UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF PUERTO RICO

EXHIBIT A

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In re: :

HMCA (CAROLINA), INC. : BK No. 90-03402 (ANV)
Debtor Chapter 11

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In re: :

HMCA (PR), INC. : BK No. 90-03403 (ANV)
Debtor Chapter 11

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OPINION AND ORDER ALLOWING COMPENSATORY SANCTIONS, AND DENYING DEBTORS' REQUEST FOR PUNITIVE SANCTIONS

APPEARANCES:

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BEFORE ARTHUR N. VOTOLATO, United States Bankruptcy Judge

Heard on the Debtors' Motion for Compensatory and Punitive Sanctions against the Puerto Rico Department of Health ("DOH"), alleging that DOH: (1) wilfully violated a prior injunction of this Court dated June 24, 1991; and (2) filed a motion to obtain Medicare reimbursement funds to which it clearly was not entitled, in violation of Fed. R. Bankr. P. 9011. For the following reasons, the Motion for Compensatory Sanctions is GRANTED, and the Debtors are awarded $9,050 in fees and costs for having to intervene to obtain Medicare receivables that were clearly the property of the Debtors. As for the Debtors' request for punitive sanctions, while the Court repeatedly requested and invited the Debtors to do so, at the hearings on March 18, 1998 and May 3, 2000, they offered no evidence to support such a claim, and so that request is DENIED. Our reasons for both rulings are given below.

BACKGROUND

This ongoing dispute between the Debtors and the DOH has a long and acrimonious history, fueled by both sides, neither of whom has always behaved at acceptable ethical levels.[1]

[1] These bankruptcy cases were precipitated in July 1990, by HMCA (Carolina), Inc. and HMCA (PR), Inc., when the DOH improperly and unilaterally withheld millions of dollars from HMCA under its operating contract with HMCA, placing the

Approximately one year after the filing, the DOH sent letters dated August 8, 1990, and February 1, 1991, to Medicare, to prevent or delay payment of substantial funds to the Debtors. In response, the Debtors sought and obtained an injunction and a ruling by the Bankruptcy Court in June 1991, that DOH's actions constituted a wilful violation of the automatic stay and a "blatant attempt by the DOH to frustrate and interfere with the Debtors' reorganization efforts." Order dated June 24, 1991, at 4. Also, the DOH was ordered to stop interfering with the Debtors' entitlement to Medicare receivables, and was enjoined from engaging in similar misconduct in the future, with a clear warning that "personal criminal sanctions would be recommended to the District Court for further violations." *Id*. at 5.

While the parties were awaiting this Court's decision on the merits as to whether the DOH breached its pre-petition operating contract with the Carolina Area Hospital, DOH approached the Debtors and indicated that it was willing to enter into a global settlement of all pending issues, if the Debtors could persuade the Court to withhold ruling on the breach of contract claims

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hospitals in financial turmoil, and their patients in physical and medical jeopardy.

during the negotiations.[2] The Debtors agreed, and requested that no ruling be issued pending approval of the global settlement. Unwisely, in hindsight, I acceded to the Debtors' request, a Settlement Agreement was approved paving the way for the joint plan of reorganization, and the DOH dodged the very severe punishment it deserved and was about to receive.

The Settlement Agreement and reorganization plan were predicated on the Debtors' transferring the hard operating assets of the Carolina Area Hospital exceeding 40 million dollars to the DOH. Section II(g) of the Agreement provided that the Debtors would own the Medicare receivables generated through the operation of the hospital *before* and until the hospital was transferred to the DOH, and it is undisputed that the effective date of the transfer was September 30, 1992. The Disclosure Statement mirrored the language of the Settlement Agreement, and both documents provided for "the retention by the debtors of any assets, choses in action, and liability not mentioned above, incurred, obtained or arising out of the

[2] This well-timed overture was made only after a full evidentiary trial, with overwhelming proof of the DOH's misconduct, including damaging testimony by the prior Secretary of Health. With the Debtors seeking damages in the millions, and recognizing that it was clearly in trouble, DOH cleverly requested the "time out."

operation of the Carolina Area Hospital prior to the transfer of the Carolina Hospital to the Health Department, and the assumption by the Health Department of all assets and liabilities originating after the transfer of the Carolina Hospital." Disclosure Statement, at 20, ¶ 11.

After this plan was approved the Debtors paid all creditors in full, the case proceeded without major incident, and a final decree was entered in March 1996. About a year later, however, the Debtors informed the Court that they could not close the bankruptcy case because they were having difficulty obtaining their final Medicare receivable. On March 20, 1997, I issued an Order directing Medicare through the Health Care Financing Administration to complete its final computation of the receivable "and to make the payment of such sum directly to the debtor HMCA (Carolina), Inc., as soon as practicable." Order dated March 20, 1997, Docket No. 593, p.2. I also stated that: "All parties should bear in mind that it is the intent of this Court to close this case as soon as possible, and that they should cooperate to achieve this end." *Id*.

Less than one month later, the DOH was once more caught interfering with the administration of the case. Instead of complying with the terms of the Settlement Agreement and the

confirmed plan of reorganization, or seeking reconsideration or modification of our March 20, 1997 Order, the DOH again took matters into its own hands and, skirting the Court's authority over the subject, on April 10, 1997, sent an *ex parte* letter to the president of Cooperativa de Seguros de Vida ("COSVI"), Medicare's fiscal intermediary in Puerto Rico, objecting to the payment of the final Medicare payment to the Debtors. DOH's *ex parte* letter informed COSVI that "the Bankruptcy Court has indicated its interest in promptly closing this case and the object of [this] letter is the only matter which impedes the closing of the same. As a result, DOH wants to clarify the situation and prevent any improper payment be made to HMCA." *Ex parte* letter translation, at 1. The letter also threatened that if COSVI paid the Debtors, the DOH would "have to resort to the courts to recover said payment." Translation of *ex parte* letter, at 1.

When it sent the letter, the DOH did not disclose its action to either the Court or the Debtors, and its explanation for the action – that DOH's letter clearly indicates that its intent was to "ensure that the Settlement Agreement approved by this Court be adhered to by all parties," is probably the most ludicrous

and/or disingenuous representation made to this court in a long time, and deserves no further comment.

Within a week after the Debtors alerted the Court to what the DOH was doing, the DOH filed its so-called "Medicare Motion," making a meritless claim to the receivable in question. The Debtors filed an opposition, and requested sanctions. On November 3, 1997, I ruled that the Medicare receivable clearly was property of the Debtors, denied DOH's motion, with prejudice, and ordered that the funds be paid to the Debtors forthwith. The DOH appealed that Order to the United States District Court for the District of Puerto Rico, and I withheld ruling on the Debtors' request for sanctions until DOH's appeal was decided. On March 24, 1999, sixteen wasted months later, because the DOH never bothered to file an appellate brief, the District Court dismissed the appeal and affirmed the November 3, 1997 Order.[3] Hearings were scheduled in Puerto Rico on March 18, 1998, and May 3, 2000, for the Debtors to present evidence in support of their request for punitive sanctions, but none was

[3] The failure to prosecute its appeal just highlights how wilful and blatant were the DOH's efforts to hinder and delay. Its actions are bad faith personified.

offered, and the hearing was concluded and taken under advisement.

DISCUSSION

The Debtors want a ruling that the DOH is in contempt of an injunction issued on June 24, 1991, and/or that it violated Rule 9011, and they request "severe sanctions for the DOH's blatant transgressions." While it is highly likely that the requested relief would have been granted if properly supported, regretfully, I cannot grant the punitive relief sought by the Debtors, based on the record before me, and in light of the Debtors' failure to meet their burden on the subject.

A. Contempt

In discussing a bankruptcy court's contempt powers the First Circuit has stated:

> It is well-settled law that bankruptcy courts are vested with contempt power.... Bankruptcy rule 9020(b) specifically provides that a bankruptcy court may issue an order of contempt if proper notice of the procedures are given.
>
> In deciding whether a proceeding before a lower court involves civil or criminal contempt, we are required to look to the purpose and character of the sanctions imposed, rather than to the label given to the proceeding by the court below....
>
> Sanctions in a civil contempt proceeding are employed to coerce the defendant into compliance with the court's order or, where appropriate, to compensate the harmed party for losses sustained .... These sanctions are not punitive, but purely remedial.

Eck v. Dodge Chemical Co. (*In re Power Recovery Sys., Inc.*), 950 F.2d 798, 802 (1st Cir. 1991) (*emphasis added*), and "a complainant must prove civil contempt by clear and convincing evidence." *Langton v. Johnston*, 928 F.2d 1206, 1220 (1st Cir. 1991).

The respondents' actions herein generally sound like a party acting in bad faith, but unfortunately the record does not support the Debtors' request for punitive or criminal sanctions, which "are imposed for the purpose of vindicating the authority of the court.... The contemnor in a criminal contempt case is entitled to a hearing, proof beyond a reasonable doubt and all the protections afforded those accused of a crime." *Power Recovery Sys.*, 950 F.2d at 802, n.18 (*citations omitted*). The Debtors have failed to support a claim for punitive sanctions, and without an evidentiary record, the Debtors have not even met the reduced burden for civil contempt in this matter. Therefore the only remedy left available to the Debtors is the relief afforded under Fed. R. Bankr. P. 9011.

B. Rule 9011

Federal Rule of Bankruptcy Procedure 9011 was amended on December 1, 1997, to track the language of Rule 11 of the

Federal Rules of Civil Procedure. The new rule governs "all proceedings in bankruptcy cases thereafter commenced and, insofar as just and practicable, all proceedings in bankruptcy cases then pending." See Supreme Court Order Amending Federal Rules of Bankruptcy Procedure (Apr. 11, 1997). Here, since the activity referenced in the Debtors' motion for sanctions occurred after the amendment, the current version of Rule 9011 applies.[4] *See 680 Fifth Avenue Assocs. v. EGI Company Services, Inc.* (*In re 680 Fifth Avenue Assocs.*), 218 B.R. 305, 312-13 (Bankr. S.D.N.Y 1998)("The case law suggests that the propriety of sanctions should be gauged by the standard in effect at the time the alleged offensive conduct occurred.")

The applicable version of Rule 9011 states:

> By presenting to the court (whether by signing, filing, submitting, or later advocating) a petition, pleading, written motion, or other paper, an attorney... is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances,--

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[4] There are two major differences between the prior version and amended Rule 9011. First, under the amended rule, if the court finds a violation, the imposition of sanctions is not mandatory. *See* Fed. R. Bankr. P. 9011(c). Second, and while it is not applicable here, the amended rule contains a "safe harbor" provision allowing the offending party 21 days after receiving notice of the alleged violation to withdraw or correct the challenged document. *See* Fed. R. Bankr. P. 9011(c)(1)(A).

> (1) it is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;
>
> (2) the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;
>
> (3) the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and
>
> (4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information or belief.

Fed. R. Bankr. P. 9011(b) (1997). In construing this Rule, courts have looked to cases involving Fed. R. Civ. P. 11, which remained substantively similar to our Bankruptcy Rule 9011, notwithstanding the December 1, 1993 amendments. *See In re Braun*, 152 B.R. 466, 471 n.3 (N.D. Ohio 1993); *In re Remington Dev. Group, Inc.*, 168 B.R. 11, 15 (Bankr. D.R.I. 1994). Both rules require attorneys "to conduct [themselves] in a manner bespeaking reasonable professionalism and consistent with the orderly functioning of the judicial system." *Figueroa-Rodriguez v. Lopez-Rivera*, 878 F.2d 1488, 1491 (1st Cir. 1988), *aff'd in*

part on rehearing *en banc*, 878 F.2d 1478 (1989) (applying prior version of Rule 11) (*quoting In re D.C. Sullivan Co.*, 843 F.2d 596, 598 (1st Cir. 1988)).

The "appropriate standard for measuring whether a party and his or her attorney has responsibly initiated and/or litigated a cause of action in compliance with Rule 11 ... is an objective standard of reasonableness under the circumstances." *Cruz v. Savage*, 896 F.2d 626, 631 (1st Cir. 1990) (applying prior version of Rule 11); *see also Plante v. Fleet Nat'l Bank*, 978 F. Supp. 59, 65-66 (D.R.I. 1997); and subjective good faith is not enough to protect an attorney from sanctions under Rule 11. *Cruz*, 896 F.2d at 631. "A violation of Rule 11 ... might be caused by inexperience, incompetence, willfulness, or deliberate choice." *Id*.

In this case, the DOH and its attorneys violated Rule 9011(b) when the Medicare Motion was filed in the Spring of 1997 seeking to obtain property to which it clearly was not entitled. The DOH merely had to read its own Settlement Agreement to see that the funds in question were property of the Debtors. Instead, without making any sort of good faith inquiry, DOH ignored the facts, wilfully prosecuted a matter that from the

outset was completely without merit,[5] forced the Debtors into needless litigation, and deprived them of the use of the Medicare receivables for several months. HMCA's statement that fees of $9,050 were incurred in opposing the frivolous DOH Medicare Motion is reasonable, and the DOH and its then counsel are jointly and severally ORDERED to pay this sum to the Debtors within ten (10) days.[6] *See* Fed. R. Bankr. P. 9011(c).

Finally, we address the DOH's sovereign immunity argument, which is every bit as lacking in merit as its other arguments. From the inception, this bankruptcy case has been all about the DOH, which was, of course, the centerpiece of the Chapter 11 plan. *See Atascadero State Hosp. v. Scanlon*, 473 U.S. 234, 238 n.1, *reh'g denied*, 473 U.S. 926 (1985) ("We require an unequivocal indication that the State intends to consent to

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[5] On November 3, 1997, DOH's request was denied, with prejudice.

[6] The Court is not privy to information as to whether DOH personnel or its then counsel were more at fault for generating and prosecuting the offending Medicare Motion. Therefore, initially at least, we leave the apportionment of this monetary sanction to the DOH and whoever its attorneys were at the time, because at this point they alone know where the responsibility lies. If given proof on the subject, the Court would have imposed sanctions personally against named *individuals*, with instructions not to apply for reimbursement. Unfortunately, on this record I cannot do that.

federal jurisdiction that otherwise would be barred by the Eleventh Amendment."); *Paul N. Howard Co. v. Puerto Rico Aqueduct and Sewer Authority* 744 F.2d 880, 886 (1st Cir. 1984)(Puerto Rico Aqueduct and Sewer Authority found to have waived immunity by appearing in the case, filing a counter claim, and filing a third party complaint. The Court stated that: "it has long been established that a [state's] general appearance may constitute ... a waiver [of its Eleventh Amendment immunity]), *cert. denied*, 569 U.S. 1191 (1985). The DOH's presence in this case has been larger than life, and further discussion is unnecessary. If there was ever a case where waiver of sovereign immunity applied, this is it.[7]

Enter Judgment consistent with this order.

Dated at Providence, Rhode Island, this 27th day of September, 2001.

/s/ Arthur N. Votolato
Arthur N. Votolato
U.S. Bankruptcy Judge*

*Of the District of Rhode Island, sitting by designation.

[7] Although "waiver" is probably the technically correct term of art in this case, "estoppel" is really more appropriate.