Department of Health and Human Services
DEPARTMENTAL APPEALS BOARD
Appellate Division

Missouri Department of Social Services
Docket No. A-13-29
Decision No. 2546
December 3, 2013

DECISION

The Missouri Department of Social Services (Missouri) appeals in part a decision by the Centers for Medicare & Medicaid Services (CMS) to disallow $704,194 in federal financial participation (FFP) claimed for Missouri's Medicaid program. According to CMS, the total disallowed amount represents the federal share of Medicaid provider overpayments for federal fiscal year 2003 that Missouri did not return to CMS as required by section 1903(d)(2)(C) of the Social Security Act (Act). Missouri appeals $139,249 of the disallowance, which consists of court-ordered penalties, fines, and costs that were awarded to it in successful litigation to recover from providers amounts which Medicaid had overpaid them. Missouri maintains that the penalties, fines, and costs do not themselves constitute provider overpayments subject to section 1903(d)(2)(C).

As we explain below, we agree with Missouri that the penalties, fines, and costs are not provider overpayments under section 1903(d)(2)(C), the federal share of which a state must refund to CMS regardless of whether the state has recovered the overpayments. Nonetheless, we uphold the disallowance at issue to the extent that it consists of court-ordered penalties, fines, and costs that Missouri has actually collected but not yet refunded to CMS. Once Missouri has collected those court-ordered awards, it must treat them as applicable credits that reduce the amount of Medicaid expenditures in which it claims FFP. Accordingly, Missouri's retention of the federal share of any such funds results in an overpayment by CMS to Missouri within the meaning of section 1903(d)(2)(A) of the Act, and CMS is authorized to recoup that overpayment via a disallowance. However, the record is unclear about how much of the challenged disallowance involves court-ordered awards that Missouri already collected or has yet to collect, and the parties make inconsistent representations on this point. Such court-ordered awards are not subject to requirements, applicable to provider overpayments, that the federal share must be repaid even before a state actually collects from the provider. Therefore, we uphold the disallowance in principle but remand to CMS to recalculate the final amount based on documentation from Missouri as to what part, if any, of the disallowance constitutes penalties, fines, and costs ordered by a court but not yet

collected from the providers by Missouri. Our decision does not preclude CMS taking a future disallowance to reflect any court-awarded penalties or costs actually collected by Missouri in the future.

Applicable Law

Section 1903(d) of the Act, 42 U.S.C. § 1396b(d), establishes a system by which states receive federal funds for Medicaid prior to the beginning of each calendar quarter based on their estimated expenditures for that upcoming quarter. Section 1903(d)(2)(A) provides that, after estimating a state's expenditures, the "Secretary shall then pay to the State, . . . , the amounts so estimated, reduced or increased to the extent of any overpayment or underpayment which the Secretary determines was made under this section to such State for any prior quarter and with respect to which adjustment has not already been made under this subsection."

Section 1903(d)(2)(C) requires states to refund to CMS the federal share of any Medicaid overpayment "made by a State to a person or entity," which we refer to as a provider overpayment, "whether or not recovery was made." During the period at issue here, under section 1903(d)(2)(C) a state had 60 days from the date of discovery of a provider overpayment to attempt to recover that overpayment from the provider before making an adjustment on its Quarterly Medicaid Statement of Expenditures for the Medicaid Assistance Program (Form CMS-64) to refund the federal share.[1]

The regulations related to refunding the federal share of Medicaid provider overpayments to CMS are found at 42 C.F.R. Part 433 subpart F. Those regulations define a provider "overpayment" as "the amount paid by a Medicaid agency to a provider which is in excess of the amount that is allowable for services furnished under section 1902 of the Act and which is required to be refunded under section 1903 of the Act." 42 C.F.R. § 433.304.

Principles for determining the allowability of costs for which states claim federal funding under grant programs such as Medicaid are found in Office of Management and Budget (OMB) Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments," codified at 2 C.F.R. Part 225 (70 Fed. Reg. 51,910 (Aug. 31, 2005)), and made applicable to states by 45 C.F.R. § 92.22(b). According to those principles, the total costs that a state claims for a federal award must be reduced by any "applicable credits." *See* 2 C.F.R. Part 225, App. A, ¶¶ C.1.i, D.1. Applicable credits are "those

[1] The Affordable Care Act (ACA) extended the recovery period to one year and allowed a state to delay refunding the federal share of provider overpayments due to fraud pending a final administrative or judicial determination, but only for overpayments identified after the effective date of the ACA. *See* Pub. L. No. 111-148, 124 Stat. 119, 777, § 6506(a)(1) (2010).

receipts or reduction of expenditure type transactions that offset or reduce expense items allocable to Federal awards as direct or indirect costs." *Id.* ¶ C.4.a. Examples of applicable credits include purchase discounts, rebates or allowances, recoveries or indemnities on losses, insurance refunds or rebates, and adjustment of erroneous charges. *Id.* "To the extent that such credits accruing to or received by" a state "relate to" allowable Medicaid costs, the state must credit them to its Medicaid award "as either a cost reduction or a cash refund." *Id.* Thus, a state that fails to reduce its claimed Medicaid expenditures to account for an applicable credit has received an overpayment of FFP from the federal government. *See Cal. Dep't of Fin.*, DAB No. 1592, at 6 (1996).

Background

In 2004, the U.S. Department of Health and Human Services, Office of Inspector General (OIG) began examining Missouri's accounts receivable system for Medicaid provider overpayments that were reportable during federal fiscal year 2003. Missouri Exhibit (Miss. Ex.) 2, at i. The OIG concluded that as of December 7, 2004, Missouri had failed to repay the federal government $1,068,751 in FFP attributable to 29 provider overpayments. *Id.*

Missouri returned a significant portion of the OIG-recommended recovery to CMS, but in November 2005, CMS notified Missouri that $715,377 of the recommended recovery was still outstanding. Miss. Ex. 3. CMS requested that Missouri refund the outstanding amount by making an adjustment to its claimed Medicaid expenditures on its Form CMS-64 for the quarter ending December 31, 2005. *Id.* Missouri refused to comply with CMS's request on the ground that the $715,377 represented "suggested court ordered penalties and court costs" that Missouri had not yet collected. Miss. Ex. 4. However, Missouri agreed to "return the [FFP] as these suggested court ordered penalties and court costs are collected."[2] *Id.*

Several years later, by letter dated July 24, 2012, CMS notified Missouri that $704,194 associated with Medicaid provider overpayments for federal fiscal year 2003 remained due, so CMS was disallowing that amount of FFP. Miss. Ex. 7, at 1-2. The parties stipulate that $139,249 of that disallowance amount constituted FFP attributable to court-ordered penalties, fines, and prosecution costs that Missouri was awarded in actions seeking to recover provider overpayments. Miss. Ex. 11. In the letter, CMS acknowledged Missouri's position that the federal share of the court-ordered penalties,

[2] In an April 13, 2005 letter responding to the original audit, however, Missouri indicated that some of the $715,377 actually consisted of acknowledged provider overpayments not recovered from the providers as to which Missouri declined to reimburse the federal government for its share. Miss. Ex. 2, at 7-8 and App. A. Based on the parties' stipulation discussed below, we conclude that none of these amounts are at issue before us.

fines, and costs did not need to be refunded until Missouri successfully collected those awards. Miss. Ex. 7, at 1. CMS also noted that Missouri had been returning small amounts of FFP on its Form CMS-64 each quarter as it was collected, but explained:

> As provided in section 1903(d)(2) of the Act, 42 CFR 433, Subpart F, and in the State Medicaid Manual section 2005.1, states are required to return the FFP related to overpayments at the end of the statutorily established period whether or not any state recovery of the overpayments has been made.

Id. at 2.

Missouri appeals the $139,249 portion of the disallowance attributable to court-ordered penalties, fines, and costs.

Analysis

1. The court-ordered penalties, fines, and costs awarded to Missouri do not constitute provider overpayments that must be refunded to CMS regardless of whether Missouri has successfully collected the awards.

The Board has explained that section 1903(d)(2) "uses the term 'overpayment' in two related senses." *W. Va. Dep't of Health & Human Resources*, DAB No. 2185, at 2 (2008). In section 1903(d)(2)(A), "the term refers to excessive FFP paid to a state in a given quarter." *Id.* In contrast, in section 1903(d)(2)(C), "the term is used to describe a payment that is made by a state Medicaid program to a Medicaid provider." *Id.* The distinction between the two uses of the term is significant. As noted above, section 1903(d)(2)(C) imposes a special refund requirement for provider overpayments: After the statutorily prescribed recovery period – 60 days during the time period relevant here – a state must return the federal share of a provider overpayment to CMS, regardless of whether the state has successfully recovered the overpayment.

CMS contends that the court-ordered penalties, fines, and costs awarded to Missouri should be viewed as themselves provider overpayments under section 1903(d)(2)(C), so Missouri was required to refund the federal share of those awards to CMS within 60 days of discovery, whether or not Missouri successfully collected the awards during that time. According to CMS, its disallowance accounting for the federal share of those awards is "based on a straightforward reading of the Medicaid statute." CMS Br. at 9. We find no merit in this argument.

CMS's designation of the court-ordered awards as provider overpayments is inconsistent with the Medicaid statute and the applicable regulations. Section 1903(d)(2)(C) of the Act applies to only provider overpayments, that is, overpayments "made by a State to a person or other entity." As noted, the implementing regulations define such an

overpayment as an amount paid "by a Medicaid agency to a provider which is in excess of the amount that is allowable for services furnished under section 1902 of the Act and which is required to be refunded under section 1903 of the Act." 42 C.F.R. § 433.304. In discussing this definition of "overpayment," the preamble to the regulations explains that provider overpayments include "[d]uplicate payments; payments for noncovered services; payments to the wrong provider; and payments at incorrect rates." 54 Fed. Reg. 5452, 5453 (Feb. 3, 1989). Court-ordered penalties, fines, and costs simply fail to fit within these definitions and examples, which all relate to amounts intended to pay for the furnishing of medical services under Medicaid.

A provider overpayment is improper from the time the state erroneously awards the excessive payment to the provider, and the provider overpayment repayment rules were issued with this fact in mind. The preamble explains that "the Federal Government's responsibility to participate financially in State Medicaid expenditures does not encompass FFP for excess or erroneous State Medicaid expenditures." 54 Fed. Reg. at 5455. "Consequently, the Federal share of overpayments must be returned to the Federal Government within the statutorily defined timeframe because the overpayments represent excessive claims for Federal reimbursement." *Id.* In contrast, court-ordered penalties, fines, and costs are not the direct result of a state's mistake. They are awarded to a state based on the administrative costs properly expended by the state to recover an overpayment to a provider. Thus, court-ordered penalties, fines, and costs do not constitute a provider overpayment by a state.

The regulatory provisions that address when a provider overpayment is "discovered," the event that triggers the start of the statutory recovery period, also cannot logically be applied to the court-ordered award of penalties, fines, and costs. The regulations define "discovery" of an overpayment as "identification by any State Medicaid agency official or other State official, the Federal government, or the provider of an overpayment, and the communication of that overpayment finding or the initiation of a formal recoupment action without notice . . . ." 42 C.F.R. § 433.304. The regulations further provide that a provider overpayment resulting from a situation other than fraud or abuse is "discovered" on the earliest of:

> (1) The date on which any Medicaid agency official or other State official first notifies a provider in writing of an overpayment and specifies a dollar amount that is subject to recovery;
> (2) The date on which a provider initially acknowledges a specific overpaid amount in writing to the Medicaid agency; or
> (3) The date on which any State official or fiscal agent of the State initiates a formal action to recoup a specific overpaid amount from a provider without having first notified the provider in writing.

42 C.F.R. § 433.316(c). An overpayment resulting from fraud and abuse is "discovered on the date of the final written notice of the State's overpayment determination that a Medicaid agency official or other State official sends to the provider." *Id.* § 433.316(d). Court-ordered penalties, fines, and costs are imposed by court directive, and thus are not "discovered" by state or federal officials or otherwise identified by providers. The fact that none of the dates identified for discovery of a provider overpayment occurs in relation to such court orders further confirms that the provider overpayment provisions are inapplicable here.

In defending its expansive interpretation of what constitutes a provider overpayment, CMS mistakenly relies on *West Virginia Department of Health & Human Resources v. Sebelius*, a Fourth Circuit case in which the court upheld CMS's disallowance of federal funding for the State's Medicaid program based on the State's recovery of settlement proceeds from a pharmaceutical company that had artificially inflated the reimbursement rate for certain drugs. 649 F.3d 217 (4th Cir. 2011), *aff'g* 709 F.Supp.2d 487 (S.D. W.Va. 2010) (affirming DAB No. 2250 (2009)).

In *West Virginia*, CMS disallowed FFP that it asserted represented the federal share of overpayments made to Medicaid providers as a result of the pharmaceutical company's scheme. The court rejected the State's argument that the Act authorizes a disallowance only when a state recovers from a Medicaid provider, and so the disallowance was unauthorized because the pharmaceutical company from which the state recovered the funds was a third party rather than a provider. 649 F.3d at 224. The court determined that the "sine qua non of a proper disallowance is an overpayment" and that a provider overpayment "requires money 'paid by a Medicaid agency to a *provider*.'" *Id.* at 224-25 (emphasis in original). The court concluded that these requirements were met because the State had overpaid Medicaid providers for drugs as a result of the pharmaceutical company's scheme. *Id.* The court further concluded that because section 1903(d)(2)(C) authorizes CMS to disallow payments to a state when that state overpays a provider, regardless of whether the state has recovered from anyone for that overpayment, it was immaterial that the State had recovered from the pharmaceutical company instead of directly from the overpaid providers. Thus, CMS errs in arguing that the court's decision in *West Virginia* was based on viewing a "provider overpayment" as going beyond amounts states overpay providers for medical expenditures to encompass payments from providers to reimburse states' litigation costs.

To the contrary, the decision provides further support for reading the term "overpayment" as used in section 1903(d)(2)(C) to refer only to an erroneous or excessive payment by a state Medicaid agency for medical expenditures. As the Board noted (in the underlying case), the key principle underlying section 1902(d)(2)(C) is that expenditures that are unallowable, such as improper overpayments for medical services, are not "medical assistance" under the terms of the Medicaid program. *W. Va. Dep't of Health & Human Resources*, DAB No. 2250, at 1-2. The court-ordered penalties, fines, and costs here, do

not reflect any unallowable expenditures by the Missouri Medicaid agency, but rather are more in the nature of a recoupment of administrative costs incurred in the pursuit of litigation.

Thus, we conclude that the court-ordered penalties, fines, and costs are not provider overpayments within the ambit of section 1903(d)(2)(C) and the applicable regulations. Accordingly, Missouri is not required to refund the federal share of those awards to CMS pursuant to that statutory provision.

2. The court-ordered penalties, fines, and costs that Missouri has collected are applicable credits that Missouri should have deducted from its claimed Medicaid expenditures.

CMS argues that, even if it did not appropriately disallow the $139,249 representing the federal share of court-ordered penalties, fines, and costs awarded to Missouri based on the provider overpayment rules, the disallowance should be upheld based on the applicable credit rules. As we explain below, we agree that the federal share of the penalties, fines, and costs that Missouri has actually collected (or actually collects in the future) constitute applicable credits that Missouri must deduct from its claimed Medicaid expenditures. Thus, we uphold the disallowance to the extent that it includes amounts Missouri has collected but not so deducted. Any failure by Missouri to account for its collection of court-ordered penalties, fines, and costs by reducing the claimed expenditures on its quarterly Form CMS-64 resulted in CMS paying Missouri excess FFP, and, thus, constitutes an overpayment within the meaning of section 1903(d)(2)(A). CMS is entitled to remedy its overpayment of FFP to Missouri via a disallowance. However, some of the $139,249 at issue may include penalties, fines, and costs that Missouri has not yet been able to collect. Any uncollected court-ordered awards do not constitute applicable credits, so there has been no overpayment by CMS to Missouri for those amounts. (This does not, of course, preclude CMS from disallowing any such costs actually collected in the future.)

The Board has "repeatedly stated that a common theme in cases where states have had to account for applicable credits is the receipt of monies (or reductions of expenditures) by a state related to its federally funded program which, if unaccounted for in the program, would result in a savings or gain to the state alone." *Me. Dep't of Health & Human Servs.*, DAB No. 2168, at 6 (2008) (internal quotation and citations omitted). A credit is applicable to a program "where there is a direct relationship or nexus between the questioned receipt and the federally-funded program." *Id.* "A state that has received an applicable credit but not reduced its allowable costs claimed under the federal grant program has received an overpayment of FFP." *Cal. Dep't of Fin.*, DAB No. 1592, at 6.

The Board has not previously addressed whether court-ordered penalties, fines, and costs are applicable credits, but it has previously determined that similar types of recoveries by states constitute applicable credits. For example, in *North Carolina Department of Human Resources*, DAB No. 361 (1982), the Board held that the Health Care Financing Administration (now CMS) was entitled to share in interest the State had earned on money that it had recovered from Medicaid providers prior to distributing that money to federal, state, and county governments. The Board held that the interest constituted an applicable credit because it "would not have been earned if the State had not recovered money from its Medicaid providers." DAB No. 361, at 8. "Since the interest was attributable to the Medicaid program," the Board determined, "it should have been credited against program expenditures." *Id.* at 9.

Similarly, in *New Jersey Department of Human Services*, DAB No. 480 (1983), the Board concluded that civil penalty interest the State had collected from overpaid Medicaid providers pursuant to a state statute constituted an applicable credit. The Board noted that half of the funds the providers were overpaid were supplied by the federal government, and that the amount of the civil penalty imposed by the State was based on the entire amount of the overpayment. Thus, the Board reasoned, "if the State were to retain all of the payment from the provider, the State would in effect be profiting from the use of federal funds." DAB No. 480, at 11. The Board concluded that, as "federal funds were used to produce these payments, they constituted an applicable credit . . . . Applying this applicable credit means a reduction in the State's expenditures allowable for FFP." *Id.* Accordingly, the State "received an overpayment [of FFP] in the amount of the federal shares of the interest, which HCFA was entitled to disallow." *Id.*

In *West Virginia Department of Health & Human Resources*, DAB No. 2185 (2008), the Board concluded that settlement proceeds the State recovered from a pharmaceutical company (a different company and settlement than in the Fourth Circuit *West Virginia* case discussed above) based on a lawsuit that alleged harm to the State's Medicaid program constituted an applicable credit. The Board reasoned that there was a direct relationship between the settlement funds and the State's Medicaid program because "the State obtained the funds to settle claims for reimbursement of that program's expenditures." DAB No. 2185, at 18. "Given that relationship," the Board determined, "there is a sufficient basis for finding that receipt of the settlement proceeds effectively reduced the State's overall costs of providing Medicaid-covered medical or health services . . . to Medicaid recipients. *Id.* Hence, CMS had overpaid the State by sharing in the inflated costs and could properly disallow the federal share. The Board concluded that "[a]bsent a disallowance that cost reduction or savings would accrue to the State alone." *Id.*

Here, it is undisputed that the administrative cost of pursuing the litigation in which Missouri received the court-ordered penalties, fines, and costs was partially derived from federal funds. Moreover, the litigation involved disputed payments to Medicaid

providers. Missouri would not have received the awards if it had not successfully litigated to recover the Medicaid provider overpayments. Thus, the penalties, fines, and costs are related to the Medicaid program, and to the extent that Missouri has failed to credit the federal share of those awards against its claimed Medicaid expenditures, Missouri alone has benefitted from them. Missouri admits as much, stating that it "long ago" agreed to repay FFP "as these suggested court ordered penalties and court costs are collected." Miss. Reply Br. at 6. Accordingly, we conclude those awards that Missouri has collected constitute applicable credits.

CMS maintains, however, that the full amount of the disallowance at issue should be upheld regardless of whether Missouri has collected the awarded amounts, even under the applicable credit rules, because those rules provide that "[t]o the extent such credits accruing to or received by the governmental unit relate to allowable costs, they shall be credited to the Federal award . . . ." *See* 45 C.F.R. Part 225, App. A, ¶ C.4.a. CMS appears to argue that Missouri has already "accrued" all the court-ordered penalties, fines, and costs, even if Missouri has not yet collected them, because Missouri has a legally enforceable right to them. CMS does not point to any cases or other authorities that endorse its interpretation of the use of the phrase "accruing to," nor have we found any.

As noted above, the Board has observed that "a common theme in cases where states have had to account for applicable credits is the receipt of monies (or reductions of expenditures) by a state related to its federally funded program which, if unaccounted for in the program, would result in a savings or gain to the state alone." *Me. Dep't of Health & Human Servs.*, DAB No. 2168, at 6. For any court-ordered penalties, fines, and costs that Missouri has not yet collected, there has been no actualized "savings or gain" to Missouri. We therefore uphold the challenged portion of the disallowance only to the extent that it includes the federal share of the penalties, fines, and costs that Missouri has collected but not yet refunded to CMS. As already stated, however, CMS would still be entitled to take a future disallowance for any additional collections that Missouri might succeed in making later.

Missouri argues that the challenged portion of the disallowance cannot be sustained based on the applicable credit rules because neither the OIG audit report that led to the disallowance nor the CMS disallowance letter asserted that the court-ordered penalties, fines, and costs constituted applicable credits. Missouri's argument ignores the fact that the Board has consistently held that a federal agency may provide new grounds for a disallowance during the appeal process so long as the grantee has an opportunity to respond. *See, e.g., W. Va. Dep't of Health & Human Resources*, DAB No. 2185, at 9. Although CMS did not raise the applicable credit rules as a basis for the disallowance in its disallowance letter, it did embrace them as an alternative basis for upholding the

disallowance in its brief, and Missouri then had an opportunity to respond to that argument in its reply brief. Therefore, CMS's failure to initially invoke the applicable credit rules is not prejudicial.

The record developed before the Board does not establish whether and to what extent the $139,249 at issue includes penalties, fines, and costs that Missouri was awarded but has not yet collected. As noted above, in its communications with CMS in 2005, Missouri stated that it would return the FFP attributable to the penalties, fines, and costs as it collected them. Miss. Ex. 4. In addition, CMS's disallowance letter to Missouri acknowledged that Missouri had been "returning small amounts" of FFP on its Form CMS-64 "each quarter as [Missouri has] collected it." Miss. Ex. 7, at 2. At the same time, we acknowledge CMS's statement in its brief that "Missouri suggests, with little or no support, that it has not collected the penalties and costs [at issue.]" CMS Br. at 8 n.4. Based upon the totality of the circumstances discussed above, we therefore remand to CMS to determine, based on any documentation it may require to be provided by Missouri, the amount of penalties, fines, and costs Missouri has collected but not refunded. CMS should then recalculate the final amount of the disallowance. If Missouri disagrees with CMS's determination of the amount, it may appeal that determination alone to the Board in accordance with 45 C.F.R. Part 16.

Conclusion

For the reasons explained above, we uphold the challenged $139,249 portion of the disallowance to the extent that it includes the federal share of court-ordered penalties, fines, and costs awarded to Missouri in actions to recover the provider overpayments at issue that Missouri has collected but not yet refunded to CMS. We remand the appeal to CMS for calculation of the final amount of the disallowance pursuant to the instructions above.

/s/
Stephen M. Godek

/s/
Sheila Ann Hegy

/s/
Leslie A. Sussan
Presiding Board Member