UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

In re:	)	Chapter 11
	)	
APF Co., et. al.,	)	Case No. 98-1596 (PJW)
	)	Jointly Administered
Debtors.	)	
_____	)	
	)	
JOSEPH A. PARDO, Trustee of FPA Creditor Trust and the PLAN ADMINISTRATOR for APF Co., et al.,	)	
	)	
Plaintiffs,	)	
	)	
vs.	)	Adv. Proc. No. 00-854 (PJW)
	)	
HORIZON HEALTHCARE PLAN HOLDING COMPANY, INC., f/k/a MEDIGROUP, INC. and MEDIGROUP OF NEW JERSEY, INC.,	)	
	)	
Defendants.	)	

MEMORANDUM OPINION

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Date: August 31, 2001

WALSH, J. /s/ Peter J. Walsh

Before the Court is the motion (Doc. # 4) by defendants Horizon Healthcare Plan Holding Company, Inc. f/k/a Medigroup Inc. and Medigroup of New Jersey, Inc. ("Horizon") to dismiss the first, second, third, fourth, fifth and seventh causes of action of the complaint filed by plaintiffs Joseph A. Pardo, Trustee of FPA Creditor Trust ("Trustee") and the Plan Administrator of APF Co. ("Plan Administrator"). Plaintiffs allege that Horizon's pre-petition withholding and post-petition failure to turn over the withheld capitation payments due APF Co., f/k/a FPA Medical Management, Inc. ("FPA") and its affiliates (collectively, the "Debtors") under a medical services agreement are a sanctionable violation of the automatic stay under 11 U.S.C. § 362 and constitute an avoidable preference under 11 U.S.C. § 547 and § 550. Plaintiffs also request a turnover of the withheld funds under 11 U.S.C. § 542.[1] For the reasons discussed below, I will grant Horizon's motion to dismiss counts one through five alleging violations of the stay, but I will deny the motion as to count seven regarding turnover of estate property.

BACKGROUND

FPA was a national physician practice management company

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[1] Unless otherwise indicated, all references hereinafter to "§____" are to a section of the Bankruptcy Code, 11 U.S.C. § 101 et seq.

which acquired, organized and managed primary care physician practices that contracted with health maintenance organizations and health insurance plans. It provided medical care services to capitated managed care enrollees and fee-for-service patients and also provided physician management services to hospital emergency departments and like facilities. FPA Medical Group of New Jersey, Inc. ("FPA New Jersey") was an affiliate of FPA. According to Plaintiffs, FPA New Jersey provided medical services to approximately 80,000 individuals within the State of New Jersey, including approximately 33,000 Horizon enrollees.

Horizon provides health care services to enrollees of its health maintenance plans living in New Jersey. Horizon was formerly known as Medigroup, Inc. and formerly conducted business as HMO Blue and Blue Cross Blue Shield of New Jersey.

On January 21, 1995, Horizon entered into a Medical Services Organization Agreement ("Services Agreement") with FPA New Jersey. Complaint at ¶ 15. Under the Services Agreement, FPA New Jersey was to provide medical services to Horizon's enrollees in exchange for Horizon's payment of a monthly fee ("Capitation Payment") to FPA New Jersey. Complaint at ¶ 15. The Capitation Payment was due on the 10th day of each month. Complaint at ¶ 18.

Prior to filing bankruptcy, FPA and some of its affiliates fell behind in their payment obligations to doctors and medical care providers who were rendering services to managed care

enrollees. Complaint at ¶ 16. Consequently, on July 10, 1998, Horizon withheld from FPA New Jersey an amount equal to the entire Capitation Payment due FPA New Jersey for that month. Complaint at ¶ 19. Horizon provided FPA New Jersey with notice of the withholding in a letter dated July 17, 1998. Complaint at ¶ 20. According to Plaintiffs, Horizon withheld at least $1,059,223. Id.

On August 3, 1998, FPA New Jersey filed a voluntary petition for chapter 11 relief.[2] On August 20, 1998, I entered an order[3] ("Payor Order")(Doc. # 383) which, inter alia, prohibited non-debtor HMOs and insurers ("Payors") from withholding and offsetting post-petition payments due the Debtors and which prohibited the Payors from making direct post-petition payments to doctors and other medical services providers. In relevant part, the Payor Order provides:

> 4. Nothing in this Order shall: (a) preclude any Payor from paying the claims, if any, of Physicians (including capitation) which arose prior to the commencement of the Debtors' chapter 11 cases, and which have been or may be presented to Payors hereafter; and (b) be determinative of whether any Payor has any obligation whatsoever to pay such prepetition claims of any Physician.

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[2] FPA and its other affiliates filed for voluntary chapter 11 relief during the period beginning July 19, 1998 and ending August 7, 1998.

[3] The August 20, 1998 order modifies and supersedes a prior payor order entered on July 21, 1998 and docketed on July 30, 1998.

> 5. Except as provided in this paragraph and until further order of this Court, Payors shall continue to make post-petition capitation and claims payments to the Debtors without withholding, setoff, or recoupment, which payments shall not be subject to disgorgement if the Court enters an order granting a Payor the right of recoupment. ...
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> Payor Order (Doc. # 383) at p. 13 ¶¶ 4-5.

On May 26, 1999, I entered an order confirming the Debtors' Modified Second Amended Joint Plan of Reorganization ("Plan"). The Plaintiffs in this proceeding are the Trustee of the FPA Creditor Trust established by the Plan and the Plan Administrator of the Plan.

Plaintiffs commenced this adversary proceeding on July 18, 2000. They seek declaratory relief, compensatory and punitive damages, and costs and attorneys' fees based on Horizon's alleged violation of the automatic stay as a result of Horizon's July withholding of the Capitation Payment. Specifically, counts I, II and III allege Horizon violated § 362(a)(3), (a)(6) and (a)(7). Count IV alleges Horizon's stay violations were willful and warrant damages, costs and attorneys fees under § 362(h). Count V requests a declaratory judgment under 28 U.S.C. §§ 2201-2202 and 11 U.S.C. § 105 that Horizon has waived all rights to the withheld funds by its failure to obtain relief from the automatic stay. Plaintiffs also seek to recover the withheld Capitation Payment as an "insufficiency" under § 553(b), as an unlawful retention of estate property under § 542, and as a preferential transfer under

§ 547 in counts VI, VII and VIII, respectively.

Horizon moves to dismiss the first through fifth and seventh counts of the complaint for failure to state a claim upon which relief may be granted under Fed.R.Civ.P. 12(b)(6).[4] Horizon argues it did not violate the automatic stay as a matter of law because its withholding of the Capitation Payment was a pre-petition act not subject to the stay. Horizon also moves to dismiss count VII for turnover of estate property under § 542. It maintains that withholding the Capitation Payment is not a retention of property of the estate and that a cause for turnover is therefore legally implausible.

In response, Plaintiffs argue that Horizon's retention of the withheld funds after the petition date, and during the pendency of the cases, constitutes a violation of the automatic stay and entitles the Plaintiffs to seek turnover of the withholdings under § 542. Plaintiffs' Memorandum of Law in Opposition to Motion by Defendants . . . to Dismiss . . . (Doc. # 5) at p. 12. Plaintiffs do not argue in their complaint, or otherwise, that Horizon's pre-petition actions, in and of themselves, violated § 362. Id. The issue, therefore, is whether Horizon's post-petition failure to remit the Capitation Payment Horizon withheld pre-petition under a pre-petition contract constitutes a violation of the automatic

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[4] Fed.R.Bank.P. 7012 makes Fed.R.Civ.P. 12(b)(6) applicable to proceedings in bankruptcy.

stay.

DISCUSSION

I. Standard of Review under Rule 12(b)(6).

A motion to dismiss for failure to state a claim upon which relief can be granted under Rule 12(b)(6) serves to test the sufficiency of the complaint. Kost v. Kozakiewicz, 1 F.3d 176, 183 (3d Cir. 1993); Loftus v. Southeastern Pennsylvania Transp. Auth., 843 F.Supp. 981, 984 (E.D. Pa. 1994). When deciding such a motion, I accept as true all allegations in the complaint and all reasonable inferences drawn from it which I consider in a light most favorable to the plaintiffs. Morse v. Lower Merion School Dist., 132 F.3d 902, 906 (3d Cir. 1997); Rocks v. City of Philadelphia, 868 F.2d 644, 645 (3d Cir. 1997). I should not grant a Rule 12(b)(6) motion "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of [its] claim which would entitle [it] to relief." Conley v. Gibson, 355 U.S. 41, 45-46, 78 S.Ct. 99, 102 (1957). Rule 12(b)(6) authorizes a court to dismiss a claim based on a dispositive issue of law. Neitzke v. Williams, 490 U.S. 319, 326, 109 S.Ct. 1827, 1832 (1989) citing Hishon v. King & Spalding, 467 U.S. 69, 73, 104 S.Ct. 2229, 2232 (1984).

II. Section 362(a).

Plaintiffs allege in counts I, II and III that Horizon violated §§ 362(a)(3), (a)(6) and (a)(7), respectively. These

sections of the automatic stay provide that:

> Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title . . . operates as a stay, applicable to all entities, of
>
> (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;
>
> * * *
>
> (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;
>
> (7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor.
>
> 11 U.S.C. § 362(a).

Based on the alleged violations of the automatic stay, Count IV seeks damages under § 362(h) which provides that:

> An individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages.
>
> 11 U.S.C. § 362(h).

Count V seeks a declaratory judgment that by reason of its failure to seek court relief from the automatic stay, Horizon has waived its rights in the withheld Capitation Payment.

By its terms, the automatic stay applies only to post-petition acts. Consequently, Horizon's pre-petition act of

withholding the Capitation Payment cannot of itself violate the automatic stay. Plaintiffs concede this. Similarly, I find that any alleged setoff occurred pre-petition and therefore cannot be a violation of § 362(a)(7). I also hold that Horizon's post-petition retention of the withheld funds does not amount to a violation of the stay under the circumstances.

A violation of § § 362(a)(3) and (a)(6) requires both (1) an act and (2) property of the estate. Even if the withheld Capitation Payment is property of the estate, which the parties dispute, Horizon's conduct does not violate the automatic stay in the absence of an affirmative post-petition act manifesting either an exercise of control over property of the estate, or collecting, assessing or recovering, such property. I find that Horizon's post-petition conduct in this case was not an affirmative act within the meaning of §§ 362(a)(3) or (a)(6). Sections 362(a)(3) and (a)(6) require more than Horizon's mere passive act of failing to remit the withheld funds for a number of reasons. First, Horizon's conduct is consistent with the purpose of the automatic stay which is to maintain the status quo that exists at the time of the debtor's bankruptcy filing. As discussed in In re Richardson, 135 B.R. 256, 258-59 (Bankr. E.D. Tex. 1992):

> By statute, the filing of a petition for relief imposes a mandatory stay of any creditor's collection attempts. The effect of this stay is to freeze the status quo. To the extent that a creditor fails to desist in these collection attempts and attempts to

> exercise control over property of the estate post-petition, such creditor can be sanctioned pursuant to § 362(h). However, this provision for creditors who affirmatively act in violation of the stay post-petition can not be extrapolated to punish creditors who, while legally seizing the property of the estate prepetition, failed to return this property immediately to the debtor post-petition. In maintaining the seized property in the status it enjoyed just before the filing of debtor's petition, a creditor is merely complying with the spirit of the § 362 freeze.
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> In re Richardson, 135 B.R. 256, 258-59 (Bankr. E.D. Tex. 1992)(emphasis added).

Second, Plaintiffs' position undermines the function of § 542. Taken to its logical conclusion, Plaintiffs' argument leads to the untenable result that the only appropriate non-sanctionable course of action for a creditor in possession of funds of the debtor withheld pre-petition is to turn over the funds to the estate immediately, thereby waiving the right to assert defenses under § 542(b) until after the funds have been turned over pursuant to a motion under § 362. It seems to me that Plaintiffs' attempt to recover the withheld Capitation Payment as a violation of § 362 is an effort to circumvent settled case law that a debtor cannot use the turnover provisions of the Bankruptcy Code to liquidate contract disputes or otherwise demand assets whose titles are in dispute.

Instructive on this point is the reasoning in United States v. Inslaw, Inc., 932 F.2d 1467 (D.C. 1991). In Inslaw, the chapter 11 debtor was a supplier of software enhancements which it

had provided to the Department of Justice ("DOJ") pre-petition. After filing bankruptcy, the debtor asked the DOJ to return the software. When the DOJ refused, the debtor filed a motion alleging that the DOJ had violated § 362(a)(3) by retaining and further disseminating the enhanced software post-petition. The District Court affirmed the bankruptcy court's finding that the DOJ had willfully violated the stay. The Court of Appeals for the District Court of Columbia reversed. It reasoned that:

> ...[The Debtor's] view of § 362(a) would take it well beyond Congress's purpose. The object of the automatic stay provision is essentially to solve a collective action problem--to make sure that creditors do not destroy the bankrupt estate in their scramble for relief. See House Report at 340; Senate Report at 49, 54- 55. Fulfillment of that purpose cannot require that every party who acts in resistance to the debtor's view of its rights violates § 362(a) if found in error by the bankruptcy court. . . . Since willful violations of the stay expose the offending party to liability for compensatory damages, costs, attorney's fees, and, in some circumstances, punitive damages, see 11 U.S.C. § 362(h) (1988), it is difficult to believe that Congress intended a violation whenever someone already in possession of property mistakenly refuses to capitulate to a bankrupt's assertion of rights in that property.
>
> * * *
>
> The limits of the turnover provisions in the bankruptcy code underscore the improbability that Congress intended § 362(a) to have the sweeping scope that [the Debtor] would assign it. It is common ground that these cannot be used against property held by another under a claim of legal right. See cases cited at p.

> 1472 above. As [the Debtor's] view would turn every act of the possessor that implicitly asserts his title over disputed property into a violation of § 362(a), it would give the bankruptcy court jurisdiction over all such disputes, creating a kind of universal end-run around the limits on turnover.
>
> * * *
>
> The automatic stay, as its name suggests, serves as a restraint only on acts to gain possession or control over property of the estate. Nowhere in its language is there a hint that it creates an affirmative duty to remedy past acts of fraud or bias or harassment as soon as a debtor files a bankruptcy petition. The statutory language makes clear that the stay applies only to acts taken *after* the petition is filed. See 11 U.S.C. § 362(a); *In re Stucka,* 77 B.R. 777, 782 (Bankr.C.D.Cal.1987) ("The automatic stay is effective as of the moment of filing of the bankruptcy petition."); *In re Mewes,* 58 B.R. 124, 127 (Bankr.D.S.D.1986) (same).
>
> Inslaw, 932 F.2d at 1473-74.

Third, I am not persuaded by Plaintiffs' argument that Horizon's retention of the withheld Capitation Payment amounts to a violation of the automatic stay because it is an exercise of control over the Debtors' contract rights. Although the Services Agreement itself, and the Debtors' alleged right to payment thereunder, may qualify as property of its estate, the mere breach of the contract itself is not a violation of the stay. See, e.g., Golden Distrib., Ltd. v. Reiss (In re Golden Distrib., Ltd.), 122 B.R. 15, 21-22 (Bankr. S.D.N.Y. 1990)(holding that defendants'

breach of restrictive covenants in employment contracts with debtor was not an attempt to obtain possession or control of property of the estate in violation of § 362(a)(3)); see also 1 DAVID G. EPSTEIN ET AL., BANKRUPTCY, § 3.14 at 174 (West, 1992)("Nothing is lost by failing to stay breach of contract. The cause of action for the breach belongs to the estate. It can remedy the wrong by any appropriate means as in any other action for breach of contract, including the recovery of compensatory, consequential and other damages or an order of specific performance.").

I do not believe my holding here is inconsistent with those cases that hold a secured creditor violates the automatic stay when it knowingly retains post-petition a debtor's collateral seized pre-petition. See, e.g., Knaus v. Concordia Lumber Co. (In re Knaus), 889 F.2d 773, 775 (8th Cir. 1989) ("[T]he duty [to turn over property of the estate] arises upon the filing of the bankruptcy petition. The failure to fulfill this duty, regardless of whether the original seizure was lawful, constitutes a prohibited attempt to 'exercise control over the property of the estate' in violation of the automatic stay."); Carr v. Security Sav. and Loan Ass'n, 130 B.R. 434, 439 (D. N.J. 1991)(it is a violation of the automatic stay in a chapter 13 for a secured creditor to refuse to turn over a repossessed car before the bankruptcy court determines that a subsequent petition was filed in bad faith); In re Sharon, 234 B.R. 676, 686, (B.A.P. 6th Cir.

1999).

These cases are individual bankruptcies and usually involve a secured lender's post-petition retention of the debtor's car. The property at issue is tangible collateral whose ownership by the debtor is not in dispute. The creditor therefor has a mandatory duty to turn over the property under § 542(a). Courts conclude that the creditor's refusal to do so is an act to "exercise control over the property of the estate." Thus, the creditor's refusal in the face of an affirmative duty under § 542(a) comprises the affirmative act which violates the automatic stay.

Horizon does not have a similar duty. Plaintiffs' right to a turnover, if any, arises under § 542(b). Section 542(b) applies to some but not all intangible assets that are property of the estate. Horizon is only obligated to turn over the withheld funds if they are "matured, payable on demand, or payable on order" and if they are not subject to offset under § 553. Thus, even assuming that the withheld Capitation Payment is property of the Debtors' estate for purposes of Rule 12(b)(6), § 542(b) does not necessarily mandate the turn over of the funds. Horizon's preservation of its pre-petition legal status by failing to act post-petition therefore does not amount to an affirmative act in violation of the automatic stay.

I also agree with Horizon that the potential factual

questions concerning whether Horizon possessed a legal right to set-off the Capitation Payment in July is not relevant to the determination of whether Horizon violated the automatic stay. Even if Horizon did not have a contractual or common law right to set-off, this alone would not give rise to a violation of the stay because the act took place pre-petition. At best, if true, FPA New Jersey has a possible cause of action against Horizon for breach of contract. For the same reason, it does not matter whether Horizon's act was a set-off, recoupment or withholding. Similarly, because Horizon's act took place pre-petition, the issue of judicial and equitable estoppel are irrelevant even in the unlikely event that these doctrines apply to the facts of this case.

I also find no merit to Plaintiffs' claim that Horizon violated the Payor Order by failing to remit the withheld Capitation Payment post-petition. This allegation is inconsistent with the language of the order. The Payor Order by its terms only prohibits post-petition withholdings and set-offs. Contrary to Plaintiffs' argument, the Payor Order does not impose an affirmative duty on Horizon to remit funds it withheld pre-petition.

In sum, Horizon's pre-petition act of withholding the July Capitation Payment does not violate §§ 362(a)(3), (a)(6) or (a)(7). It follows that Horizon also did not run afoul of § 362(h) (count IV) nor can its conduct be deemed a waiver of rights based

on a failure to seek relief from stay (count V). I will therefore grant Horizon's motion to dismiss counts I through V of the complaint.

III. Turnover under § 542.

Horizon moves to dismiss count VII of the complaint in which Plaintiffs request turnover of the withheld Capitation Payment under § 542. Horizon argues that it is not in possession of property of the estate because once it acted to exercise its right to withhold the money pre-petition, FPA New Jersey lost all right, title and interest in the receipt of that payment. Horizon therefore concludes that Plaintiffs cannot maintain as a matter of law a cause of action for the turn over of property of the estate.

I recently held in a related adversary proceeding that the complexity of the contractual relationships at issue, and the absence of any evidence either by way of affidavit or copies of the relevant contracts, precludes a determination under Rule 12(b)(6) that the withheld Capitation Payment is property of the Debtors' estate. See Pardo v. Pacificare of Texas, Inc. et al. (In re APF Co.), 264 B.R. 344, 356 (Bankr. D. Del. 2001). Consequently, Plaintiffs are entitled to submit evidence to establish that the withheld Capitation Payment is property of FPA New Jersey's estate. See Scheuer v. Rhodes, 416 U.S. 232, 236, 94 S.Ct. 1683, 1686 (1974)("Indeed, it may appear on the face of the pleadings that a

recovery is very remote and unlikely but that is not the test [for dismissal under Rule 12(b)(6)]").

CONCLUSION

For the reasons set forth above, I grant Horizon's motion to dismiss counts I through V of Plaintiffs' complaint based on alleged violations of the automatic stay. Under the circumstances, Horizon's pre-petition withholding of the Capitation Payment is not a violation of §§ 362(a)(3), (a)(6) or (a)(7). There is therefore also no cause of action under § 362(h); nor can Horizon's conduct be deemed a waiver of rights based on a failure to seek relief from stay. I will, however, deny Horizon's motion to dismiss count VII given the factual dispute surrounding the legal characterization of the withheld Capitation Payment.

UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

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APF Co., et. al.,	)	Case No. 98-1596 (PJW)
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HORIZON HEALTHCARE PLAN HOLDING COMPANY, INC., f/k/a MEDIGROUP, INC. and MEDIGROUP OF NEW JERSEY, INC.,	)	
	)	
Defendants.	)	

ORDER

For the reasons set forth in the Court's Memorandum Opinion of this date, the motion (Doc. # 4) of defendants Horizon Healthcare Plan Holding Company, Inc., f/k/a Medigroup, Inc. and Medigroup of New Jersey, Inc., to dismiss counts I, II, III, IV, V and VII of the Complaint is **GRANTED** as to counts I, II, III, IV and V, and is **DENIED** as to count VII.

/s/ Peter J. Walsh
Peter J. Walsh
United States Bankruptcy Judge

Date: August 31, 2001