delta Health Systems case the Court also noted that the defendants (various

[25] This doctrine is similar to the doctrine of exhaustion of administrative remedies; under that doctrine a plaintiff is required to pursue administrative redress before proceeding to the court. Reiter, 507 U.S. at 269. Until administrative remedies are exhausted suit is premature and must be dismissed. Id.

Health and Human Services agencies) had filed a motion to require debtor to assume or reject their provider agreements as executory contracts. 251 B.R. at 816. See 11 U.S.C. § 365(d)(2). The assumption motion is a core proceeding. 28 U.S.C. § 157(b)(2)(A). In order to enable the debtor to assume the agreement, however, the amount of any existing default needed to be determined. 251 B.R. at 816. See 11 U.S.C. § 365(b)(1)(A)-(B).

> Consequently, before this court can determine whether the provider agreements can be assumed by the plaintiffs, the administrative remedies, necessary to ascertain the amount of the Medicare overpayment, must be exhausted. Consequently, the court must hold in abeyance a decision on the defendants' motion to compel assumption or rejection until this process is completed.

Mid-Delta Health Systems, 251 B.R. at 816.

As an alternative, the Bankruptcy Court recommends that this adversary proceeding be stayed, Reiter v. Cooper, 507 U.S. at 268 n. 3, under the doctrine of primary jurisdiction pending an exhaustion of the administrative process.

5. Abstention

Federal courts have a strict duty to exercise the jurisdiction that is conferred upon them by Congress. Quackenbush v. Allstate Insurance Company, 517 U.S. 706, 716 (1996). "This duty is not, however, absolute." Id.

> Abstention is a narrow exception to the generally broad duty of federal courts to exercise jurisdiction. See Ankenbrandt v. Richards, 504 U.S. 689, 705, 112 S.Ct. 2206, 2215, 119 L.Ed.2d 468 (1992). There is little, if any, discretion to abstain in a case which does not meet the requirements of a particular abstention principle. See Bethpage Lutheran Serv., Inc. v. Weicker, 965 F.2d 1239, 1245 (2nd Cir. 1992).

Planned Parenthood of Dutchess-Ulster, Inc. V. Steinhaus, 60 F.3d 122, 126 (2nd Cir. 1995). Discretion may be somewhat greater in the bankruptcy context. See 11 U.S.C. § 1334(c)(1); In re Republic Reader's Service, Inc., 81 B.R. at 425 ("The 1984 amendments to the abstention provisions contained in section 1334(c) thus reflect a clear expansion of the abstention doctrine within the realm of bankruptcy.") HSD argues that the Court should abstain from hearing this adversary proceeding under 28 U.S.C. § 1334(c)(1) or (2), or under the common law doctrines of Burford (Burford v. Sun Oil Co., 319 U.S. 315 (1943)) or Pullman (Railroad Comm'n of Texas v. Pullman Co., 312 U.S. 496 (1941)).

A. Statutory Abstention.

28 U.S.C. § 1334(c) contains provisions related to abstention:

> (1) Nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11.

(2) Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under title 11 but not arising under title 11 or arising in a case under title 11, with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction.

Section 1334(c)(2), the "mandatory abstention" provision, requires a bankruptcy court to abstain from hearing a purely state law question that is only "related to" a bankruptcy if an action "is commenced" that can be timely adjudicated. Midgard, 204 B.R. at 779-780; Worldwide Collection Services of Nevada, Inc. v. Aaron (In re Worldwide Collection Services of Nevada, Inc.), 149 B.R. 219, 223 (Bankr. M.D. Fl. 1992). Alliance's basic claim is a collection action against the State. A collection action under contract or quantum meruit principles is a state law cause of action, despite the fact that a bankruptcy practitioner could also view it as a turnover action pursuant to 11 U.S.C. §542. At the same time, the focus of Alliance's complaint is the Boren Amendment, 42 U.S.C. § 1396a(a)(13)(A) and the interaction of that section with New Mexico's regulatory framework. See generally Arkansas Medical Society, Inc. v. Reynolds, 6 F.3d 519, 521-22 (8th Cir. 1993):

> Medicaid is a cooperative federal/state program through which the federal government grants funds to participating states to provide health care services to needy individuals. See 42 U.S.C. § 1396; Wilder v. Virginia Hosp. Ass'n, 496 U.S. 498, 502, 110 S.Ct. 2510, 2513, 110 L.Ed.2d 455 (1990). State participation in Medicaid is voluntary, but if states choose to participate, they must comply with the requirements outlined in the Medicaid statute. Wilder, 496 U.S. at 502, 110 S.Ct. at 2513. To qualify for federal funds, a state must submit a plan to the Secretary of Health and Human Services (HHS) which complies with fifty-eight subsections outlined in 42 U.S.C. § 1396a(a). Id. The state plan must include a system of reimbursing costs incurred by health care providers in providing services to Medicaid recipients. Id.

It is at least questionable, therefore, whether the case is based solely on state law. Compare Midgard, 204 B.R. at 777 (claims for malicious prosecution, interference with business relations, abuse of process and private nuisance make the proceeding "clearly based solely upon state law claims or causes of action"). The objection to the proof of claim is clearly not a state law cause of action, but the Court has already pointed out that the resolution of this count is entirely dependent on the resolution of counts A, B and C.

Because the complaint is essentially a collection action, it relates to the title 11 case, rather than arising under Title 11 or arising in the case. Id. See also above at pp. 14-15. And Alliance concedes that the action could not have been commenced in federal court absent bankruptcy court

jurisdiction. Memorandum in Support of Response to New Mexico Human Services Department's Motion to Dismiss or for Abstention, ¶ 28, at 11.[26] Doc. 13. Id. On the other hand, it is conceded that no state court action has been commenced, Memorandum in Support of New Mexico Human Services Department's Motion to Dismiss or for Abstention, at 12 (doc. 10) ("HSD Memorandum"), and that seems fatal to the demand for mandatory abstention. Id. at 778.[27] For that reason, and

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[26] But see Amisub v. State of Colorado Department of Social Services, 879 F.2d at 793 (1990)(Boren Amendment creates enforceable rights in health care providers and implies a private right of action under 42 U.S.C. § 1983.) That sort of cause of action can be pursued independently in a federal court. E.g., Keniston v. Roberts, 717 F.2d 1295, 1298 (9th Cir. 1983).

[27] HSD cites Midgard and World Solar Corporation v. Steinbaum (In re World Solar Corporation), 81 B.R. 603, 609-612 ((Banks. S.D. Cal. 1988) for the minority proposition that a state court action need not be pending when the adversary proceeding is initiated. HSD Memorandum, at 12. What Midgard held was that a state court action need not have been "commenced and pending", since, as the court correctly pointed out, that interpretation added a requirement not in the statute. Midgard, 204 B.R. at 778, n. 16. However, Midgard states that the statute "requires that the proceeding in question must have been 'commenced...in a State forum of appropriate jurisdiction.' 28 U.S.C. § 1334(c)(2). It is not contested that the State Court action was commenced in a State Forum of appropriate jurisdiction and, therefore, this requirement has been met." 204 B.R. at 778. Presumably the Bankruptcy Appellate Panel raised the issue of the "pending" language because the adversary proceeding under consideration in the case had been removed from the state court to bankruptcy court, and thus may not have been "pending" in the state court at the time. In any event, the language of § 1334(c)(2) seems clear enough in requiring that a state court

because it is at least questionable whether the adversary proceeding is based solely on state law, it is not necessary to consider also whether there has been a sufficient showing that any state court action could be timely adjudicated. For the foregoing reasons, therefore, this adversary proceeding does not meet the mandatory abstention requirements.

When mandatory abstention is not required, permissive abstention may be appropriate based on various factors. In re Republic Reader's Service, Inc., 81 B.R. at 428. Relevant factors considered by that court were:

> (1) the effect or lack thereof on the efficient administration of the estate if a Court recommends abstention, (2) the extent to which state law issues predominate over bankruptcy issues, (3) the difficulty or unsettled nature of the applicable state law, (4) the presence of a related proceeding commenced in state court or other nonbankruptcy court, (5) the jurisdictional basis, if any, other than 28 U.S.C. § 1334, (6) the degree of relatedness or remoteness of the proceeding to the main bankruptcy case, (7) the substance rather than form of an asserted "core" proceeding, (8) the feasibility of severing state law claims from core bankruptcy matters to allow judgments to be entered in state court with enforcement left to the bankruptcy court, (9) the burden on [the bankruptcy court's] docket, (10) the likelihood that the commencement of the proceeding in bankruptcy court involves forum shopping by one of the parties, (11) the existence of a right to a jury trial, and (12) the presence in the proceeding of nondebtor parties.

Id. at 429.

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action have been commenced at least before the abstention motion is filed, if not sooner.

The Court will apply these twelve factors. (1) The testimony presented was that HSD could timely resolve the administrative issues. (2) Non-bankruptcy laws predominate this case; the bankruptcy issues are only incidental to the nonbankruptcy issues. (3) The applicable state law is difficult; the State of New Mexico established a comprehensive framework for dealing with the legal issues. (4) There is a pending administrative case involving these issues. (5) It is at best questionable whether there is independent federal jurisdiction; see above at pp. 44-45). (6) This case is related to the bankruptcy and very important to the success of any plan that might be proposed; this factor would be less important, however, if it were shown that the issues can be timely resolved in the state forum, including any appeal to a state court from the administrative proceedings. (7) The substance of this case is non-core. (8) It is feasible and easy to sever the non-bankruptcy claims from the bankruptcy claims. (9) This case would be a burden on the docket; the parties estimated a trial of several weeks. The case could be handled more efficiently by a tribunal established for exactly this type of case. See United States v. Bagley (In re Murdock Machine and Engineering Company of Utah), 990 F.2d 567, 571 (10th Cir. 1993)("[W]hen jurisdiction over disputed claims is

placed by law in a specialized tribunal, we expect that the litigation over the trustee's claims to recovery will be conducted in that forum.") (10) There is no direct evidence that Alliance was forum shopping; however the circumstance suggest that conclusion. Alliance had a pending administrative proceeding which it elected not to pursue, then filed bankruptcy and asked the bankruptcy court to rule on the exact issues that were pending in the administrative proceeding. (11) No jury has been requested. (12) HSD is the only defendant, so this factor is not an issue.

Based on the foregoing, the Bankruptcy Court recommends that the District Court enter an order exercising its discretion to abstain from Counts A, B, C, and E.

B. Common Law Abstention.

1. Railroad Commission of Texas v. Pullman Co.[28] abstention.

Pullman abstention applies in "cases in which the resolution of a federal constitutional question might be obviated if the state courts were given the opportunity to interpret ambiguous state law." Quackenbush, 517 U.S. at 716-17. It is clear that Pullman abstention is warranted only when (1) there is substantial uncertainty as to the meaning of

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[28] Railroad Comm'n of Texas v. Pullman Co., 312 U.S. 496 (1941).

the state law and (2) there exists a reasonable probability that the state court's clarification of state law might obviate the need for a federal constitutional ruling. International College of Surgeons v. City of Chicago, 153 F.3d 356, 365 (7th Cir. 1998).

Pullman abstention does not apply to this case. First, the laws at issue are both federal and state and there are many cases interpreting the Boren Amendment. Second, Alliance is not seeking a constitutional ruling. See Virginia Hospital Association v. Baliles, 868 F.2d 653, 664 (4th Cir. 1989)(Pullman abstention not appropriate for case by medicaid providers challenging state's procedures for reimbursements.)

2. Burford v. Sun Oil Co. abstention.

> Burford [319 U.S. 315, 63 S.Ct. 1098, 87 L.Ed. 1424 (1943)] allows a federal court to dismiss a case only if it presents difficult questions of state law bearing on policy problems of substantial public import whose importance transcends the result in the case then at bar, or if its adjudication in a federal forum would be disruptive of state efforts to establish a coherent policy with respect to a matter of substantial public concern.

Quackenbush, 517 U.S. at 726-27 (Citations and internal punctuation omitted.) The Supreme Court has explained the power to abstain in terms of the discretion that federal courts have in deciding whether to provide equitable relief. Id. at 730. In actions seeking damages, the federal court may

enter a stay until state court proceedings have concluded but may not dismiss the case. Id. at 730-31.

The relief Alliance seeks in this case is legal, not equitable. Alliance seeks damages[29]. Compare Id. at 729 (Classifying Plaintiff's request for damages as a "run-of-the-mill" contract dispute.) Therefore, to the extent Burford may apply[30], the Court could only stay federal proceedings until the state law issues are resolved. Dismissal would not be appropriate.

The Court would find that the issues in this case impact on substantial public policy matters whose importance transcends the result in the case. Although this is a contract case between Alliance and HSD, it will involve an examination into HSD's rate making behavior which may have ramifications for other providers. The law on which it is based, however, is not purely state law. Furthermore, the

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[29] Quantum meruit, despite its equitable nature, is an action at law seeking money damages. Webb v. B.C. Rogers Poultry, Inc., 174 F.3d 697, 704-05 (5th Cir.), cert. denied, 528 U.S. 964 (1999). "Sitting at law, without discretion to deny relief, a court cannot remand a quantum meruit claim under Quackenbush." Id. at 705.

[30] "[W]e have not held that abstention principles are completely inapplicable in damages actions. Burford might support a federal court's decision to postpone adjudication of a damages action pending the resolution by the state courts of a disputed question of state law." Quackenbush, 517 U.S. at 730-31.

statute was repealed, so any ruling would unlikely be disruptive of state efforts to establish an ongoing coherent policy. The Bankruptcy Court would recommend that Burford abstention is not warranted[31]. See also Arkansas Medical Society, Inc., 6 F.3d at 529 (Medicaid laws are "routinely interpreted" by federal courts and Burford abstention not warranted.); Virginia Hospital Association v. Baliles, 868 F.2d at 665 (Burford abstention not proper because Medicaid is subject of both state and federal concern.) Compare Bethpage Lutheran Service, Inc. v. Weicker, 965 F.2d 1239, 1242, 1247 (2nd Cir. 1992)(Plaintiff sought only declaratory and injunctive relief under Boren Amendment. Second Circuit affirmed District Court's decision to abstain under Burford with leave to return to federal court if the state court ruled that a remedy was unavailable.)

CONCLUSION

For the reasons set out above, the Court makes the following recommendations:

As to sovereign immunity, the Court recommends that the District Court not dismiss the adversary proceeding.

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[31] If Burford abstention were warranted, it would achieve the same result as that recommended in the Primary Jurisdiction section above.

As to exhaustion of administrative remedies, the Court recommends that the District Court dismiss without prejudice counts A, B, C and E, and also dismiss without prejudice Count D, pending exhaustion of administrative remedies by Alliance.

As to primary jurisdiction, the Court recommends that the District Court stay the adversary proceeding pending exhaustion of administrative remedies by Alliance.

As to abstention, the Court recommends that the District Court not abstain based on the mandatory abstention provisions of 28 U.S.C. § 1334(c)(2), that the District Court abstain based on the discretionary abstention provisions of 28 U.S.C. §1334(c)(1), and that the District Court not abstain based on the common law abstention standards of Railroad Comm'n of Texas v. Pullman Co., 312 U.S. 496 (1941) or of Burford v. Sun Oil Co., 319 U.S. 315 (1943).

In summary, the Court recommends that the District Court dismiss the complaint without prejudice as to all of the counts, pending completion of administrative review by HSD. In the alternative, the Court recommends that the District Court stay the adversary proceeding pending completion of administrative review by HSD.

Honorable James S. Starzynski
United States Bankruptcy Judge

I hereby certify that on February 12, 2002, a true and correct copy of the foregoing was either electronically transmitted, faxed, delivered, or mailed to the following:

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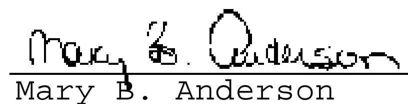

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