STATE OF MICHIGAN

COURT OF CLAIMS

LAKESHORE REGIONAL ENTITY,

Plaintiff,

v

Case No. 25-000078-MK

Hon. Sima G. Patel

STATE OF MICHIGAN, STATE OF MICHIGAN DEPARTMENT OF HEALTH AND HUMAN SERVICES (MDHHS), and ELIZABETH HERTEL, in her Official Capacity as Director of MDHHS,

Defendants.
_____ /

OPINION AND ORDER DENYING DEFENDANTS' MCR 2.116(C)(8) MOTION FOR SUMMARY DISPOSITION, DENYING PLAINTIFF'S COUNTERMOTION FOR PARTIAL SUMMARY DISPOSITION UNDER MCR 2.116(I)(2), AND CONSOLIDATING THIS CASE WITH CASE NO. 24-000198-MZ

In this breach-of-contract and declaratory-judgment action, plaintiff, Lakeshore Regional Entity, sues defendants—the State of Michigan, Michigan Department of Health and Human Services (MDHHS), and Elizabeth Hertel, in her official capacity as Director of MDHHS[1]—after MDHHS announced its intent, beginning February 13, 2025, to lapse over $13.7 million in Medicaid funds for the purpose of repaying a Historical Deficit. Plaintiff alleges that this decision was premised on "flawed accounting," violated the parties' Contracts, and violated a prior ruling

[1] After this lawsuit was filed, Amy Epkey was appointed Acting Director of MDHHS. However, plaintiff has not requested to amend the complaint to replace Hertel with Epkey as a named defendant.

of this Court. At the outset of the case, defendants moved for summary disposition under MCR 2.116(C)(8), arguing that the language of the parties' Contracts supports defendants' position and that plaintiff failed to state a breach-of-contract or declaratory-judgment claim.[2] Plaintiff countermoves for partial summary disposition of certain claims, arguing that some of the arguments raised by defendants are barred by a prior ruling of this Court under principles of res judicata. The Court heard oral arguments on the motion on August 6, 2026. For the reasons discussed in this Opinion and Order, defendants' motion for summary disposition is DENIED, plaintiff's countermotion for partial summary disposition under MCR 2.116(I)(2) is DENIED, and, because the issues in the two cases significantly overlap, this matter is CONSOLIDATED with *NorthCare Network Mental Health Care Entity v Michigan*, Court of Claims Case No. 24-000198-MZ.

I. BACKGROUND

Plaintiff is a regional entity Prepaid Inpatient Health Plan (PIHP) that "helps facilitate delivery of behavioral health services for individuals with mental illness, developmental disabilities, and substance disorders" in several counties on the west side of Michigan. Plaintiff contracts with MDHHS (which administers the Medicaid program in Michigan) to provide PIHP services for its designated region (Region 3).[3] Such services are "carved out" from traditional

[2] MDHHS withheld approximately $4.86 million in capitated payments (as partial satisfaction of the $13.7 million) on February 13, 2025, but placed that amount in escrow after the parties agreed to a status quo order.

[3] In its recent history, Michigan has recognized 10 PIHP regions. However, in 2025, MDHHS announced its intention to reduce the total number of PIHP regions to three and to shift to a competitive-procurement model for each region. That situation was addressed in *Region 10 PIHP v Michigan*, Court of Claims Docket No. 25-000143-MB, which is currently pending on appeal to the Michigan Court of Appeals. The reduction in total PIHP regions does not affect directly the

Medicaid health plans and arrangements via a federal "1115 Behavioral Health Demonstration Waiver." MDHHS also administers the Healthy Michigan Plan (a Medicaid expansion program), which plaintiff helps to facilitate along with Medicaid.[4]

MDHHS receives federal Medicaid funding and transmits those funds to plaintiff. Plaintiff, in turn, contracts with community mental health service programs (CMHs), which provide behavioral health services at the county level. Plaintiff assists in managing services provided by the individual CMHs in its region, essentially reducing the administrative burden on each CMH. According to plaintiff, MDHHS must "pay administrative expenses and fund services provided by CMHs in the counties represented within its region." MDHHS has historically contracted with regional entities, such as plaintiff, and pays plaintiff on a capitated basis "based on a per eligible per month methodology." This means that MDHHS estimates and prepays the amount of funds plaintiff will need to fund future Medicaid services. This matter involves four Fiscal Year (FY) Contracts between the parties: the FY18 Contract, FY19 Contract, the FY20–23 Contract, and the FY24 Contract. Plaintiff declined to sign a proposed FY25 Contract containing a 7.5% cap on the overall amount in the Internal Service Fund (ISF).[5]

To address the situation that may arise if the estimated capitated payments do not reflect the precise costs of Medicaid services, each Contract contained a Risk Corridor provision that

---

issues presented in this lawsuit, although plaintiff alleges that MDHHS's decision to reduce the total number of PIHP regions is a motivating factor behind its accounting in this case.

[4] According to MDHHS, the Contracts permit plaintiff to use surplus Medicaid funds to cover a deficit of Healthy Michigan funds, and vice versa, before using reserve funds.

[5] The FY18, FY19, FY20–23, and FY24 Contracts will collectively be referred to as "the Contracts."

outlined how the parties shared risk. When expenses exceed funding, the parties engage in a process known as Cost Settlement to decide whether plaintiff owes money to the State, whether the State owes money to plaintiff, and whether plaintiff may retain funding. For example, the FY20–23 Contract[6] provided, in relevant part:

> A. The Contractor must retain unexpended risk-corridor-related funds between 95% and 100% of said funds. The Contractor must retain 50% of unexpended risk-corridor[-]related funds between 90% and 95% of said funds. The Contractor must return unexpended risk-corridor-related funds to the MDHHS between 0% and 90% of said funds and 50% of the amount between 90% and 95%.
>
> * * *
>
> C. The Contractor must be financially responsible for liabilities incurred above the risk[-]corridor-related operating budget between 100% and 105% of said funds contracted.
>
> D. The Contractor will be responsible for 50% of the financial liabilities above the risk[-]corridor-related operating budget between 105% and 110% of said funds contracted.
>
> E. The Contractor will not be financially responsible for liabilities incurred above the risk[-]corridor-related operating budget over 100% of said funds contracted.

According to plaintiff, Cost Settlement may take many years and occurs sequentially, meaning that until Cost Settlement for one FY is complete, Cost Settlement for the next FY cannot occur. Given the cost-sharing arrangement, plaintiff was required to establish an ISF for purposes of covering risk exposure. ISFs function like savings or reserve accounts. Under the Contracts, when capitated payments exceed expenses, those excess funds are added to the ISF. If expenses exceed capitated payments, then plaintiff may use ISF funds to cover the shortfall. The FY20–23

[6] The Court will quote the language from the FY20–23 Contract, which is cited throughout the complaint, but notes that the language of the FY18, FY19, and FY20–23 Contracts did not differ in any material respect in relation to the ISF and Risk Corridor provisions.

Contract explained, "The establishment of an ISF is one method for securing funds as part of the overall strategy for covering risk exposure." However, the FY20–23 Contract provided, "The ISF fund balance should be kept *at a minimum* to assure that the overall level of Contractor funds is directed toward consumer services." (Emphasis added.) The FY20–23 Contract explained, "The amount of funds paid to the ISF will be determined in compliance with reserve requirements as defined by [generally accepted accounting principles (GAAP)] and applicable federal and State financing provisions contained in the State/Contractor Contract."

Plaintiff does not have carte blanche discretion over the amount kept in the ISF. In addition to the requirement that the ISF fund balance be kept at a minimum, federal regulations require that risk-sharing mechanisms, such as the ISF, be developed in accordance with a federal regulation requiring actuarial soundness, 42 CFR 438.4, as well as GAAP. See 42 CFR 438.6(b)(1). Section 4(C) of the ISF provision of the FY20–23 Contract specified:

> When establishing an ISF, the Contractor may apply any method it considers appropriate to determine the amounts to be charged to the various funds covered by the ISF provided that:
>
> 1. The total amount charged to the various funds dos not exceed the amount of the estimated liability determined pursuant to Governmental Accounting Standard Board (GASB) Statement No. 10, *General Principles of Liability Recognition*, or such other authoritative guidance as issued by the American Institute of Certified Public Accountants (AICPA); and
>
> 2. Non-compliance with the provision of GASB Statement No. 10 and 2 CFR 200 Subpart E Cost Principles relative to any applicable matter herein will cause the ISF charges to be unallowable for purposes of the State/CMHSP [CMH Services Program] Contract.

Additionally, plaintiff was required to maintain "[a] set of self-balancing accounts" in the ISF "in compliance with [GAAP]," and the ISF was restricted to use for "the defined purpose."

The ISF cannot be used to finance any activities or costs other than what is deemed an "ISF eligible expense." The FY20–23 Contract explained, "Payments to the ISF must be based on either actuarial principles[,] actual historical cost experiences, or reasonable historical cost assumptions, pursuant to the provisions of 2 CFR 200 sub part E." According to plaintiff, balancing the ISF is "[o]ne of the most important components" of Cost Settlement.

As it relates to increasing payments to the ISF, the FY20–23 Contract provided, "The Contractor must establish a policy and procedure for increasing payments to the ISF in the event that it becomes inadequate to cover future losses and related expenses." And when the ISF became overfunded, plaintiff was required under the Contracts to reduce the funding within one FY through abatement of current charges or, if that method was inadequate, through refunds in accordance with 2 CFR 200, Subpart E, Cost Principles. Notably, the contract language for the FY18, FY19, and FY20–23 Contracts did *not* include an express 7.5% cap on the ISF contributions. However, defendants insist that such a cap existed and, when applied in this situation, required that any funds above that limit lapse back to MDHHS. Thus, under MDHHS's accounting methodology, it determined that $13.7 million must lapse back to MDHHS for the FY22 Cost Settlement as described in more detail later in this opinion.

Plaintiff alleges that MDHHS's attempts to limit the cumulative amount in the ISF to 7.5% violated federal regulations requiring that the ISF accounts be developed using actuarial soundness and GAAP. It argues that the only reference to the 7.5% cap on the contributions appeared, for the first time, in the FY24 Contract, which provided, in relevant part: "Contractor may transfer Medicaid Capitation funds up to 7.5% of the Medicaid/Healthy Michigan Plan pre-payment authorization to the ISF in any given year. Contractor may not transfer any funds in excess of that percentage to the ISF in any year." Although the FY24 Contract contemplated an express 7.5%

cap on transfers of capitated funds into the ISF for any given year, the parties dispute whether the 7.5% cap applied to the overall amount that may be present in the ISF. Plaintiff also alleges that, even assuming the 7.5% cap exists under the contractual language, the 7.5% cap does not satisfy GAAP and is not actuarially sound.

Plaintiff further alleges that defendants began underfunding certain PIHPs beginning in FY18, which prevented their member CMHs from receiving complete funding and individuals from receiving medically necessary services. Plaintiff asserts that this funding deficit continued into FY19. Plaintiff asserts that the result of the funding deficit was that plaintiff's CMH partners accumulated a $29 million shortfall (the Historical Deficit) to ensure that individuals continued to receive medically necessary services. However, during FYs 20–22, the deficit became a surplus after the CMHs, plaintiff, and the State implemented "a series of changes." In 2022, plaintiff stated its intention to use surplus funds to pay down the Historical Deficit. MDHHS maintained that if plaintiff used surplus or ISF funds to pay the deficit, then it would be in breach of the FY20–23 Contract.

The dispute led to a September 2022 declaratory action in this Court, *Lakeshore Regional Entity v Michigan*, Court of Claims Case No. 22-000146-MK, before Court of Claims Judge DOUGLAS B. SHAPIRO (the 2022 Lawsuit). In the 2022 Lawsuit, plaintiff sought a declaration that it could use its Medicaid savings funds, surplus funds, or ISF funds to reimburse its member CMHs for the Historical Deficit. Defendants[7] sought to prevent payment of the Historical Deficit through ISF or surplus funding, arguing that the Contracts were prospective in nature and did not allow

[7] The lawsuit involved the same parties, although there were two intervening plaintiffs in the 2022 Lawsuit who are not involved in this lawsuit.

payment of past deficits through ISF or surplus funds. Defendants argued in connection with that lawsuit that plaintiff was properly funded and that the shortfall resulted from financial mismanagement. During the 2022 Lawsuit, the parties provided the Court with a requested Joint Glossary, which included agreed-upon definitions of key terms to assist the Court with the technical details of the case.

On March 23, 2023, Judge SHAPIRO issued an opinion and order granting plaintiff's motion for summary disposition and denying defendants' motion for summary disposition, finding that plaintiff could pay the Historical Deficit from FY22 surplus funds *and* plaintiff's ISF. *Lakeshore Regional Entity v Michigan*, opinion of the Court of Claims, issued March 23, 2023 (Docket No. 22-000146-MK). The basis for the Court's decision was MDHHS's approval of plaintiff's Proposal to Resolve the Historical Deficit, which appeared as part of a settlement agreement in an administrative matter that plaintiff filed after MDHHS threatened to end the parties' relationship over issues surrounding the Historical Deficit. *Id.* at 5-6. The parties' Proposal to Resolve the Historical Deficit contemplated payment of the Historical Deficit through, in relevant part, ISF funds and FY20 surplus funds. *Id.*

Additionally, the Court explained that MDHHS approved plaintiff's FY22 Risk Management Strategy, which, in relevant part, represented that plaintiff would use any FY22 surplus funds to settle the Historical Deficit. *Id.* at 7-8. The Court therefore ruled that even if MDHHS were correct on the interpretation of the Contracts, "it waived enforcement of the contract provisions it relies on or alternatively agreed to a modification of the contract so as to allow payment of the subject historical deficit from surplus funds and its ISF." *Id.* at 9. However, the opinion explained, "The Court makes no findings as to the disputed contractual language . . . ." *Id.* at 9 n 7. Neither party appealed. MDHHS argues that the current case is distinguishable from

the 2022 Lawsuit because the opinion in that case was based on the settlement agreement and risk-management plan rather than the language of the FY20-23 Contract. There is no dispute that the issue of the 7.5% cap was not raised or decided in the 2022 Lawsuit. There is also no dispute that the 2022 Lawsuit was filed and decided before FY24.

Although the 2022 Lawsuit resolved *what* funds may be used, a new dispute quickly arose after the decision in the 2022 Lawsuit about *how* those funds could be used. Defendants summarize the dispute in their motion for summary disposition as follows:

> Lakeshore argues that the FY18 and FY19 payments should be applied to the ISF before allowable expenditures are subtracted from the total revenue for the year and Lakeshore should treat the debt payments like they were Medicaid services provided in that year. MDHHS argues that the debt payments are not current year expenditures and that the debt payments should apply once the ISF for the FY22 maximum balance is calculated.

In early November 2023, Kristen Jordan, Director of the Bureau of Specialty Behavioral Health Services, issued a memorandum to plaintiff about Cost Settlement for FY18 through FY22, outlining MDHHS's expectation that plaintiff would use its ISF to cover the Historical Deficit. For FY22, the memorandum provided that "[t]he ISF will be utilized to cover the [FY18] and [FY19] unfunded local share of the risk corridor." The memorandum added, "Section 1.1 PIHP Transferred To/From ISF balances of the ISF report will be utilized to report the portion of the ISF used to cover the [FY18] and [FY19] unfunded local share of the risk corridor." Additionally, "[t]he Medicaid lapse shall be returned to MDHHS." The ISF worksheet allows PIHPs to input certain data into locked calculations developed by MDHHS. According to plaintiff, portions of the workbook are locked and cannot be edited. Section 1.1 of the worksheet is where the PIHP shows transfers made into and out of the ISF during the year. The worksheet then calculates the final balance after transfers to decide whether the ISF exceeds the 7.5% cap.

According to plaintiff, the Excel worksheet showed that the ISF was within allowable limits (with an ISF balance of about $28 million) and therefore plaintiff did not owe more funds to MDHHS. However, on July 24, 2024, MDHHS issued a letter to plaintiff, taking a different approach to the accounting. MDHHS took the position that approximately $13.7 million must lapse back to MDHHS and explained that it disagreed with how plaintiff had calculated the amount owed because the ISF had to be capped at the 7.5% limit first, and then plaintiff could deduct the Historical Deficit payment. MDHHS explained:

> A condition of the approved reporting exception was that the contribution to the ISF would be calculated prior to utilization on the prior year deficits and would not exceed the maximum allowed for the FY22 contract period. The . . . ISF balance reflected in the compliance examined [financial status report] exceeds the maximum allowed . . . for the contract year.

On January 30, 2025, MDHHS informed plaintiff that it intended to lapse over $13.7 million from Medicaid funds owed to plaintiff beginning on February 13, 2025. On February 13, 2025, MDHHS withheld approximately $4.86 million for payments due under the FY24 Contract, but the parties were able to negotiate a status quo order, in which MDHHS placed the $4.86 million in escrow and agreed to provide notice of additional withholdings to give plaintiff time to file this lawsuit. The status quo order was extended during this lawsuit. Plaintiff alleges that the withholdings will result in its ISF account being "significantly reduced if not completely depleted." Plaintiff further alleges that MDHHS cannot offset payments due for one year against disputed payments from another year. Plaintiff asserts that MDHHS owes $1,418,547 to plaintiff for FY18 and $3,026,559 for FY19, regardless of the Historical Deficit for this timeframe. Plaintiff recognizes it owes $4,140,766 to MDHHS for FY21—but only if the amount of the ISF contributions are capped at 7.5%. Plaintiff maintains that if this Court determines the 7.5% cap does not apply on either an annual or cumulative basis, plaintiff does not owe any money to

MDHHS for FY21. The net result of this accounting, according to plaintiff, is that a net payment of $304,340 is owed *to* plaintiff.

Plaintiff filed this lawsuit on May 13, 2025, raising six claims for relief. Count I of the complaint alleges that defendants breached the FY18 Contract by failing to pay the amount owed for that FY simply because no agreement has been reached regarding the FY22 Cost Settlement. Count II alleges that defendants breached the FY19 Contract by not paying plaintiff the amount owed for that FY. Count III alleges that defendants breached the FY20–23 Contract and the parties' FY22 Cost Settlement by (1) prohibiting plaintiff from contributing more than 7.5% of its Medicaid funds to its ISF, (2) requiring plaintiff to account for payment of the Historical Deficit by using FY22 ISF funds when Judge SHAPIRO permitted plaintiff to use ISF funds *or* surplus funds, and (3) applying a nonexistent 7.5% ISF cap to the amount available for repayment of the Historical Deficit. Plaintiff alleges approximately $13.7 million in total damages (the amount claimed by MDHHS as the lapse payment), plus any amount plaintiff would have contributed to its ISF but for the imposition of the 7.5% cap.

Count IV of the complaint alleges that MDHHS breached the FY20–23 Contract by prohibiting plaintiff from contributing more than 7.5% of the capitated payments on an annual or cumulative basis to its ISF and improperly withholding $4.14 million owed under the FY24 Contract for payment of the amount owed for FY21. Count V raises a claim for breach of the FY24 Contract and asserts that defendants improperly withheld over $4.85 million in payments owed to plaintiff that FY on the basis of what defendants believed plaintiff owed for the FY21

Cost Settlement.[8] Plaintiff notes that the Contracts allowed plaintiff a period of one year to reduce the ISF to an acceptable level before MDHHS may act. Finally, Count VI raises a claim for a declaratory ruling that the FY18, FY19, and FY20–23 Contracts do not contain a 7.5% limit on the amount plaintiff can contribute annually or cumulatively to its ISF or that any such limit would be void. Count VI further requests a declaratory ruling that plaintiff may fund its ISF on an annual and cumulative basis up to an actuarially sound amount and that plaintiff may account for payment of the Historical Deficit using FY22 surplus funds *or* FY20/FY22 ISF funds. Finally, plaintiff asserts that even assuming a cap applies, it should be applied to the balance remaining in the ISF *after* payment of the Historical Deficit

Defendants moved for summary disposition at the outset of this case, arguing that (1) the language of each Contract limited the annual contributions and total account balance in the ISF accounts to 7.5% and complied with federal regulations and GAAP; (2) the Contracts and federal regulations require that plaintiff lapse $13.7 million back to the State; and (3) a finding in defendants' favor does not violate Judge SHAPIRO's Opinion and Order from the 2022 Lawsuit. Defendants further argue that plaintiff does not state a claim in relation to FY24. They contend that the FY24 Contract allowed MDHHS to offset funds for amounts due and owing, which was the case here. Finally, defendants argue that plaintiff cannot state a claim in relation to FY18 and

[8] In Count V, plaintiff alleges it has been damaged in the amount of at least $4,140,766 (presumably referring to the amount it acknowledges it owes for FY21 but claims could not be withheld for FY24). However, plaintiff further alleges that it has been damaged in the amount of $4,858,348 for FY24, which is the amount MDHHS withheld on February 13, 2025. The Court need not resolve the precise amount at issue in Count V for purposes of resolving the motion for summary disposition but notes that the amount plaintiff asserts is owed under the FY24 Contract would be an appropriate subject for discovery.

FY19 because plaintiff's claims for those FYs are not ripe. Defendants note that the amount withheld has been placed in escrow.

Plaintiff responds that the FY18, FY19, and FY20–23 Contracts do not include a 7.5% cap on either annual ISF contributions and total ISF balances, and that any caps on contributions should be decided based on sound actuarial principles rather than an arbitrary, flat rate. Plaintiff also argues that MDHHS ignored the prior Court of Claims ruling from the 2022 Lawsuit that plaintiff could use *either* ISF *or* the surplus funds to pay the Historical Deficit and contends that res judicata prohibits defendants from relitigating the issues raised in the 2022 Lawsuit in the context of this lawsuit. Plaintiff further argues that the ruling in the 2022 Lawsuit allowed payment of the Historical Deficit from surplus funds without regard to any ISF cap, and therefore plaintiff is entitled to summary disposition under MCR 2.116(I)(2) on that issue.

Plaintiff contends that even if this Court disagrees on the interpretation of the opinion in the 2022 Lawsuit, factual disputes prevent summary disposition under MCR 2.116(C)(8) because discovery is needed regarding whether the 7.5% cap is actuarially sound and complies with GAAP. They argue that the remedy, even if MDHHS were correct, would not be an immediate lapse of the funding back to the State. Rather, plaintiff should have a full year to reduce the ISF balance to the correct level. Plaintiff also argues that defendants cannot offset payments across FYs, for purposes of FYs 18, 19, and 24. For example, because defendants admit that money was owed to plaintiff for FY18 and FY19, MDHHS cannot withhold that money to satisfy future disputed Cost Settlement amounts. Plaintiff argues the same is true for the more recent payments owed to plaintiff under the FY24 Contract. Plaintiff further argues that defendants' ripeness argument relating to FYs 18 and 19 lacks merit because plaintiff has not received money it is owed at the present time, rendering its claims ripe for judicial review.

Defendants reply by reiterating that the language of the Contracts supports their interpretation that the ISF is subject to 7.5% annual and total contribution limits and that there is no provision of federal law that prohibits the parties from agreeing to such a cap. They also argue that the 2022 Lawsuit did not resolve whether the ISF limit could deviate from the cap imposed by the Contracts. Defendants further reiterate that plaintiff "must return 7.5% over any surplus of funds to MDHHS . . . [a]nd MDHHS must pay [plaintiff] for funds spent after the initial 7.5%." The Court heard oral arguments on the motion on August 6, 2026.

II. ANALYSIS

Defendants move for summary disposition under MCR 2.116(C)(8).

> A motion under MCR 2.116(C)(8) tests the legal sufficiency of a claim based on the factual allegations in the complaint. When considering such a motion, a trial court must accept all factual allegations as true, deciding the motion on the pleadings alone. A motion under MCR 2.116(C)(8) may only be granted when a claim is so clearly unenforceable that no factual development could possibly justify recovery. [*El-Khalil v Oakwood Healthcare, Inc*, 504 Mich 152, 159-160; 934 NW2d 665 (2019) (cleaned up).]

MCR 2.116(I)(2) provides, "If it appears to the court that the opposing party, rather than the moving party, is entitled to judgment, the court may render judgment in favor of the opposing party." Additionally, because the case involves the interpretation of the parties' Contracts, the Court recognizes the following principles of contract interpretation:

> The main goal in the interpretation of contracts is to honor the intent of the parties. This is done by giving the plain and unambiguous words of a contract their plain and ordinary meaning. The words and phrases of the contract cannot be read in isolation but must be construed in context and read in light of the contract as a whole. If the contract, although inartfully worded or clumsily arranged, fairly admits of but one interpretation, it is not ambiguous. [*Allen Park Retirees Ass'n, Inc v Allen Park*, 347 Mich App 1, 11; 13 NW3d 865 (2023) (cleaned up).]

When a contract is ambiguous, its meaning becomes a question of fact to be decided by the trier of fact. *Klapp v United Ins Group Agency, Inc*, 468 Mich 459, 469; 663 NW2d 447 (2003).

A. BREACH OF CONTRACT: FYS 21 AND 22

The first issue presented on summary disposition involves the interpretation of the ISF provision within the parties' Contracts, which affects Counts III (breach of contract re: FY22 Cost Settlement), IV (breach of contract re: FY21 Cost Settlement), and VI (declaratory relief). Defendants challenge whether plaintiff has pleaded a claim for breach of contract, as well as whether plaintiff has adequately pleaded damages. The central dispute is whether the plain language of the Contracts limited the ISF annual contributions and account balances to 7.5% of the annual capitated payment.

"A party asserting a breach of contract must establish by a preponderance of the evidence that (1) there was a contract (2) which the other party breached (3) thereby resulting in damages to the party claiming breach." *Miller-Davis Co v Ahrens Constr, Inc*, 495 Mich 161, 178; 848 NW2d 95 (2014). MCR 2.605(A)(1) provides, "In a case of actual controversy within its jurisdiction, a Michigan court of record may declare the rights and other legal relations of an interested party seeking a declaratory judgment, whether or not other relief is or could be sought or granted."

In Counts III and IV, plaintiff asserts that defendants prohibited plaintiff from contributing more than 7.5% of its Medicaid capitated payments to its ISF, and improperly required plaintiff to account for payment of the Historical Deficit after reducing the ISF balance to that cap. Plaintiff further alleges that defendants are improperly limiting its ability to pay the Historical Deficit through the ISF.

The only reference to a 7.5% cap appears in the FY24 Contract, which provides, in relevant part, "Contractor may transfer Medicaid Capitation funds up to 7.5% of the Medicaid/Healthy Michigan Plan pre-payment authorization to the ISF in any given year. Contractor may not transfer any funds in excess of that percentage to the ISF in any year." This Court addressed a similar FY24 Contract provision in *NorthCare*, Case No. 24-000198-MZ, a case that also involves MDHHS's historical contracts with certain regional-entity PIHPs. This Court explained:

> When read in isolation, this provision of the FY24 Contract is limited to the contributions per year—and not the total amount in the ISF account. The provision does not say anything about a limit on the total amount in the ISF account. And no other restrictions appear in the ISF section of the contract, other than a broad suggestion that "[t]he ISF fund balance should be kept at a minimum to assure that the overall level of Contractor funds is directed toward consumer services." The Contract does not specify that the "minimum" must be capped at 7.5% of the annual operating budget. [*NorthCare Network Mental Health Care Entity v Michigan*, amended opinion of the Court of Claims, issued June 3, 2026 (Docket No. 24-000198-MZ), p 21.]

The Court finds that same ruling applicable here, where the FY24 Contract referred to a 7.5% cap for "any given year," and did not include an express limit on the total amount in the ISF account. Moreover, the FY18, FY19, and FY20-23 Contracts did *not* contain the language referencing a 7.5% cap on either annual contributions or the total amount in the ISF, making the case even stronger that such a cap did not apply.

Defendants recognize that the 7.5% cap does not appear expressly in any Contract other than the FY24 Contract. To support their interpretation that there is, in fact, a 7.5% cap on ISF contributions, defendants rely on the language of the Risk Corridor language, which again provided, in relevant part:

> A. The Contractor must retain unexpended risk-corridor-related funds between 95% and 100% of said funds. The Contractor must retain 50% of unexpended risk-corridor[-]related funds between 90% and 95% of said funds. The

> Contractor must return unexpended risk-corridor-related funds to the MDHHS between 0% and 90% of said funds and 50% of the amount between 90% and 95%.
>
> * * *
>
> C. The Contractor must be financially responsible for liabilities incurred above the risk corridor-related operating budget between 100% and 105% of said funds contracted.
>
> D. The Contractor will be responsible for 50% of the financial liabilities above the risk corridor-related operating budget between 105% and 110% of said funds contracted.
>
> E. The Contractor will not be financially responsible for liabilities incurred above the risk corridor-related operating budget over 100% of said funds contracted.

Defendants argue that this language supports that "7.5% over the surplus must be returned to MDHHS," and that "[t]he combined effect" of the provisions "mandate that Lakeshore, and not MDHHS, is financially responsible for 107.5% of their liabilities." Plaintiff, in contrast, argues that the ISF and Risk Corridor provisions "serve distinct purposes," as demonstrated by their separate treatment in different portions of the Contract.

Defendants raised a nearly identical argument about the Risk Corridor provisions in *NorthCare*, and this Court concluded as follows:

> The Court agrees with plaintiffs that, at the very least, the contractual language contains an ambiguity because it could be interpreted either way—as allowing a cumulative total of over 7.5% in the ISF and as prohibiting a total exceeding that amount. It is unclear from the statutory language whether the Risk Corridor section of the contract was intended to apply to the ISF account provision in the manner defendants suggest and, if so, whether it would apply to cap the total amount in the ISF funds to 7.5%. Both parties' interpretations of the statutory language are plausible. Because the meaning of the contractual provision in the FY24 Contract is not inherent in the plain language, the provision is ambiguous, and discovery is appropriate to develop the factual record on this issue. [*Id*. at 22.]

The Court adopts the same reasoning in this case. Because the language of the Risk Corridor provision does not expressly provide that a 7.5% cap applies to the ISF, the provision

could be interpreted either way, and discovery is required to determine its precise meaning in this context. Another factual issue for discovery is whether plaintiff's argument is correct that a 7.5% cap is arbitrary and not actuarially sound, in violation of federal regulations requiring that the ISF be maintained in accordance with GAAP. See 42 CFR 438.6(b)(1). Once again, a similar issue was raised in *NorthCare* on a (C)(8) motion in relation to the FY24 Contract:

> [A] further factual question exists for discovery: whether this restriction was actuarially sound. Plaintiffs allege that the ISF provision in the FY24 Contract violates 42 CFR 438.6(b)(1), which requires that risk-sharing mechanisms between the State and a PIHP are formed through "generally accepted actuarial principles and practices," and 42 CFR 438.4(a), which requires actuarial soundness in relation to capitation rates. The parties also dispute whether the provision violates 42 CFR 438.6(c)(1), which prohibits MDHHS from directing plaintiffs' expenditures under the contract.
>
> Plaintiffs assert that the 7.5% limit is not actuarially sound or developed following generally accepted actuarial principles or practices. Plaintiffs allege that NorthCare retained an actuarial firm, Milliman, Inc., to perform an analysis of its ISF, which resulted in a conclusion that it should be funded at a higher rate of 12.3% of the annual operating budget. Plaintiffs also cite as evidence 2 CFR Pt 200, App V, which is a Code of Federal Regulations Appendix relating to state and local government central service cost allocation plans, to support that the ISF limit should be closer 16.4%, rather than 7.5%. In sum, plaintiffs suggest that the entire mechanism through which defendants restrict their use of their ISFs violated the federal regulations and fundamental actuarial principles. [*NorthCare*, op at 22-23.]

This Court resolved the issue as follows:

> The issue whether the 7.5% limit complied with the federal regulations involves questions of fact on what an actuarially sound level is and whether the actuarial methods were used, which require development of the factual record in discovery. . . . Also, plaintiffs rely on Government Accounting Standards Board (GASB) Statement No. 10, which was cited in the FY24 Contract and which plaintiffs argue permits funding of the ISF account over a reasonable period without a specific cap on contributions. Thus, they have cited a factual basis to support their claim. [*Id.* at 23-24.]

The Court adopts the same reasoning in this case. The issues regarding the actuarially sound level and whether the appropriate actuarial methods were used to develop the 7.5% cap require development of the factual record in discovery. The Court recognizes defendants'

argument that the lack of a cap would create an absurd result because plaintiff could "stockpile" a limitless balance in the ISF account, but notes that plaintiff is restricted in terms of how much funding is in the ISF by certain provisions of the Contracts in question, including the requirement that the ISF be kept at a minimum, as well as the requirement that the ISF be maintained and developed in a manner that is actuarially sound.

Defendants further contend that the federal regulations cited by plaintiff do not apply in this case, particularly because, under its authority in 42 CFR 438.3(a) to approve all PIHP contracts, the Centers for Medicare & Medicaid Services (CMS) approved the Contracts in question. However, defendants do not cite any legal basis to support that CMS's approval of the Contracts (the majority of which did not include an express 7.5% ISF cap) constituted a legally binding conclusion that the caps are actuarially sound or otherwise comply with federal regulations. Nor does it appear that CMS ever confronted the legal questions presented in this case in an administrative matter for purposes of res judicata or collateral estoppel.

Defendants also argue that plaintiff has not alleged damages with a reasonable degree of certainty. They rely on the principle that "[t]he party asserting a breach of contract has the burden of proving its damages with reasonable certainty, and may recover only those damages that are the direct, natural, and proximate result of the breach." *Van Buren Charter Twp v Visteon Corp*, 319 Mich App 538, 550; 904 NW2d 192 (2017) (cleaned up). Damages cannot be conjectural, speculative, or contingent in nature. *Id.* Defendants contend that plaintiff's argument that it would not owe money to MDHHS is speculative and "nonsensical." They argue, "Lakeshore asks this Court to enforce the portions of the Contracts that require MDHHS to pay Lakeshore when Lakeshore has overspent their capitated rate, but Lakeshore also asks that they be permitted to keep any funds that they do not spend."

However, plaintiff outlines in its complaint how the imposition of a blanket 7.5% cap on its ISF account leads to a massive disparity between the amount MDHHS claims should lapse and the amount plaintiff alleges that it is owed per FY. Plaintiff alleges that it is owed funds for FY18–19 that cannot be used to pay the Historical Deficit. These allegations give rise to factual disputes warranting development in discovery. Furthermore, plaintiff asserts that, even if the 7.5% cap applied, the Contracts allowed plaintiff one year to reduce the ISF balance to the appropriate level before lapse. Yet MDHHS withheld millions of dollars without allowing the one-year period to lapse, giving rise to damages in the amount withheld. This allegation of damages has been pleaded with reasonable certainty. For the reasons discussed, plaintiff stated valid breach-of-contract and declaratory-judgment claims for Counts III, IV, and VI, and a factual dispute exists over whether the 7.5% caps are incorporated within the Contracts and are actuarially sound.

B. EFFECT OF 2022 LAWSUIT

Next, defendants argue more broadly that the Contracts and federal regulations mandate that plaintiff must lapse $13.7 million back to the State. Defendants argue the issues presented in this lawsuit were not resolved in the 2022 Lawsuit. Plaintiff retorts that Judge SHAPIRO ruled in an Opinion and Order in the 2022 Lawsuit that plaintiff could use ISF or surplus funds to pay down the Historical Deficit, and that ruling is protected from relitigation under principles of res judicata. Plaintiff therefore argues it is entitled to summary disposition of parts of Count III and VI of the complaint.

Res judicata prevents multiple lawsuits arising from the same cause of action and "bars a second, subsequent action when (1) the prior action was decided on the merits, (2) both actions involve the same parties or their privies, and (3) the matter in the second case was, or could have been, resolved in the first." *Adair v Michigan*, 470 Mich 105, 121; 680 NW2d 386 (2004). Judge

SHAPIRO ruled in the 2022 Lawsuit that even if MDHHS were correct on the interpretation of the Contracts, "it waived enforcement of the contract provisions it relies on or alternatively agreed to a modification of the contract so as to allow payment of the subject historical deficit from surplus funds and its ISF." *Id.* at 9.[9]

Although Judge SHAPIRO previously ruled that plaintiff may use its ISF or the surplus funds to pay the deficit, there is no dispute that the precise issues raised in this case were not presented in the declaratory action, or that Judge SHAPIRO specifically declined to engage in any contractual interpretation. As defendants explain, their dispute is not over whether the ISF or surplus funds may be used, but whether the 7.5% cap applies to the available funds: "Defendants do not disagree that the order provides for payment using the ISF or surplus funds. However, whether surplus funds or the ISF is used, the 7.5% cap still applies." Moreover, this case also involves new issues that arose during FY24, which could not have been raised in the 2022 Lawsuit. Because Judge SHAPIRO's ruling did not address this accounting issue (and indeed expressly declined to address any issues of contractual interpretation), the Court concludes that this is not a matter that is barred by res judicata.

The parties also disagree about the impact of the Joint Glossary submitted in the 2022 Lawsuit, which defined the term "surplus funds" for purposes of the 2022 Lawsuit and Judge SHAPIRO's ruling. However, in the 2022 Lawsuit, the parties agreed that the term "surplus funds" was not defined in the Contracts and that its meaning would depend on the context. The parties

[9] Defendants did not raise the precise issue in the 2022 Lawsuit that they raise in this case regarding the 7.5% cap on ISF funding. Again, that matter related to what funds could be used, while this matter relates to how the funds may be used.

agreed that the term "surplus funds" includes two potential definitions: funds that remain in Medicaid or Healthy Michigan after payment of expenses or services but before funding any deficit or reserve fund, such as the ISF, or funding that is subject to lapse back to the State, meaning "money that remains after payment of current year expenses/services, after funding or replenishment of reserves such as Medicaid Savings and ISF, and after final cost settlement is complete."

The plain language of those definitions does not address the central question of whether the 7.5% cap would apply in this context. Nor does it definitively answer which party has appropriately calculated the Cost Settlement. Additionally, the Court concludes that factual disputes exists over whether plaintiff's calculations are consistent with federal regulations and the requirement that plaintiff keep its ISF "at a minimum" at all relevant times. Because factual questions exist in this case that are ripe for discovery, the Court DENIES summary disposition in relation to Counts IV and V. Furthermore, because the precise issues in this case were not decided in the 2022 Lawsuit, and plaintiff has not established that they could have been decided in the context of the 2022 Lawsuit, the Court DENIES plaintiff's countermotion for partial summary disposition of Counts III and parts of Count VI under MCR 2.116(I)(2).

C. FY18, 19, AND 24 CONTRACTS

As it relates to Counts I, II, and V, plaintiff contends that defendants cannot offset payments across different FYs to account for the Historical Deficit. In Count V, plaintiff alleges that MDHHS improperly withheld approximately $4.86 million in payments under the FY24 Contract. In Counts I and II, plaintiff alleges defendants breached the FY18 and FY19 Contracts, respectively, by failing to pay funds owed to plaintiff for those years.

For FY24, defendants argue that summary disposition is appropriate. They rely on a provision in the FY24 Contract allowing defendants to set off any amount "then due and owing to it" by plaintiff to support that it is entitled to withhold the funds in question. They also argue that plaintiff does not have damages for FY24. However, what amount is "due and owing" to MDHHS is a factual question for the reasons discussed earlier. Plaintiff stated a claim for relief in Count V.

For FY18 and FY19, defendants argue that the claims are not ripe because MDHHS was permitted to offset funds under the Contract and has agreed to stay the withholdings and hold already-withheld funds in escrow. The doctrine of ripeness requires that a party sustain an actual injury to bring a claim and prevents a plaintiff from bringing a claim based on a hypothetical controversy. *Van Buren*, 319 Mich App at 554.

The Court agrees with plaintiff that a ripe dispute exists over whether plaintiff is owed money for FY18 and FY19. Defendants' argument that the claim is not yet ripe because it has agreed to stay the $13.7 million lapse payment lacks merit. The claims regarding FY18 and FY19 relate to what plaintiff characterizes as overdue funding. The fact that defendants have agreed to temporarily suspend withholdings and place withheld funds into escrow does not render plaintiff's claims hypothetical in nature. Plaintiff has stated cognizable breach-of-contract claims in Counts I and II.

D. CONSOLIDATION WITH 24-000198-MZ

As discussed throughout this Opinion and Order, this case has multiple common questions of fact and law with *NorthCare*, Case No. 24-000198-MZ. Discovery in both matters will significantly overlap, particularly on whether MDHHS can impose a 7.5% cap on the amount that

regional entities can contribute to their ISF accounts on annual and cumulative bases, as well as whether the 7.5% cap is actuarially sound. Although the current plaintiff is not a plaintiff in *NorthCare*, it has retained the same counsel as the plaintiffs in *NorthCare*. Defendants in this matter are also the same defendants as in *NorthCare*. Accordingly, on the Court's own motion, this matter is consolidated with Case No. 24-000198-MZ.[10]

III. CONCLUSION

IT IS ORDERED:

1. Defendants' motion for summary disposition is DENIED.
2. Plaintiff's partial countermotion for summary disposition under MCR 2.116(I)(2) is DENIED.
3. This matter is CONSOLIDATED with 24-000198-MZ.
4. This order does not resolve the last pending claim and does not close the case.

Date: September 3, 2026

Sima G. Patel
Judge, Court of Claims

[10] The Court asked counsel for both parties at the hearing whether this matter should be consolidated with *NorthCare*. Counsel for both parties responded that they would need to consult with their client before expressing an opinion on the issue.