DEPARTMENTAL GRANT APPEALS BOARD

Department of Health and Human Services

SUBJECT: California Department of Health Services
Docket Nos. 79-229-CA-HC
80-169-CA-HC
Decision No. 158

DATE: March 31, 1981

DECISION

This decision concerns two appeals by the State of California Department of Health Services (State) from disallowances made by the Health Care Financing Administration (Agency) of Federal financial participation (FFP) claimed under Title XIX (Medicaid) of the Social Security Act (the Act). The two appeals have been considered jointly without objection by the parties. The disallowed amounts were claimed for administrative costs of providing medical care and services to persons eligible for such services under certain State programs but ineligible under Title XIX. The Agency amended its regulation (45 CFR 248.10(d)(1)) so that FFP for such administrative costs could no longer be claimed. The amendment of the regulation was made retroactively effective based on the Agency's contention that the legislative repeal of Section 1903(e) of the Act eliminated the Agency's authority to allow FFP for such administrative costs. The principal issue is whether the repeal of Section 1903(e) requires that the Agency apply this retroactively effective regulation. For reasons stated below, we find that the disallowances must be upheld.

We have determined that there are no material facts in dispute and that a conference or hearing would not be helpful. This decision is based on the State's applications for review, the Agency's responses to the applications and both parties' responses to questions posed in the Board's request for a stipulation of facts. The State's response to the Board's Order to Show Cause regarding an issue raised by the State about certain disallowed monies already repaid is also briefly addressed in this decision.

Procedural Background of the Appeals

Board Docket No. 79-229-CA-HC involves a disallowance in the amount of $1,962,414 for the period October 30, 1972 through June 30, 1974, claimed as administrative costs of providing medical assistance to persons eligible for the State's Medical Indigents Only (MIO) program. The amount in dispute is $1,254,317 because the State admits that it should repay the money for the period January 3 through June 30, 1974. Board Docket No. 80-169-CA-HC involves a disallowance of $183,360 for the period October 30, 1972 through December 31, 1973 for administra-

tive costs of providing medical assistance to certain recipients of Aid to Families with Dependent Children (AFDC). The persons in both groups were ineligible for medical assistance under Title XIX of the Act.

With respect to Docket No. 80-169-CA-HC, the Agency originally requested, by letter dated June 26, 1979, a refund in the amount of $872,721 for the period October 30, 1972 through December 31, 1978. The State agreed, by letter dated July 13, 1979, to make an adjustment for the period December 3, 1973 through December 31, 1978, and actually refunded $689,361 for that period by means of a decreasing adjustment during the quarter ending September 30, 1979. When the State later appealed from the October 15, 1980 letter of disallowance that involved only $183,360 (the unrefunded portion of the larger amount originally involved), the State also attempted to appeal the already-refunded portion, on the ground that the regulation upon which the Agency based its request did not apply to the State.

On December 12, 1980 the Board issued an Order to Show Cause expressing its tentative opinion that the Board lacked jurisdiction over the $689,361 FFP already refunded because there did not appear to have ever been a final disallowance of that amount or of the $872,721 originally requested as a refund. Moreover, the Board stated that even if there were a final disallowance over which the Board had jurisdiction, the State's appeal was untimely, the refund having been made over a year prior to this appeal, with no good cause shown by the State for such a delay in appealing. Finally, the Board expressed its tentative opinion that if it heard the appeal, it would have to uphold the disallowance on the basis that the State's claim was untenable because it appears that there was a regulation limiting FFP to administrative costs for eligible persons that applied to the State during the period in question (45 CFR 248.10, recodified effective March 11, 1974 as 45 CFR 248.4).

The State's response to the Order to Show Cause, dated February 10, 1981, withdrew the request for review of the amount already refunded and stated an intent to limit the appeal to the $183,360 disallowed through retroactive application of the amended regulation.

Factual Background

Section 1903(e) of the Act was enacted in 1965. It read:

> (e) The Secretary shall not make payments under the preceding provisions of this section to any State unless the State makes a satisfactory showing that it is making efforts in the direction of broadening the scope of the care and services made available under the plan and in the direction of liberalizing the eligiblity requirements for medical assistance, with a view toward furnishing by July 1, 1975 com-

> prehensive care and services to substantially all individuals who meet the plan's eligibility standards with respect to income and resources, including services to enable such individuals to attain or retain independence or self-care.

The Handbook of Public Assistance Administration, Supplement D, Medical Assistance Programs, dated June 17, 1966, Section D-4050, stated:

> Federal financial participation may be claimed in the administrative costs of providing medical care and services to all persons included in the plan, including those in the cost of whose medical care and services the Federal Government will not now share, provided all other provisions of the approved State plan are applicable to them.

Another section, D-4010.C., listed and quoted the provisions of the Act, including Section 1903(e).

In mid-1970 the Social and Rehabilitation Service (SRS) proposed that the Handbook requirements be codified (35 FR 8780, June 5, 1970). The regulations were published on February 27, 1971 (36 FR 3871), including a regulation implementing Section D-4050 of the Handbook (45 CFR 248.10(d)(1)). No reference was made to the statutory authority for that regulation. The codified regulations indicate that the authority for 45 CFR Part 248 was Section 1102 of the Act, 42 USC 1302.

Congress repealed Section 1903(e) of the Act, effective October 30, 1972 (P.L. 92-603, Section 230, Social Security Amendments of 1972). 1/ On November 21, 1972, SRS Memorandum MSA-IM-73-5 informed state agencies administering medical assistance plans that Sections 1903(d) and (e) were repealed. The Memorandum explained and discussed the repeal of Section 1903(d) but not Section 1903(e). On April 2, 1973 a memorandum to Regional Commissioners (Field Staff Information & Instruction Series #136) stated that the repeal of Section 1903(e) took away the "legal base" for 45 CFR 248.10(d)(1) and terminated FFP in the administrative costs of persons not eligible for services under Title XIX.

On June 21, 1973 the Agency published a Notice of Proposed Rulemaking (38 FR 16308), implementing P.L. 92-603. The preamble stated that FFP in the administrative costs of providing medical assistance to persons not eligible for such assistance under Medicaid had been made available on the basis of Section 1903(e), and that its repeal removed the justification for 45 CFR 248.10(d)(1). It also stated that the new provision

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1/ There does not appear to be any legislative history for either the enactment or repeal of this provision that bears directly on the issue before the Board.

would be effective as of the date of repeal, October 30, 1972. Section 1102 is cited as rulemaking authority. The proposed regulation read:

> Federal financial participation is available in the administrative costs of providing medical care and services to all persons covered under the plan, in the cost of whose medical care and services the Federal Government shares.

The Agency sent SRS Identical Memorandum #73-32 to state agencies on July 11, 1973. This memorandum contained an explanation of the relationship between the repeal of Section 1903(e) and the change in the availability of FFP for certain administrative costs. It informed the states of the proposed rulemaking and of the effective date of the proposed regulations.

On December 3, 1973 the final regulations were published at 38 FR 33380. 2/ Again, the preamble stated that FFP for these administrative costs had been terminated by the repeal of Section 1903(e) and that the proposed regulation was amended to clarify the fact that it was retroactively effective. Thus, the final regulation differed from that proposed in June by the fact that it read "Effective October 30, 1972...." The preamble stated that comments were received from eight respondents about the proposed regulation. The preamble's discussion of those comments included:

2/ A Notice of Proposed Rulemaking (NPRM), published at 38 FR 32216, November 21, 1973, concerned new regulations implementing Title XVI of the Act and also included a proposed reorganization and recodification of Part 248. It included "for the convenience of reviewers ... changes in elibility provisions required by P.L. 92-603, which were contained in a notice of proposed rulemaking published June 21, 1973 .... The existing sections on coverage and general and financial eligibility conditions (§§248.10 and 248.21) are being revoked and their content reorganized into four new sections in order to simplify and clarify ... In general, the proposed regulations would become effective January 1, 1974." This publication reprinted the language of the amended §248.10(d)(1) as proposed in June 1973 and designated the proposed amended §248.10(d)(1) as §248.4(a). Neither the preamble nor the regulation itself contained any language concerning the effective date.

On March 11, 1974 (39 FR 9512), the Notice of these final regulations was published. That Notice included §248.4 with no indication of its effective date. It also shows §248.10 amended so that effective January 1, 1974 it applied only to Guam, Puerto Rico and the Virgin Islands. It refers to §248.4 as applicable to other jurisdictions.

A county official objected to the termination of federal matching for certain administrative costs, while another comment predicted that termination of such matching would force on the States "a massive accounting problem from which any potential savings will most probably be more than offset by increasing administrative costs." Such termination is required, however, since the statutory support for such matching has been removed. (38 FR 33380, December 3, 1973)

Discussion

Both of these appeals challenge the disallowance of FFP claimed by the State for administrative costs of providing medical assistance to persons ineligible for medical assistance under Title XIX during the period October 30, 1972 to December 3, 1973, or alternatively, January 3, 1974. 3/ The State asserts that retroactive application of the amended version of §248.10(d)(1) to this period of time denies the State due process, impairs the contractual relations existing between the State and the Federal Government with respect to the sharing of

2/ Cont.
The State asserts that the publication of this version of the regulation, together with the conflicting versions published in June and December, was, at a minimum, sufficiently confusing to both Agency and State so as to provide inadequate notice of any firm intent to deny FFP retroactively. Furthermore, the State asserts that the publication provides evidence that the Agency had changed its mind about application of the regulation retroactively. The Agency alleges that the published notices of reorganization and recodification were not intended to be viewed as substantive rulemakings, and furthermore, that the language of the June 21, 1973 NPRM, which did not contain a statement of the effective date within the proposed regulation, was inadvertently used in the recodification notices rather than the language of the final regulation. We note that the recodified regulation as it appears in the Code of Federal Regulations does not contain the effective date language either.

3/ The State raised the question, in the event that retroactive application of the regulation was found not to be proper, whether the regulation could take effect immediately upon publication or could only be effective 30 days later. We do not reach this issue because of our conclusion that retroactive application must be upheld in this case.

Medicaid costs, and places an undue burden on the State and its counties. Furthermore, the State asserts that the amendment is a retroactive change of settled law and is therefore impermissible.

The Agency maintains that retroactive application of a regulation is valid where the regulation and the action of making it retroactively applicable are reasonable and that, in this case, the Agency's actions in amending the regulation and retroactively applying it were mandated by the statutory design of Medicaid, manifested by the repeal of Section 1903(e). The Agency interprets the repeal of Section 1903(e) as removing the sole authority to allow FFP for the administrative costs claimed in these cases.

The Supreme Court has set out a principle to be considered when faced with a choice between applying preenactment and post-enactment law: where the result of applying the original regulation in force at the time, rather than the amended regulation, is one contrary to the intent of the statute, the amended regulation should be used. "A regulation out of harmony with the statute is a nullity...." Manhattan General Equipment Co. v. Commissioner of Internal Revenue, 297 U.S. 129, 134 (1936); accord, United States v. Larionoff, 431 U.S. 864, 873 (1977).

Applying this principle to the facts in these appeals, we have concluded that the disallowance must be upheld. The Agency has consistently claimed since 1973 that the repeal of Section 1903(e) removed the statutory authority for the original §248.10(d)(1) and mandated its amendment effective as of the date of repeal. The Agency argues that the mandate in Section 1903(e) that the states broaden the scope of care and services available under the plan and make an effort to liberalize the eligibility requirements for medical assistance provided a legal basis for the Secretary's determination that certain administrative costs were necessary as an incentive to enable the states to liberalize their eligibility requirements. The Agency states that when the repeal of Section 1903(e) eliminated the requirement that the states expand their programs, the Secretary's authority to determine such costs to be necessary was more narrowly limited to the general principle set forth in the Medicaid scheme that reimbursement is available for services to eligible persons. Since the statutory provision authorizing payment for individuals who are eligible for medical assistance, Section 1903(a)(1), does not authorize payment for ineligible persons, the agency argues that it cannot provide reimbursement through regulations when there is no statutory basis for the reimbursement. Summit Nursing Home, Inc. v. United States, 572 F.2d 737, 742 (Ct. Cl. 1978).

Although the Agency's assertion that there is a clear relationship between the provision for administrative costs and Section 1903(e) is not completely persuasive, there does not appear to be any other

statutory authority for allowing administrative costs for medical assistance to ineligible persons. 4/

This Board gives deference to the interpretation given a statute by the Agency, in accordance with principles established by the courts. New York Department of Social Services, Decision No. 101, May 23, 1980, p. 6. The primary rationale for this practice is the deference accorded agency expertise. Southern Mutual Help Assoc., Inc. v. Califano, 574 F.2d 518, 526 (D.C. Cir. 1977). Where the Agency has interpreted the statute by promulgating a regulation, based upon the Agency's expertise and policy-making authority, and that interpretation is a reasonable one, even though it may not be the only possible interpretation, the Board will generally accept the Agency's interpretation. This is particularly so where the Agency manifested that interpretation contemporaneously with the promulgation of the regulation, and substantially contemporaneously with the statutory enactment. National Muffler Dealers Ass'n v. United States, 470 U.S. 472, 477 (1979).

Following this Board's practice to give deference to a reasonable Agency interpretation of a statute, we accept the Agency's position that retroactive application of the amended regulation was required by the repeal of Section 1903(e). By accepting this position under the rule

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4/ The only authority for the regulations that is cited in the Code of Federal Regulations is the statutory delegation in Section 1102 of the Act, which gives general authority to promulgate substantive rules and regulations "not inconsistent with this Act, as may be necessary to the efficient administration of the functions ... under this Act." Although such delegations should be construed to include authority to promulgate any regulation reasonably related to the purposes of the enabling legislation, Mourning v. Family Publications Service, 411 U.S. 356, 369 (1973); Maryland v. Mathews, 415 F. Supp. 1206, 1212 (D.D.C. 1976), that authority is limited in that a regulation may not be inconsistent with another, more specific, portion of the Act. Green v. Philbrook, 576 F.2d 440, 442 (2d Cir. 1978); National Welfare Rights Organization v. Mathews, 533 F.2d 637, 640 (D.C. Cir. 1976).

Furthermore, a similar analysis seems applicable to the State's allegation in its application for review (Docket No. 80-169-CA-HC, November 14, 1981, p. 4) that 45 CFR 248.10(d)(1) as originally promulgated was authorized by 42 USC 1396b(a)(3) [this citation appears to be erroneous and probably should be 42 USC 1396b(a)(6), now (a)(7)]. The power to pay FFP for amounts "necessary ... for the proper and efficient administration of the State plan" is limited to costs for which there is a statutory basis. Summit Nursing Home, Inc. v. United States, supra.

set out in Manhattan General Equipment Co., supra, the Board must uphold the disallowances. We realize that there are circumstances here that favor the State, such as: the retroactive application of the regulation abruptly changes a previous rule, the existence of justifiable reliance by the State on the old rule (§248.10(d)(1) as originally promulgated), and the substantial financial and administrative burden imposed on the State. 5/ Under the above analysis, all these factors are irrelevant.

Even if our conclusion were not mandated by the repeal of Section 1903(e), the Board would arrive at the same conclusion, using a balancing process developed by the courts. This process is based on principles of due process and is used to determine when administrative rules and regulations may be applied retroactively. This balancing consists primarily of weighing the public interest manifested by the regulation against the burden placed on the party against whom the regulation will be applied. Which side weighs heavier depends on several factors. The Supreme Court established a standard for deciding whether to allow administrative rules to have retroactive application in SEC v. Chenery, 332 U.S. 194 (1947).

> . . .[R]etroactivity must be balanced against the mischief of producing a result which is contrary to a statutory design or to legal and equitable principles. If that mischief is greater than the ill effect of the retroactive application of a new standard, it is not the type of retroactivity which is condemned by law. At 203.

In Retail, Wholesale & Dept. Store Union, AFL-CIO v. NLRB, 466 F.2d 380 (D.C. Cir. 1972), Judge McGowan applied this standard and articulated some specific considerations that enter into such a balancing process. Factors applicable to the appeals before the Board are: (a) whether the new rule represents an abrupt departure from well-established practice or merely attempts to fill a void in settled law; (b) the extent of

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5/ The State, under the original regulation, had allowed its counties to use a modified billing system in which they were relieved of the burden of performing a complete FFP-eligibility check on every applicant for medical aid before providing services. The county could qualify an applicant for services under a State program and retain the possibility of finding Medicaid eligibility at a later date. This system allowed the State to partially defray administrative costs by claiming them under 45 CFR 248.10(d)(1) as originally promulgated. If this regulation had not been in existence, the State may have performed eligibility checks in a different manner so as to be certain at an earlier stage whether an applicant was eligible for Medicaid. Presumably some of those applicants would have been found eligible under Title XIX, thus allowing the State to claim FFP for associated administrative costs.

reliance on the former rule by the party against whom the new rule is applied; (c) the degree of burden the retroactive rule places on a party; (d) the statutory interest in applying the new rule despite reliance by a party on an old rule. Judge McGowan explained how these factors were to be balanced:

> Unless the burden of imposing the new standard is de minimis, or the . . . statutory design compels its retroactive application, the principles which underlie the very notion of an ordered society, in which authoritatively established rules of conduct may fairly be relied upon, must preclude its retroactive effect, ...

Thus, statutory design is given great weight in the balancing process. Accord, Runnells v. Andrus, 484 F. Supp. 1234 (D. Utah 1980). See also Addison v. Holly Hill Fruit Products Inc., 322 U.S. 607 (1944).

If the circumstances favoring a prospective application existed when there was no strong statutory interest in retroactive applicability, even if the rule itself were reasonable, retroactive application might be justifiable only to the point where actual notice of the rule was given because the practical operation of the change in Agency regulations would be to "work hardship... altogether out of proportion to the public ends to be accomplished." Retail, Wholesale & Dept. Store Union, AFL-CIO v. NLRB, supra, at 393. However, weighing the factors that favor the State against the statutory intent, as interpreted by the Agency, leads this Board to a balance that favors the statutory interest over the burden the State may bear. SEC v. Chenery, supra; Addison v. Holly Hill Fruit Products, Inc., supra. Thus, using the balancing analysis, we would also conclude that the regulation may be applied retroactively as of the date of the repeal of Section 1903(e). 6/

In considering the State's impaired contractual relations argument, the same basic analysis applies. The contract clause of the U.S. Constitution, art. I, §10, does not apply to contracts between the Federal Government and the states. Either a due process analysis under the Fifth Amendment or a contract analysis must start with a contract right or vested property interest that has been abridged. Although the courts have held generally that retroactively effective regulations may not

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6/ The conclusion reached by the Board means that we do not need to reach the issue of when the State had notice of the Agency's interpretation. Because the Board does not reach the issue of notice, there is no reason to consider the State's motion to strike one document submitted by the Agency, since it applies to the question of notice.

impair contractual obligations, Satterlee v. Mathewson, 27 U.S. 380, 413 (1829); Lynch v. United States, 292 U.S. 571, 577 (1934), there are many exceptions to that language, particularly with regard to the restriction that contracts made or property rights acquired in an area subject to the regulatory powers of the legislature are subject to the future exercise of those powers. Home Building & Loan Assoc. v. Blaisdell, 290 U.S. 398 (1934); Veix v. Sixth Ward Building & Loan Assoc., 310 U.S. 32 (1940). Where a contract calls for a series of performances over a long period of time, retroactive application of new legislation must be possible, subject to the restrictions of the balancing analysis discussed above, or else there is a genuine possibility of serious interference with legislative power. C.B. Hochman, The Supreme Court and the Constitutionality of Retroactive Legislation, 73 Harv. L. Rev. 692, 700 (1960).

Conclusion

We conclude that the Agency's interpretations of Section 1903(e) of the Act, and of its subsequent repeal, are reasonable; we also conclude that the retroactive application of the amended regulation is proper when the statutory intent, as interpreted by the Agency, is weighed against the burden on the State of this retroactively effective regulation, and that such application may begin as of the date of the repeal of Section 1903(e). We therefore conclude that the disallowances should be upheld.

/s/ Cecilia Sparks Ford

/s/ Alexander G. Teitz

/s/ Donald F. Garrett, Panel Chair