Department of Health and Human Services

DEPARTMENTAL APPEALS BOARD

Appellate Division

SUBJECT: Missouri Department of Social Services
Docket No. A-05-101
Decision No. 2184

DATE: July 11, 2008

DECISION

The Missouri Department of Social Services (Missouri), by letter dated July 28, 2005, requested review of a disallowance of $87,246,689 in federal financial participation (FFP) issued by the Centers for Medicare & Medicaid Services (CMS). CMS disallowed FFP in payments made by Missouri to certain nursing facilities in State fiscal years (SFYs) 2001 and 2002 which CMS contended exceeded the amounts permissible under a final rule on upper payment limits (UPLs) issued on January 12, 2001 and effective for purposes of this case on March 31, 2001. 66 Fed. Reg. 3148 (2001) (Final Rule).

The Final Rule changed the way the UPL for nursing facilities was calculated by creating a separate aggregate UPL for non-state government-owned or operated facilities. These facilities had previously been included in an aggregate UPL for all facilities, public or private, while only state-owned or operated facilities were subject to a separate UPL. Many state plans had provided for supplemental payments up to the UPL amounts, with various methodologies for dividing the supplemental payments among the facilities. Recognizing that the regulatory change could impact state budget arrangements under such existing state plans, CMS provided time for states to come into compliance (known as "transition periods"), the length of time depending on how long an approved state plan had provided for supplemental payments that would become noncompliant under the Final Rule. States with state plan provisions approved on or after October 1, 1999 were required to come into compliance by September 30, 2002. States with state plan provisions approved between October 2, 1992 and September 30, 1999 had five years to achieve compliance and were required to follow a phase-down schedule during the last three years. States with state plan provisions approved on or before

October 1, 1992, had eight years to comply and a longer phase-down period.

The parties agree that Missouri fell into the first group of states, i.e., those with state plan provisions approved after October 1, 1999, to which we refer below as "post-1999 states." The dispute centers on the meaning of a general rule for transition periods set out in the regulation mandating that the amount by which a state's payment "exceeded" the UPL described in the Final Rule "must not increase."

CMS contends that the regulatory language is clear on its face and means that the amount by which the supplemental payments any state had been making before March 31, 2001 exceeded what would be permissible if the new UPL limits under the Final Rule had been in effect then serves as a cap on the supplemental payments that may be made during any applicable transition period. Missouri contends that the regulatory language is susceptible of multiple interpretations, of which CMS's interpretation is among the least plausible, and that Missouri's interactions with CMS led Missouri to believe that the "must not increase" language was inapplicable to post-1999 states.

For the reasons explained below, we conclude that the regulatory language is less than clear, but that CMS's interpretation of the "must not increase" provision is a permissible and reasonable one. We generally accord appropriate deference to CMS's permissible and reasonable interpretation of ambiguous Medicaid regulations, so long as a state had actual notice of that interpretation that was timely and adequate. In the absence of actual notice, we will nevertheless defer to CMS's interpretation unless a state can show that it actually relied to its detriment on a reasonable alternative interpretation. In this case, we conclude that Missouri did not have actual notice of CMS's interpretation, but that Missouri failed to demonstrate actual reliance on a reasonable alternative interpretation. We therefore apply the interpretation propounded by CMS.

We further conclude, for the reasons explained below, that CMS failed to adequately explain its use of a methodology to calculate the disallowance different than the methodology CMS itself set out as normal under the interpretation we have upheld. The record does not provide all the information that would be necessary to recalculate the disallowance amount. We therefore remand to CMS to recalculate the amount consistent with this decision.

Background

1. Upper payment limit regulation before March 2001

Section 1902(a)(30)(A) of the Social Security Act (Act)[1] requires that state Medicaid programs adopt methods under their approved state plans that ensure that payments for care and services provided are consistent with efficiency, economy, and quality of care and are sufficient to enlist enough providers to make access available. Act § 1902(a)(30)(A); 42 C.F.R. § 447.250(b). Within that framework, states have historically been given "wide latitude structuring Medicaid payments." CMS Br. at 5.

Nevertheless, federal regulations provided that state payment methods could not result in aggregate Medicaid payments for specified categories of providers which exceeded a reasonable estimate of what would be paid for the services of those providers collectively using Medicare principles of reimbursement. 42 C.F.R. § 447.272(a)(October 2000). The reasonable estimate thus constituted a ceiling, known as a UPL, for Medicaid payments to the specified categories of providers in a particular year. FFP was not available for a state's Medicaid expenditures to the extent that those expenditures exceeded the applicable UPL.[2] Id.; see also 42 C.F.R. § 447.257.

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[1] The current version of the Social Security Act can be found at www.ssa.gov/OP_Home/ssact/comp-ssa.htm. Each section of the Act on that website contains a reference to the corresponding United States Code chapter and section. Also, a cross reference table for the Act and the United States Code can be found at 42 U.S.C.A. Ch. 7, Disp Table.

[2] In its introduction to its responses to questions to the parties issued by the Board in a letter dated February 29, 2008 (Board Questions), CMS offers a "background reminder" that the "efficiency, economy, and quality of care" standard in the statute is the authority for CMS's issuance of the UPL regulations which "[c]onsistent with the statutory language . . . provide limitations on payments [and] . . . do not authorize or permit payments." CMS Response to Board Questions at 1. Certainly, the UPL regulations do provide a ceiling on the payments that may be authorized by a state Medicaid plan, consistent with the statutory requirement that payment rates be appropriate for economically and efficiently run facilities. The statutory provision cited by CMS, section 1902(a)(13)(A) of the Act, does also provide, however, that the rates must be

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Prior to March 2001, section 447.272 imposed two separate UPLs on payments for institutional services, such as the nursing facility services at issue here. First, section 447.272(a) imposed a UPL on aggregate payments to all nursing facilities, whether public or private. Second, section 447.272(b) imposed a separate UPL on payments to "state-operated" nursing facilities.

2. Revision of the UPL regulations

CMS became concerned that the existing regulation grouping non-state public and private nursing facilities together under a combined UPL ceiling could result in a state paying rates for some public facilities inconsistent with the goals of efficiency and economy. This concern arose because the aggregate UPL could be divided among individual facilities in such a way as to channel a greater share of the funds under the UPL to non-state public government nursing facilities, such as those owned and operated by county governments. In CMS's view, if these counties received funds under the UPL that exceeded the reasonable costs of the individual facilities which they operated, they might make intergovernmental transfer (IGT) payments remitting such funds to the state, which might use the funds for a variety of purposes other than providing efficient, economical and quality care to Medicaid recipients. CMS Br. at 5. In CMS's view, such an arrangement would divert Medicaid funds inappropriately. Id.

CMS therefore sought to revise the regulation to remove the "incentive and ability for States to pay excessive rates to non-State government-owned or operated Medicaid providers" by publishing a proposed rule on October 10, 2000. 65 Fed. Reg. 60,151, at 60,152 (Oct. 10, 2000). Among other things, the proposed rule sought to establish a separate UPL applicable to non-state government facilities. Id. at 60,153. Recognizing that the new UPL framework could "disrupt State budget arrangements for States with approved enhanced plan amendments," CMS proposed a "transition policy" for such states. Id. at 60,154. The proposed rule set up two "transition periods" for states with what were termed "noncompliant" approved plan amendments, i.e., those that "result in payments that exceed the maximum amount allowable under the new UPLs." Id.[3]

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[2](...continued)
sufficient to ensure that such facilities can provide quality care.

[3] It is important to recognize that the state plan
(continued...)

For those states with noncompliant amendments effective before October 1, 1999, the rule proposed a three-year transition period beginning with the first full SFY that starts in calendar year 2002. Under the three-year transition period plan, states would have to incrementally reduce "excess payments," defined by CMS as the difference between the payments made to non-state owned or operated NFs under the UPL in the base year of SFY 2000 and the amount of payments that could have been made if the new UPL applicable to that group of facilities had been in effect during the base year. Id. Under proposed section 447.272(b)(2)(iii), the maximum allowable payments to such facilities in the first year of the transition period would be the lower of the base SFY 2000 payments or the amount allowed under the new UPL, plus 75% of the excess payment amount (that is, the base SFY 2000 payments minus the amount that would have been allowed under the new UPL for SFY 2000).

The rule proposed a transition period amounting to approximately 18 months for post-1999 states before full compliance was required, whereas states with plan amendments effective prior to October 1, 1999 were permitted until three years after the first full SFY beginning in calendar year 2002 before full compliance was required. 65 Fed. Reg. at 60,154. The shorter adjustment time for post-1999 states was intended to reflect CMS's view that, since "these programs are relatively new (in fact, some may be deemed approved during the comment period for this proposed rule), States are not likely to have developed the same level of reliance on the enhanced payments. . . ." Id. These states would "have until September 30, 2002 to come into compliance with the requirements" of the new UPL. Id.

In December 2000, Congress enacted the Medicare, Medicaid, and SCHIP Benefits Improvement and Protection act of 2000 (BIPA). BIPA required the Secretary to publish a final UPL rule "based on" the October 10, 2000 proposed rule no later than December 31,

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[3](...continued) provisions involved were compliant with existing law at the time they were approved, so that the use of the term "noncompliant" for such provisions, or the similar use of the term "excess payments" discussed below for payments which did not exceed the applicable restrictions at the time made, are shorthand used by CMS. While we have used these terms in the decision to some extent in order to convey CMS's arguments, we do not thereby imply any judgment that the plan provisions or payments made under them prior to the effective date of any contrary provisions of the Final Rule were in any way improper.

2000, and to publish the final rule "notwithstanding any requirement of the Administrative Procedure Act under chapter 5 of title 5, United States Code, or any other provision of law[.]" Pub. L. No. 106-554, app. F, § 705(a), 114 Stat. 2763 (2000). Section 705(b) of BIPA further required that the final rule provide for a third — and lengthier — transition period for any state with a noncompliant state plan amendment in effect on or before October 1, 1992.

On January 12, 2001, CMS issued a final UPL rule with an effective date of March 13, 2001.[4] 66 Fed. Reg. 3148 (Final Rule). As required by BIPA, the Final Rule added a five-year transition period for states with noncompliant state plan amendments effective on or before October 1, 1992. Id. at 3160-61.

The Final Rule amended section 447.272 to read in relevant part as follows:

> (e) *Transition periods* —
>
> > (1) *Definitions*. For purposes of this paragraph, the following definitions apply:
> >
> > > (i) *Transition period* refers to the period of time beginning March 13, 2001 through the end of one of the schedules permitted under paragraph (e)(2)(ii) of this section.
> > >
> > > (ii) *UPL* stands for the maximum payment level under the upper payment limit described in paragraph (b) of this section [i.e., the UPL for non-state government facilities] for the referenced year.
> > >
> > > (iii) *X* stands for the payments to a specific group of providers described in paragraphs (a)(2) and (a)(3) of this section in State FY 2000 that exceeded the amount that would have been under the upper payment limit described in paragraph (b) of this section if that limit had been applied to that year.

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[4] The effective date of the Final Rule was March 13, 2001, but CMS used, without objection, March 31, 2001 in its calculations at issue here. CMS Br. at 20, n.18.

(2) *General rules*.

(i) The amount that a State's payment exceeded the upper payment limit described in paragraph (b) of this section must not increase.

(ii) A State with an approved State plan amendment payment provision effective on one of the following dates and that makes payments that exceed the upper payment limit described in paragraph (b) of this section to providers described in paragraphs (a)(2) and (a)(3) of this section may follow the respective transition schedule:

(A) For approved plan provisions that are effective on or after October 1, 1999, payments may exceed the limit in paragraph (b) of this section until September 30, 2002.

(B) For approved plan provisions that are effective after October 1, 1992 and before October 1, 1999, payments during the transition period may not exceed the following:

(1) For State FY 2003: State FY 2003 UPL + .75X.

(2) For State FY 2004: State FY 2004 UPL + .50X.

(3) For State FY 2005: State FY 2005 UPL + .25X.

(4) For State FY 2006; State FY 2006 UPL.

(C) *For approved plan provisions that are effective on or before October 1, 1992, payments during the transition period may not exceed the following*:

(1) For State FY 2004: State FY 2004 UPL + .85X.

> (2) For State FY 2005: State FY 2005 UPL + .70X.
>
> (3) For State FY 2006: State FY 2006 UPL + .55X.
>
> (4) For State FY 2007: State FY 2007 UPL + .40X.
>
> (5) For State FY 2008: State FY 2008 UPL + .25X.
>
> (6) For the portion of State FY 2009 before October 1, 2008: State FY 2009 UPL + .10X.
>
> (7) Beginning October 1, 2008: UPL described in paragraph (b) of this section.

66 Fed. Reg. 3176 (underlining added; italics in original).[5] We set out above the details for all three transition periods in order to give a full context to our discussion of the conflicting interpretations of whether and how the underlined language applies to post-1999 states. For Missouri, as a post-1999 state, the applicable transition period ran roughly 18 months from March 13, 2001 to September 30, 2002. 42 C.F.R. § 447.272(e)(2)(ii)(A).

The preamble to the Final Rule provided no detailed explanation of how the "must not increase" provision in section 447.272(e)(2)(i) was to be understood or implemented, particularly in relation to the "short" transition period for states with no "phase-down" periods. The following exchange in the discussion of public comments, however, was cited by both parties in different ways as shedding some light on those questions:

> *Comment*: Several commentators indicated that the text of § 447.272(b)(2)(iii) as proposed limits payments <u>to</u>

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[5] CMS amended section 447.272(e)(2)(ii)(A) after the Final Rule was issued in January 2001, but for purposes of this case, the post-January 2001 changes are immaterial. Section 447.272(e)(2)(ii)(A) presently reads: "For State plan provisions that are effective after September 30, 1999 and were approved before January 22, 2001, payments may exceed the upper payment limit in paragraph (b) of this section until September 30, 2002."

> the lower of the base State FY 2000 payments or the limit based on the reduction schedule. Commentators stated that this restriction could result in a lower transition payment than that which would be available in the absence of the transition provisions. . . . Commentators recommended that the reference to "base State FY 2000 payments be deleted . . . ."
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> *Response*: While we have included generous transition periods, we do not think it is appropriate to permit States to make payments that would further increase the amount of payment that is in excess of the new UPLs. We have revised the text of the transition provisions . . . to make this clarification. We have also extended this policy to all transition periods.

66 Fed. Reg. 3163 (emphasis added).

3. Missouri's State plan amendment and UPL payment system

On August 1, 2000, near the start of SFY 2001, Missouri implemented an approved amendment to its State plan (SPA 00-08) which provided for the distribution of two pools of supplemental payments above the per diem Medicaid reimbursement payments to nursing facilities.[6] Missouri Ex. 2. The amendment created two "Medicaid enhancement pools" to be administered by the state "[s]ubject to federal approval." Id. Public non-state facilities could receive quarterly payments from the first enhancement payment pool if they entered into an IGT agreement with the State. Id. All Medicaid-enrolled nursing facilities could receive quarterly "efficiency grants" from a second enhancement payment pool. Id.

Supplemental (or enhanced) Medicaid payments to be disbursed from both pools were based on the calculation of the aggregate amount by which regular per diem Medicaid payments for the facilities fell short of the then-applicable UPLs. This difference, sometimes referred to as the Medicare or UPL "gap," was divided into the first pool for the IGT-agreement enhanced payments and the second pool for the efficiency grant payments based on percentages to be determined by the state. Id.; see also State Plan description at CMS Ex. 22, at 5. Thus, under SPA 00-08, the

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[6] Missouri's SFY ran from July 1 to June 30th. Because the SPA authorizing the supplemental payments did not go into effect until August 1, 2000, those payments were made for only eleven months of SFY 2001.

combined total of all the supplemental payments could not exceed the UPL for the group of all public and private facilities.

According to Missouri, this payment structure was "designed to pay amounts that, in the aggregate, would have been paid by the Medicare program using Medicare payment principles, i.e., up to the overall UPL cap for all facilities." Missouri Br. at 5.

4. Missouri's payments at issue

In January 2001, Missouri, through its outside counsel, Mr. Charles Miller, provided to Mr. Robert Weaver at CMS calculations showing how the State arrived at estimated UPL ceilings for nursing facilities for SFYs 2001 and 2002, which spanned the 18-month transition period beginning with the effective date of CMS's rule on March 13, 2001 through September 30, 2002. Missouri Br. at 9; Missouri Exs. 6 and 8. The letter stated that the UPL calculations were based on Medicare rates which had been raised by BIPA, effective April 1, 2001. Missouri used these UPL calculations to determine the amount of enhanced payments to be made to non-state government-owned nursing facilities for SFY 2001 using the methodology in its existing State plan, i.e., SPA 00-08.

Since the Medicare amounts Missouri used to calculate the UPL in SFY 2001 had increased over those used prior to March 13, 2001, while Missouri's Medicaid rates had not increased by the same amount, the "gap" between the applicable UPL and the amounts paid under Medicaid rates grew wider. Missouri made enhanced payments under SPA 00-08 to fill this larger "gap." At the time of the letter to Mr. Weaver, Missouri explained that it had not yet set its Medicaid rates for SFY 2002, but anticipated that they would increase and therefore would "reduce the amount shown as the difference between Medicaid payments and the Medicare upper limit." Missouri Ex. 6, at 2. On April 5, 2001, Mr. Miller wrote to Missouri that Mr. Weaver had informed him by telephone that the calculation methodology was acceptable. Missouri Ex. 7.

Beginning in November 2001, CMS staff engaged in correspondence with Missouri regarding whether Missouri had used the higher Medicare rates under BIPA to compute enhanced payments to non-state government-owned nursing facilities and expressing concern that such payments result in an increase in "excess payments" contrary to the requirement that excess payments not increase. Missouri Exs. 9 and 10. Also in November, CMS sent "guidance" in draft form to other states with an example illustrating the position that such an increase in excess payments would violate the "must not increase" provision. See, e.g., Missouri Ex. 12.

CMS followed up in February 2002 with a request for Missouri to submit its computations of the "new UPL during the transition period, and the SFY 2000 excess payment being made during the transition." Missouri Ex. 13, at 1. In April 2002, Missouri submitted calculations for the UPL and the UPL gap during the parts of its SFYs that fell in the transition period and asserted that the SFY 2000 excess payment requested was inapplicable to Missouri which did not "have a phase-down transition period." Missouri Ex. 14, at 1.

5. CMS final audit and the calculation of the disallowance

The disallowance at issue resulted from recommendations in a March 15, 2005 final report of a financial management review of UPL calculations for governmental nursing facilities in SFYs 2001 and 2002. CMS Ex. 15 (final audit). The final audit report was prepared by the CMS Regional Office, which reviewed only the State's documentation and calculations of the UPLs, in other words the methodology for estimating the Medicare UPL amounts. Id. at 4. The final audit report, however, also included the conclusions of a separate review by CMS's National Institutional Reimbursement Team (NIRT) focused on the State's "UPL methodology and rationale for payments made." Id. at 1. The Regional Office review found the documentation and calculations adequately supported. Id. The NIRT review, however, concluded that the "UPL payments made exceeded the available excess by $22,861,249 ($13,943,443 FFP) for SFY 2001 and $120,063,168 ($73,303,246 FFP) for SFY 2002." Id.

The NIRT "focused on evaluating the State's UPL payment methodology and determining whether it was in accordance with Federal regulatory guidelines," and specifically reviewed the UPL methodology and calculations for SFYs 2001 and 2002 for state and non-state government nursing facilities (NFs) and other NFs. Id. at 3. The NIRT also "reviewed the State's calculation of the UPL gap – that is, the amount by which the Medicare UPL exceeded the amount the State reimbursed providers for Medicaid services." Id. at 3-4. The NIRT audit process was described as follows:

> The NIRT selected one quarter of the State's NF UPL program in order to analyze a piece of the UPL program in order to determine the quarterly maximum excess payment allowable to non-State government NFs. Based on data from the 3rd Qtr of SFY 2001 (March 31, 2001), the NIRT determined the quarterly maximum excess payment allowable to the non-State government NFs.

> Finally, the NIRT reviewed supplemental Medicaid payments made by the State to nursing facilities to determine if the State's overall Medicaid reimbursement exceeded allowable UPL limits. The NIRT's review was focused on the State's compliance with the UPL regulations at 42 C.F.R. § 447.272 that were revised effective March 13, 2001.

Id. at 4. The final audit stated that the Final Rule provided for "transition periods in which States could continue aggregate payments that exceed the new UPL requirements," but that it "also 'capped' those excessive payments at the March 13, 2001 level," citing 42 C.F.R. § 447.272(e)(2)(i). Id. The NIRT determined that the maximum allowable "excess payment" to non-state government nursing facilities in the quarter ending March 13, 2001 was $54,126,803, which it annualized to $216.5 million "for an entire State fiscal year." Id. Since Missouri had made supplemental payments for only 11 months in SFY 2001, the NIRT then multiplied the annualized amount by 11/12. The result was then compared to the amounts of UPL supplemental payments actually made to those nursing facilities during the fiscal years in question. The NIRT considered the amounts by which the actual payments exceeded the annualized quarterly calculations of allowable excess payments to constitute unallowable increases in excess payments and recommended that the FFP share of these unallowable increases be returned by the State. Id. at 5.

Based on the NIRT calculations, CMS issued a disallowance dated June 29, 2005. This appeal was filed July 28, 2005.

6. Case development

In its notice of appeal, Missouri indicated that it was seeking discovery of documents from CMS related to its appeal. CMS also requested document discovery from Missouri. CMS letter to Missouri counsel, dated August 19, 2005. After a lengthy period of discovery negotiation and production, the parties filed their briefs by July 27, 2006. A supplemental declaration from CMS was accepted without objection by Missouri on August 15, 2006.

In its initial brief, Missouri requested a hearing and oral presentation before the Board. Missouri Br. at 1. After the retirement of the Presiding Board Member previously assigned to this matter, the current Presiding Board Member initiated a contact to the parties about scheduling an opportunity for oral presentations in the form of an informal conference pursuant to 45 C.F.R. § 16.10. E-mail from Board staff to counsel, dated October 30, 2007. A time was set in December 2007 for the informal conference, but the parties indicated that they

preferred not to proceed without first receiving questions from the Board. Letter from Board to counsel, dated February 29, 2008. The Board therefore provided to the parties a detailed list of questions, the resolution of which appeared useful to a sound decision in the matter, and instructed the parties that they were free to address any of these questions or other matters they considered relevant at the time of the oral presentation. Id. The parties then elected to submit written responses to the Board's questions, which Missouri submitted on April 11, 2008 and CMS on April 15, 2008. Both parties stated that, in light of this detailed exchange, no further oral proceedings were necessary.

The Board therefore closed the record and proceeded to decision.

Arguments of the parties

Missouri disputes CMS's interpretation of the "must not increase" language as capping "excess payments by post-1999 states to non-state government-owned nursing facilities." Missouri argues that it lacked adequate and timely notice of CMS's interpretation, so that CMS should not be permitted to enforce the interpretation against Missouri. Further, Missouri argues that the interpretation itself constituted a substantive rule that should have been subject to notice-and-comment rulemaking under the Administrative Procedure Act (APA), 5 U.S.C. § 553(b). Missouri asserts that CMS is improperly attempting to apply its interpretation retroactively. In addition, Missouri contends that, even if CMS's interpretation is properly applied to it, the disallowance amount is "vastly overstated because the NIRT auditors misapplied the agency's own interpretation when calculating Missouri's 'allowable excess amount.'" Missouri Br. at 14.

CMS argues that its interpretation constitutes the plain meaning of the "must not increase" provision. Alternatively, CMS contends that Missouri had adequate notice of CMS's interpretation of the provision, if not through language in the preamble, then by constructive notice to its counsel. Furthermore, CMS states that its interpretation of the "must not increase" provision is reasonable and entitled to deference. Finally, CMS argues that its determination of how the must-not-increase provision applies is an interpretive, not a substantive, rule, and that, in any case, Congress exempted the Final Rule from APA requirements. CMS Br. at 44-45.

Analysis

1. Contrary to CMS's position, the provision at issue was not unambiguous on its face.

CMS argues that the "words 'must not increase' are not ambiguous words." CMS Br. at 19. This argument misses the point stressed by Missouri that the sentence as a whole fails to specify with clarity what payments must not increase from what baseline amount over what period. See Missouri Br. at 14.

The relevant provision states:

> The amount that the state's payment exceeded the UPL described in paragraph (b) must not increase.

42 C.F.R. § 447.272(e)(2)(i). Paragraph (b) of section 447.272 (at the relevant time) described the three new categories, including non-state government owned or operated facilities, as to which separate aggregate UPLs would be applied under the Final Rule.[7]

Missouri points out that the use of the past tense verb "exceeded" suggests a reference to past events. Hence, the sentence might be read to mean that the payments made prior to the effective date must not be increased by retroactive adjustments, if they already exceeded the new UPL limits. Missouri suggests that this potential reading could make sense since one concern was that some states were required to phase down their payments based on percentages of a base year amount (called "X" in the Final Rule). The regulations define "X" as state payments to private or non-state government operated provider groups in SFY 2000 "that exceeded the amount that would have been paid under the [UPL] described in paragraph (b) of this section if that limit had been applied to that year." 42 C.F.R. § 447.272(e)(1)(iii). If such states could retroactively recalculate payments to increase "X," they might thereby also raise the ceiling throughout their transition phase-down periods. Missouri argues that, since post-1999 states would not have made payments under their state plans for a full year in SFY 2000, and had no phase-down periods to which to apply the X formulas, the

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[7] These provisions have also undergone changes after the time period at issue here. Throughout this discussion, references to Part 447 provisions should be understood to refer to their language as in effect during the relevant time period.

"must not increase" provision should be read as inapplicable to them.

This proposed alternative reading is less than compelling itself, however. The X amount is defined by how much the state's SFY 2000 payments to the providers in the new UPL groups exceeded the amount that "would have been paid" to them if the UPLs "had been applied" in SFY 2000 (which, of course, they were not). The "must not increase" provision contains no similar contrary-to-fact language about what amounts would have been excessive had the new rules been applicable previously. Instead, it states that the amount a state's payment "exceeded" (at an unstated point) the new UPL is not to get any larger. The two provisions are not necessarily referring to the same payment amounts. Thus, while the use of the term "exceeded" in both provisions might suggest a connection, the differences in the two provisions are not explained by Missouri's suggested interpretation. It is also not clear why a separate general rule for all transition periods would be created if the only intention was to indicate that the base year X amount could not be retroactively increased by states using that SFY 2000 figure for a phase-down calculation. For present purposes, we simply conclude that the use of the past tense "exceeded" in the context of the "must not increase" provision is not clear on its face. Thus, the plain language of the regulation did not give Missouri clear notice of CMS's present interpretation.

CMS states that "when the rule uses the past tense in describing the 'amount that a State's payment exceeded the [new UPL],' it is referring to the amount that the state's payments to state facilities and to private facilities each exceeded the reasonable reimbursement rates for those respective categories of facilities prior to March 13, 2001" and further states that it is also referring to "the amount that the state's payments to county facilities exceeded the reasonable reimbursement rates for county facilities prior to March 13, 2001." CMS Br. at 20-21.[8] It is

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[8] CMS explains in its briefing that it substitutes, "[f]or ease of style," the phrase "reasonable reimbursement rates" for "that portion of a state Medicaid payment which is at or below the reasonable estimate of the amount that would be paid using Medicare principles." Id. at 4, n.4. The aggregate of these reasonable estimates of the amounts that would be paid for the services furnished by a specified group of facilities under Medicare payment principles is what the regulations refer to as the UPL for that group of facilities. 42 C.F.R. § 447.272(b)(1)
(continued...)

undisputed, however, that no separate UPL for county facilities actually applied to any state prior to March 13, 2001, making it again less than obvious what it means to say that the reasonable reimbursement rates were "exceeded" prior to that date. Again, this ambiguity contrasts with the clarity of the explanation of the "X" amount to be used during the phase-down periods.

One way to read the "must not increase" provision might be that the calculation of "X" must be fixed and not affected by changes in methodology during the period before the phase downs were to begin. Missouri cites some language in the preamble as supporting the idea that CMS was concerned about such efforts by states to raise the base year amount to reflect, for example, changes in Medicare reimbursement. Missouri Br. at 15-16, citing 66 Fed. Reg. 3148, 3162. The states, like Missouri, whose now-noncompliant state plan provisions became effective after September 30, 1999, were instructed that their "payments may exceed" the new UPL ceilings "until September 30, 2002." Of course, this does not address the issue here about whether there was a cap on the amount of excess payments prior to September 30, 2002, but post-1999 states would not have an "X" amount to alter. As CMS points out, however, the "must not increase" provision is presented as a "general rule" for all "transition periods." 42 C.F.R. § 447.272(e). The meaning of the provision should, therefore, be one which makes sense for all the transition periods set up in the Final Rule. We also note that the discussion of comments in the preamble to the Final Rule can give little direct guidance on the "must not increase" language because this provision did not appear in the proposed rule to which the commenters were referring.[9]

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[8](...continued)
and (e)(1)(ii). We do not use "reasonable reimbursement rates" to imply that payments which complied under an approved state plan and met the regulatory and statutory requirements at the time made were in any other sense "unreasonable" rates.

[9] The proposed rule did contain a provision not included in the Final Rule which specified that pre-1999 states had three SFYs in which to achieve compliance and that, during those years, state payments could not "exceed the lower of the base State FY 2000 payments" or the new UPL plus the phase-down percentage amounts. 65 Fed. Reg. at 60,158. As discussed in more detail below, the Final Rule preamble indicates that the idea of using prior payments as a ceiling was expanded to all transition periods (and therefore moved to the general rules).
(continued...)

CMS itself acknowledges that the "must not increase" provision "does not identify the base period from which no increases in the excess payments can occur." CMS Br. at 21. In fact, CMS suggests that, "at one extreme," a state might use a one-day period based on "the excess payment to county facilities on March 12, 2001" as the "maximum amount (in excess of UPL payments) permitted on and after March 13, 2001." Id. CMS proceeds to discuss multiple acceptable yearly or quarterly alternative methods of calculating a base amount. Id. at 21-24. CMS's discussion does not entirely resolve whether the absence of a specified base period serves to give states discretion to set different base periods, permits CMS to make case-by-case determinations of what it considers reasonable and appropriate in particular circumstances, or simply leaves a void requiring further guidance. At a minimum, therefore, the silence regarding a baseline period from which excess payments may not increase makes it difficult to view the application of the provision as clear on its face, as CMS now claims.

Indeed, the record suggests that CMS itself did not immediately settle on an interpretation of how this provision should be applied. The record includes an email from CMS staff person Mary Stuart to Missouri state officials in November 2001 seeking information about the UPL amounts and "the amount above the UPL" for nursing facilities and hospitals for federal fiscal year (FFY) 2000. Missouri Ex. 10. The email goes on to express an expectation that "this issue" will be "on-going for awhile since CMS is still reviewing how the UPL regulation is to be applied." Id. In another email, the same CMS staff person forwarded an undated and unsigned attachment described as explaining that "the excessive payment is based on State fiscal year 2000." Missouri Ex. at 11. It is undisputed that the attachment was draft

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[9](...continued)
While one could argue that the use of SFY 2000 as a base in the proposed rule could be taken to mean that the "must not increase" provision implicitly referred to the same period, one could equally conclude that the removal of the reference to SFY 2000 in the "must not increase" general rule in the Final Rule implied that CMS recognized that a base year SFY 2000 would not necessarily make sense for certain states which had not made excess payments during the full SFY 2000 period. Making that change could be viewed as evidence that CMS was indeed intending to include post-1999 states in the scope of the "must not increase" ceiling. But again, the preamble does not make the reasoning for the change clear in a way that fairly put Missouri on notice of CMS's intention.

guidance which merely circulated informally among the states. See Missouri Ex. 12. It is also undisputed that the draft guidance was never formally issued in final form. We discuss in the next section the role these documents play in evaluating what notice Missouri received of CMS's interpretation. Here, we simply note that they support our conclusion that the meaning and application of the "must not increase" provision was not obvious on its face.

CMS also suggests that the "must not increase" provision is "best understood" in the context of the purposes of the Final Rule. CMS Br. at 24. The purposes, according to CMS, were to "unbundle the UPL" to preclude states from paying county facilities more than "reasonable reimbursement levels" and to smooth the transition for states based on how long they had relied on previously-approved funding mechanisms that would have to be brought into compliance. Id. CMS reasons that any increase in the amount exceeding the new UPL would make the obligation to achieve compliance by September 30, 2002 more rather than less "precipitous." Id. at 24-26.

This analysis may well be relevant to determining whether the interpretation proffered by CMS is reasonable, but does nothing to demonstrate that the meaning of the provision can only be understood in one way. Furthermore, it ignores the countervailing concern, also expressed in the preamble, that states' budget expectations not be disturbed abruptly. The expectations of post-1999 states presumably might have been based on expected Medicare rate increases resulting in higher UPL amounts being available under their approved state plan methodologies.[10] Since the post-1999 states had only the short 18-month period to make changes to their budgets before achieving full compliance, imposing a ceiling on payments below that which would have been otherwise permissible under the state plan during the transition period could be viewed as inconsistent with allowing reasonable time to the states to make budgetary adjustments.

We therefore conclude that the meaning and application of the "must not increase" provision to states, like Missouri, required to achieve compliance by September 30, 1992, is not clear on its face.

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[10] Under CMS's interpretation, the Medicare rate increases would still benefit the states in absolute dollars since the amount of the new UPLs would be based on the Medicare rates in effect at the time the UPL was calculated.

2. CMS's interpretation is a permissible and reasonable reading of the regulatory language.

Concluding that the language of the "must not increase" provision is not entirely plain on its face, as we have, does not imply that it amounted to promulgating formless "mush" devoid of meaning as Missouri suggests. Missouri Br. at 15, citing Paralyzed Veterans of America v. D.C. Arena L.P., 117 F.3d 579, 584 (D.C. Cir. 1997). Furthermore, the existence of more than one potential interpretation or application does not imply that all interpretations are equally valid. As we have noted, we, like the courts, will generally defer to an agency's interpretation of its own regulations so long as that the interpretation is permissible and reasonable. We therefore turn next to whether CMS's proposed interpretation here meets those criteria.[11]

In the present case, we find little question that the agency interpretation was permissible and reasonable. Although its initial brief describes the interpretation put forward by CMS as "[p]erhaps the least plausible," Missouri acknowledges in its reply brief that it "has not claimed that the agency's interpretation is unreasonable, only that it cannot reasonably be applied to the State because CMS failed to provide the notice required under the APA as well as under constitutional principles of due process and federalism." Compare Missouri Br. at 17 with Missouri Reply Br. at 2, n.1.

Indeed, the interpretation that the "must not increase" provision was meant to prevent any upward movement after the effective date of the Final Rule in what CMS terms "excess payments" made by states under approved state plans is fully in accord with the purposes of the regulation discussed above. While such consonance does not establish a plain meaning out of less than facially clear wording, it does support the reasonableness of interpreting the language in a manner consistent with the overall regulatory purpose. CMS clearly viewed the use of an aggregate UPL to direct funds to non-state government operated facilities whose governmental owners made IGT payments to the state governments as an abusive funding mechanism which it sought to curtail. CMS Br. at 4-8. Further, CMS clearly issued the proposed and final rules with a view to closing this "loophole" as quickly as could feasibly be accomplished, while permitting

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[11] We leave to the following section the question of whether Missouri had notice sufficient to subject it to adverse consequences of that interpretation.

states some time to come into compliance. CMS Br. at 7, citing 65 Fed. Reg 60,151, 60,152 (2000); see also 66 Fed. Reg. 3148, 3149-50, 3164.

CMS thus reads the provision to use "excess payments" that a state permissibly made as of the date the rule took effect, i.e., at the beginning of a transition period, as a "cap" on the permissible level of payments which that state could make at any time during its transition period. This reading is not made unreasonable simply because the regulation does not specify a methodology for determining the relevant amount that would serve as the cap for a particular state. The Medicaid program generally permits considerable discretion by the individual states in developing payment methodologies so long as they are approved by CMS and conform to applicable statutory and regulatory requirements. Hence, CMS could reasonably interpret the "must not increase" provision to allow states to develop differing methodologies to determine the amount of their caps so long as those methodologies were consistent with the "must not increase" provision. While we have noted that this understanding of the determination of the cap as within the states' discretion is not self-evident from the regulatory language, Missouri has shown, and we find, no basis to consider it unreasonable.

Finally, interpreting the "must not increase" provision, as CMS does, in a manner that applies it to all of the transition periods is reasonable given other language in the text. "Transition period" is defined in the Final Rule as "the period of time beginning March 13, 2001 through the end of one of the schedules permitted under paragraph (e)(2)(ii) of this section." 42 C.F.R. § 447.272(e)(1)(i). One of those schedules is the transition period from March 13, 2001 through September 30, 2002 for post-1999 states set out at section 447.272(e)(2)(ii)(A). For the other states, the period before their phase-down schedules begin is also, by definition, included as part of their transition periods. Since the "must not increase" provision is couched as a general rule for transition periods, it is reasonable for CMS to interpret it to give effect to the provision in a way that affects all transition periods (not merely the phase-down periods).

We therefore conclude that CMS's interpretation of the "must not increase" provision as applying to states with a short transition period, i.e., post-1999 states, is a permissible and reasonable one.

3. Missouri did not receive timely and adequate notice of an official interpretation by CMS.

The next point to be resolved is whether Missouri received actual timely and adequate notice that CMS had adopted the interpretation it relies on here. This issue thus focuses on three questions – (1) Was notice actually received by Missouri? (2) Was such notice adequate in content? (3) Was such notice timely? CMS points to several sources by which it contends Missouri should be found to have received notice.

a. Preamble language did not provide adequate notice.

First, CMS points to language in the preamble to the Final Rule which it argues should have sufficed to enlighten Missouri about the proper interpretation and purpose of the "must not increase" provision. CMS Br. at 26-27. As noted above, however, the preamble contains no explicit discussion of the purpose of the "must not increase" language nor any explanation of why this provision was added to the general rules applicable to all transition periods.

CMS nevertheless suggests that certain responses to commenters explained the provision in a way that should have informed Missouri of what CMS intended. CMS Br. at 26-27. While these responses are useful in understanding the way CMS interprets the provision, we do not find them sufficiently clear in themselves to constitute actual advance notice of that interpretation. First, none of the excerpts cited by CMS references the new "must-not-increase" language directly or purports to be explaining the ambiguous language regarding the "amount that a State's payment exceeded" the new UPL. Second, CMS quotes selectively in a manner that creates a misleading sense of clarity where the preamble excerpts in context are more ambiguous than CMS acknowledges. For example, CMS quotes only responses even though the comments to which the response was directed appear to refer to those transition periods involving phase-down processes, i.e., not to the post-1999 state transition period. Below, we quote in context four statements from the preamble on which CMS relies and discuss why none provided adequate actual notice of how the "must not increase" provision would be interpreted in relation to states in Missouri's position.

i) First preamble excerpt --

> Comment: Several commenters indicated that the text of § 447.272(b)(2)(iii) as proposed, limits payments to

> the lower of the base State FY 2000 payments or the limit based on the reduction schedule. Commenters stated that this restriction could result in a lower transition payment than that which would be available in the absence of the transition provisions. This requirement also appears in § 447.321(b)(1)(iii) and (b)(2)(iii). Commenters recommended that the reference to "base State FY 2000 payments" be deleted from each regulation.
> Response: While we have included generous transition periods, we do not think it is appropriate to permit States to make payments that would further increase the amount of payment that is in excess of the new UPLs. **We have revised the text of the transition provisions in §§ 447.272(e) and 447.321(e) to make this clarification. We have also extended this policy to all transition periods.**

66 Fed. Reg. at 3163 (emphasis added).

CMS quotes only the response and emphasizes the final sentence stating that CMS has "extended this policy to all transition periods." CMS Br. at 26. The policy about which the commenter asked, however, was the use of either the "base FY 2000 payments or the limit based on the reduction schedule." The Final Rule does not provide for the use of either the set base year FY 2000 payments or any reduction schedule in the case of states like Missouri which do not fall under any phase-down schedule. While the reference to revising section 447.272(e) might be read as referring, inter alia, to the addition of the "must not increase" provision, especially in light of the reference to not allowing "further increases," we do not find the context sufficiently clear for this discussion to establish notice of CMS's interpretation of the effect of the "must not increase" provision on post-1999 states.

ii) Second preamble excerpt --

> Comment: In phasing out a payment methodology during a particular transition period, a commenter asked if we will require new State plan amendments to effect reductions in payment, or will we consider compliance with the regulation, such as applying the percentage in the regulation to the last approved State plan amendment sufficient without a new State plan amendment.

> Response: **Given the diverse nature of UPL State plan amendments, it is difficult to describe a single action that would be appropriate in all cases. States are required under 42 C.F.R. § 430.12(c) to reflect changes in Federal law, regulations, policy interpretations or court decisions. We anticipate States, in many cases, will need to change their payment methodologies in order to reduce payments to levels that comply with the new UPLs and ceilings during the transition period.** Under § 447.257 and § 447.304, we provide disallowance authority to the extent that States do not submit conforming State plan amendments. We encourage affected States to contact their [CMS] Regional Office for guidance specific to their situation.

66 Fed. Reg. at 3163 (emphasis added).

CMS quotes only the bolded language, emphasizing its reference to "ceilings" that are in effect "during the transition period" as making the meaning of the "must not increase" provision "manifestly clear." CMS Br. at 26.[12] Again, however, the excerpt is less transparent when considered in conjunction with the comment to which it responds. Here, the commenter specifically asked what CMS would require in "phasing out a payment methodology during a particular transition period," while states like Missouri have no phase-down period. Furthermore, the point made in the response is that states may need to submit a conforming amendment in order to support their making payments at the levels compliant with the new requirements but not compliant with their prior (pre-Final Rule) state plans. Yet CMS has not suggested that post-1999 states were expected to submit and get approval for a new state plan amendment adopting a methodology for implementing a new ceiling during the relatively brief period before they were to come into full compliance. Where a state will be subject to a disallowance despite making payments in accordance with an approved state plan, it seems particularly important that this effect either be clear on the face of a

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[12] Although CMS views the reference to "ceilings" in effect during transition periods as clearly pertaining to the "must not increase" rule, the preamble uses the term "ceilings" in other contexts. For example, the preamble discussion of how the new UPLs will interact with the assessment of budget neutrality for managed care waiver programs talks about adjusting "budget ceilings for section 1115 demonstration programs." 66 Fed. Reg. 3156-57.

regulation or be made clear in guidance.[13] Here, CMS concluded that the decision would have to be made on a case-by-case basis with consultation. While that conclusion is certainly within CMS's province to make, it cannot be read in itself as providing notice of how the regulation is meant to be applied.[14]

iii) Third preamble excerpt --

> **We made it clear to States whose SPAs were deemed approved after October 1, 1999, that we intended to change the regulation, and therefore, put them on notice that they could not permanently rely on the additional Federal dollars generated through these mechanisms.** However, States with SPAs approved prior to October 1, 1999 were not aware of our intention to change the regulations related to UPL. The reliance concept is applicable because these funds have been built into State and provider budgets for longer periods of time. We note also that in enacting a third transition period for States with excessive payment methodologies in place on or before October 1, 1992, the Congress has ratified our approach to establish transition periods based on a "reliance concept."

66 Fed. Reg. at 3161 (emphasis added).

CMS quotes only the first sentence and concludes that it put Missouri on notice of the "purpose which the 'must not increase' provision was intended to support." CMS Br. at 27. The content of the notice which CMS asserts that it provided to states like Missouri that sought to amend their state plans after October 1, 1999 warns only that the approved financing mechanism was not one on which they would be able to "permanently rely." The preamble does not indicate that CMS informed those states that a cap would be imposed on the payment amounts generated under an approved

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[13] At the same time, we recognize that where a new legal obligation is explicitly imposed by statute or regulation, states may have to abide by applicable legal requirements and conform any conflicting state plan provisions by later amendment.

[14] We note that, while this language does not give adequate notice of the agency's interpretation of the meaning of the "must not increase" provision, it does put states on notice that they should contact CMS when they feel that their particular situation has not been sufficiently addressed. We discuss the significance of that advice in the next section of this decision.

state plan amendment prior to the date the state would be required to come into compliance with any new regulation that might be published. Therefore, we do not see how this preamble language provides any notice of the meaning or intent of the "must not increase" language as applied to post-1999 states.

Plainly, as the preamble explains, states which sought amendments after October 1, 1999 had more awareness that CMS was considering action to restrict these funding mechanisms than did states which had long had approved plans including such mechanisms. Logically, too, the longer a state employed such mechanisms, the greater its likely dependence on them for budgeting and planning. The quoted passage thus provides a reasoned explanation for assigning different lengths of time for states to come into compliance depending on how long their state plans included the funding mechanisms being discontinued. The passage leaves unresolved, however, how the "reliance concept" might apply to the post-1999 states' expectation that they would be able to rely on approved state plan methodology until the regulation required them to come into compliance with the new UPLs.

iv) Fourth preamble excerpt --

> Comment: Many commenters urged us to approve pending applications in their State, or in all States before finalizing the rule.
> Response: **We have given all States ample notice of our position that these programs are abusive and of our intent to publish this regulation to curtail such programs.** To affirmatively approve pending applications would be counterproductive to our purpose of preserving the fiscal integrity of the Medicaid program.

66 Fed. Reg. at 3164 (emphasis added).

CMS relies on the bolded language in this exchange as providing notice of the purpose of the "must not increase" provision. CMS Br. at 27. The context again does not suggest any reference to the "must not increase" provision. The comment related to states which, unlike Missouri, had not yet amended their state plans to adopt the financing mechanism which CMS was proposing to phase out. The response stated CMS's intention at the time not to approve further applications, but did not say anything about how the transition period for the states with existing post-1999 plans was to be administered. The preamble does make clear that CMS felt it had communicated to the states its view that this funding mechanism was "abusive" and that its intention in

developing the proposed regulation was to “curtail” it. The ultimate effect of the Final Rule was indeed to phase it out completely over time. The excerpt in context does not, however, shed light on exactly what role the “must not increase” provision was intended to play in the process of curtailing the future use of the “abusive” mechanism during the transition period for post-1999 states.

In summary, we agree with CMS that the various quoted excerpts are consistent with its interpretation of the “must not increase” provision. None of them, however, precludes other reasonable interpretations or provides unambiguous notice of how the provision should be understood or applied.

b. CMS contacts with counsel for Missouri in 2001 did not provide adequate notice.

CMS next alleges that Missouri received imputed notice of the CMS interpretation through various contacts with Missouri’s outside counsel, Charles Miller, between April and November 2001. CMS suggests that Missouri’s counsel received this information from three sources. First, CMS points to Mr. Miller’s firm having worked with the State of Virginia on a project related to IGTs. CMS Br. at 28-30. CMS alleges that a Virginia staff person was told by a consultant to Virginia that the consultant had had “a conversation with CMS personnel during the January 2001-May 2001 period to the effect that CMS was interpreting the ‘must not increase’ regulation as prohibiting any increase in the levels of excess payments made by states to county facilities following the effective date of the Final Rule.” CMS Br. at 28-29, citing CMS Ex. 13 (Declaration of Stanley Fields). Second, CMS relies on statements by Robert Weaver of CMS that he recalled talking to Mr. Miller between January 26 and April 5, 2001 “about various provisions contained in the final rule” and telling him “in substance or effect” that CMS intended the interpretation it now puts forward. CMS Ex. 14, at 3; CMS Br. at 30. The allegations in both these declarations are much too nonspecific as to time, place, person or content to form a basis to determine the state of Mr. Miller’s knowledge at any given point, much less to impute such knowledge to Missouri.

CMS’s third alleged source of information to Mr. Miller is in the form of a November 26, 2001 email sent to Mr. Miller from an Iowa official attaching “a portion of a draft letter that may go out to the states” with examples of how to apply the “must not increase” provision. CMS Ex. 25, at 3; CMS Br. at 30-31. The source of the attachment was a CMS staff person named Mark Byler. Mr. Miller does not deny receiving this email attachment but

recalls it as the first "document he saw from CMS setting forth an interpretation of the 'must not increase' language," and denies that any "official or definitive" interpretation was advanced to him in any of his prior discussions with CMS staff. CMS Ex. 25, at 1; see also Missouri Ex. 21. The attachment itself in no way purports to be an official or definitive interpretation, and is devoid of any identification, signature, date, or other indicia of formal status. On the contrary, Mr. Byler's email transmitting it to Iowa describes it as a "draft" and indicates that CMS had not even decided at that point to issue it to the states. At most, Mr. Miller's receipt of this email informed him, and potentially made information available to his other clients such as Missouri, that CMS was contemplating issuing this interpretation. Such informal information about a mere draft of a policy document cannot form the basis of actual notice of an agency interpretation sufficient to make that interpretation enforceable against the recipient, much less against another state whose counsel received the draft from the original recipient.

We conclude that none of these channels of information can be viewed as adequate notice to Missouri of the interpretation on which CMS presently relies. We need not therefore reach Missouri's argument that the actual notice required by the APA cannot be based on imputed constructive notice through counsel. See Missouri Reply Br. at 7-11.[15]

4. Missouri has not proven that it actually formed and relied to its detriment on a specific reasonable alternative interpretation.

The preceding discussion does not imply that CMS may not take any action to enforce a regulation unless it has previously discerned all possible ambiguities or uncertainties that might arise from

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[15] Missouri also argues that information provided in November 2001 could not be considered timely notice since by that time it had "closed the books on SFY 2001, had settled expectations about payment levels for SFY 2002, and [was] well along in the budgeting process for SFY 2003." Missouri Br. at 23-24. CMS responds that Missouri law provided a method to request supplemental funds from the state legislature which Missouri could have used to correct its course when it learned of CMS's interpretation. CMS Br. at 33-34. We need not resolve this aspect of the dispute either, given our conclusion that the draft material forwarded to Mr. Miller did not constitute adequate notice that CMS had adopted an interpretation.

its language and preemptively issued official interpretative guidance resolving them. It would indeed be difficult to administer any new regulation in a manner foreclosing any possibility of misreading or misunderstanding. The APA requirements regarding publication of interpretive rules do mean, however, that a state may not be adversely affected by an ambiguous provision when it has in good faith acted on a reasonable, if mistaken, understanding of what the regulation means. See 5 U.S.C. § 552(a). It is at this stage of the analysis that Missouri's position breaks down for several reasons.

First, Missouri has not presented evidence that it actually formulated a reasonable interpretation of the provision and relied on that interpretation. Second, Missouri should have known at a minimum that the "must not increase" provision raised questions about how to apply the Final Rule as adopted to post-1999 state plan provisions, yet Missouri did not make appropriate efforts to find out how CMS intended the provision to apply.

Rather than specify an alternative reasonable interpretation on which it purportedly relied in making payments, Missouri's initial brief simply identifies multiple conceivable explanations for the "must not increase" language. Missouri Br. at 15-17. Missouri described the provision as "opaque and subject to a number of different interpretations as to its purpose and applicability." Id. at 2. The Board therefore questioned how Missouri could demonstrate that it actually relied on any specific interpretation of the "must not increase" language, as opposed to merely identifying in retrospect possible ambiguities in the language. Board Questions at 9. Missouri's response is that the various alternative readings were "merely intended to illustrate that the rule is ambiguous and that the State's interpretation was as reasonable as any other." Missouri Response to Board Questions at 7. Missouri still fails, however, to state what it understood the "must not increase" provision to mean and how it acted on that understanding. Missouri only states that its practice and interpretation was that the provision did not establish a ceiling requiring Missouri "to deviate from its approved state plan during its transition periods." Id. This statement offers no explanation of how Missouri interpreted the words which Missouri asserts, and we have found, are susceptible of more than one reading. In essence, Missouri seems to be saying that it did not know what the language meant but decided that, whatever it meant, it had no effect on what Missouri was to do. To find a regulatory phrase ambiguous as to how it applies in a particular context is not the equivalent of finding all imaginable readings equally acceptable

and is certainly not license to ignore altogether the fact that it is stated as a general rule applicable to that context.

Missouri does not dispute that good faith includes seeking guidance where the state is aware of an apparent ambiguity or uncertainty. Many of the sources of information which we have found inadequate as actual notice to Missouri of a single binding interpretation are nevertheless more than sufficient to make states with post-1999 plans aware that, at a minimum, uncertainty existed as to the restraints to which they were subject during their transition period. We have already found that CMS's interpretation of the "must not increase" provision was, at a minimum, reasonable, even though the language is not without ambiguity. Much of the ambiguity arises from the absence of a specific base period reference for the figure which is not to increase, in contrast to the specific X calculation from which phase-down amounts are to be derived for phase-down period calculations. This problem is discussed further in the section dealing with Missouri's challenge to the methodology CMS applied to calculate the disallowance amount. Ambiguity also arises, as we have noted, from the infelicitous use of the word "exceeded." The use of the past tense, however, does not support Missouri in presuming that it could ignore the provision altogether. Missouri has not shown that it could and did reasonably interpret the past tense as demonstrating that this provision was intended to have no impact on the post-1999 state transition period despite the fact that it was identified as a general rule for all transition periods.[16] As CMS points out, in order to qualify for any transition period at all, a state had to have payment methodologies in place before the Final Rule's effective date that resulted in payments that exceeded the UPLs under the new rule. CMS Responses to Board Questions at 14, n.9, citing 66

[16] We have noted that the reference to a specific base year of SFY 2000 for phase-down calculations creates some confusion about how the "must not increase" provision is to be applied to post-1999 states which did not make "excess payments" for a base year of SFY 2000, when no other specific baseline period is spelled out for the "must not increase" calculation. We do not accept, however, that this confusion justified Missouri simply presuming that the "must not increase" provision had no relevance for post-1999 states because their "excess payment" methodologies were implemented too late to create a full SFY 2000 base year amount.

Fed. Reg. 3163, and at 19, n.14.[17] CMS explains that its use of past tense was intended to reference the payments that had been made under those methodologies and require those payments to serve as a cap on future payment amounts to be made during the transition period. Id. at 18-19.

Any alternative interpretation that seeks to justify giving no effect to the "must not increase" provision in the case of post-1999 states runs into serious difficulty with the statement in the preamble, discussed above, that the proposed section 447.272(e) was clarified to establish that states could not further increase payment amounts in excess of the new UPLs, even though such payments might continue during the transition periods, and that this restriction was extended to all transition periods. 66 Fed. Reg. at 3163.[18] While we have agreed with Missouri that the preamble does not conclusively provide notice of how CMS now applies the "must not increase" provision to post-1999 states, we do not find that Missouri has explained how it reads this explanation in the preamble in a manner that justifies simply ignoring the section 447.272(e) restriction for its transition period.

Missouri also suggests that the "must not increase" provision is impermissibly vague for the very reason that it is "expressly labeled a 'general rule.'" Missouri Br. at 18. Apparently, Missouri views a general rule as meaning a provision that has no specific effect. This argument ignores the real implication of the categorization of the "must not increase" provision as a

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[17] CMS did ultimately approve state plan amendments by additional states (Virginia and Wisconsin) after the Final Rule was published. CMS submitted a declaration from a former Virginia official who later worked at CMS asserting that Virginia complied with the interpretation of the "must not increase" provision articulated by CMS and did not subsequently exceed the level of excess payments in the quarter ending March 31, 2001. CMS Ex. 13, at 2-3. CMS also asserts that neither state included April 1, 2001 Medicare rate increases in calculating the excess payments.

[18] We therefore find it difficult to reconcile the application of section 447.272(e) to all transition periods with Missouri's suggestion that the past tense "exceeded" was meant to "preclude retrospective increases" of the X base-year amount rather than to "set prospective ceilings," given that the X base-year amount exists only for those transition periods with phase-down periods. Cf. Missouri Response to Board Questions at 3.

“general” rule. Section 447.272(e) divides the discussion of all transition periods into definitions (set out in subsection 1) and general rules (set out in subsection 2). 66 Fed. Reg. at 3177. The general rules address all states with approved state plan provisions permitting payments that exceed the new UPLs with the various applicable transition schedules specified in subsection 2 which includes the post-1999 states. The “must not increase” provision is thus an overarching requirement applicable to all states permitted to follow one of the listed transition schedules, which include post-1999 states.

Missouri further argues, however, that it did seek guidance on interpreting the Final Rule, and that it did so by communicating with the CMS contact person identified in the Final Rule, Robert Weaver. Missouri Br. at 21-22, n.2, citing 66 Fed. Reg. 3148; Missouri Reply Br. at 8. As mentioned above, on January 26, 2001, counsel for Missouri wrote to Mr. Weaver enclosing “Missouri’s calculation of the upper payment limit for payments to nursing homes for the period August 2000 - June 2001, and for July 2001 - June 2002." Missouri Ex. 6, at 1. The letter explained that the beginning dates of the two periods “correspond to the beginning dates of changes in the Medicare nursing home rates.” Id. The letter also informed Mr. Weaver that the State anticipated, but had not yet set, increases in Medicaid rates for nursing homes in SFY 2002, so that the calculations assumed the same level of Medicaid payments as in SFY 2001. Id.

The letter on its face neither sought guidance about the “must not increase” provision for states in Missouri’s situation nor disclosed how Missouri interpreted the provision. Missouri explains that the calculations were sent to “confirm that [Missouri’s] methodology for calculating the upper payment limit (using the RUGS methodology) was correct,” but also asserts that, at the time, “Missouri had no reason to be focused specifically on the must-not-increase provision, and counsel for Missouri did not ask Mr. Weaver specifically to consider its impact.” Missouri Response to Board Questions at 6.

Missouri contends that someone with Mr. Weaver’s “familiarity with UPL calculations” could have extrapolated from the fact that an increase in Medicare rates would expand the “UPL gap” to an awareness that Missouri was not factoring in a cap on any such resulting increase in “excess payments.” Id. This extrapolation, even if possible, was not a necessary conclusion from the data given, especially since the Medicaid rates for SFY

2002 were not set.[19] Further, Mr. Weaver explicitly denies that he was able to reach that conclusion, stating that the letter provided him with "no information or data from which it could be determined" whether Missouri would be in compliance with the "must not increase" provision. CMS Ex. 14, at 3. He goes on to state that he had no other information about whether Missouri would actually increase the amount by which its payments were in excess of the new UPL during its transition period so as to come in conflict with CMS's interpretation of the "must not increase" provision, until around the time the disallowance was issued. Id. at 4.

Mr. Weaver's approval of Missouri's calculations did not necessarily imply that supplemental payments would not be subject to, or necessarily suggest approval for Missouri's supplemental payments to increase in a manner that would violate, the "must not increase" provision as interpreted by CMS. Missouri acknowledges as much in its reply brief, in which it notes that an increase in Medicare rates "(unless accompanied by a concomitant increase in Medicaid rates) will cause the UPL 'gap' to increase." Missouri Reply Br. at 8, n.2. Thus, Mr. Weaver's approval based only on the UPL calculations sent to him by Missouri is not sufficient for Missouri to have concluded that CMS would have no objection if the "excess payments" did increase during the transition period.

Missouri nevertheless argues that "[w]hile Mr. Weaver may not have expressly approved those calculations as compliant with the 'must not increase' provision, neither does he appear to have informed the State or Mr. Miller that the calculations shared with him would have to be 'capped' on account of the rule's application." Id. Missouri thus effectively concedes that the exchange with Mr. Weaver did not expressly address compliance with the "must not increase" provision. Mr. Weaver disputes the factual claim that he failed to notify Mr. Miller of CMS's understanding of the application of the "must not increase" provision.[20] We do not find it necessary to resolve the factual

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[19] Since the anticipated higher Medicaid payments would reduce the gap between Medicaid payment rates and UPLs based on Medicare reasonable estimates, the information in the January 2001 letter and the enclosures did not disclose that Missouri's "excess payments" would necessarily increase during the transition period.

[20] As discussed previously, Mr. Weaver recalled in his (continued...)

disagreement between Mr. Weaver and Mr. Miller about whether Mr. Weaver advised Mr. Miller on CMS's view. However helpful such advice might have been, Missouri has not shown that it ever directly posed the question to Mr. Weaver or anyone else at CMS about whether the general rule that excess payments must not increase applied to post-1999 state transition periods.

Missouri also suggests that it relied to its detriment on its understanding that the "must not increase" provision was inapplicable to it because, prior to receiving the November 2001 draft CMS letter, it could not have known of CMS's putative interpretation in preparing its budgets and program plans. Missouri Br. at 23-24. This delay, according to Missouri, made it impossible to change either its state plan or its budget in time for the transition period. Id. at 24. Missouri points to CMS's recognition in the preamble of the difficulties with abrupt changes in federal rules for state Medicaid funding as demonstrating that notice in November 2001 could not be timely notice "given the realities of state budgeting." Id., citing 66 Fed. Reg. at 3161.

As far as the timing, the November 2001 draft letter was not the first or only source that should have triggered at least further inquiry and analysis by Missouri about how the "must not increase" provision should be applied. Given the regulatory context and the preamble language discussed above, it was not

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[20](...continued)
declaration having informed Mr. Miller of CMS's interpretation at some point. CMS Ex. 3, at 2-3. Missouri also asserts that Mr. Weaver assured its counsel orally that the "methodology and [UPL] calculation" were consistent with CMS regulations and policies and that any future need to change the methodology would only be required "on a prospective basis." Missouri Br. at 10, quoting Missouri Ex. 7. Mr. Weaver denied giving Mr. Miller this advice. CMS Ex. 3, at 2-3. We do not consider it necessary or worthwhile to attempt to determine precisely what information was exchanged between Mr. Miller and Mr. Weaver during oral communications more than seven years ago. The written documentation does not establish that Missouri disclosed its purported interpretation or its intended application of the "must not increase" provision to Mr. Weaver. We do not rely on these disputed recollections of oral conversations to establish either that Missouri had actual notice of CMS's interpretation (as CMS alleged) or that Missouri made a good faith effort to determine CMS's interpretation (as Missouri asserted).

reasonable for Missouri to simply assume until November 2001 that the language did not affect it.

Furthermore, we note that, while we are not without sympathy for the practical difficulties presented to states by the changes in permissible financing methodologies, the preamble actually states that the transition periods themselves were provided in order to balance the "need to protect the fiscal integrity of the Medicaid program with State budget issues." 66 Fed. Reg. at 3161 (Emphasis added.). We cannot conclude that it was inconsistent with this balancing effort to cap further increases in "excess payments" during the short transition period before full compliance.

While states are indeed required to make Medicaid payments using the methodology in their approved state plans and not to make material changes without notice to providers, those requirements do not justify ignoring the restriction on increasing excess payments here. Missouri's state plan provision on enhanced payments states that Missouri shall administer the payment enhancement pools for Medicaid-covered services "[s]ubject to federal approval." Missouri Ex. 2. Missouri providers could not count on federal approval for the enhanced payments to be forthcoming contrary to applicable federal restrictions on payments during the transition periods adopted in the Final Rule. Since the restriction involved here was contained in a federal regulation adopted by formal notice and comment rulemaking, Missouri non-state government providers had constructive notice of the "must not increase" provision and could have commented on it at that time. Despite the ambiguity we have identified about how the provision was intended to be applied to post-1999 states, we find sufficient notice that neither Missouri nor its providers could assume that the provision would have no impact on enhanced payments during the short transition period.

For the same reason, we are not persuaded that Missouri has shown that it did not receive "at least one legislative session to fully analyze, evaluate, and assess the procedural and substantive ramifications [of] the rule and before SPAs would have to comply with the new upper limits" as promised, in Missouri's view, by the preamble. Missouri Responses to Board Questions at 2, citing 66 Fed. Reg. at 3169. The preamble states that the transition periods themselves permitted this period for analysis and budget action before a state plans had to comply with the new UPL limits. 66 Fed. Reg. at 3169.

The "must not increase" provision involved here is not a new UPL limit. The new UPLs are set out in sections 447.272(a) and (b)

whereas the "must not increase" provision is one of the general rules explicitly applicable only to the transition periods. While placing a cap on increases otherwise allowed under existing state plans may well affect budget planning, it does not impose an actual reduction in funding which the state had been receiving, as did the new UPL limits with which states had to comply after their transition periods. Missouri and the other post-1999 states had the entire transition period to analyze and take action to prepare for full compliance, but CMS made clear its conclusion that the transition periods as provided in the regulation allowed "sufficient time for State legislatures and Medicaid programs to prepare for any budgetary consequences." Id. Nothing in the preamble language promised the states that they would be held harmless from any budgetary impact of the transition period requirements.

Furthermore, in this instance, the full context of the language Missouri quotes from the preamble undercuts Missouri's contention that CMS's understanding of the "must not increase" provision applying to Missouri's transition period would conflict with an intention to ensure that every state had at least one legislative session before the Final Rule could have any effect on its Medicaid financing. The statement about the transition periods in the Final Rule sufficing to provide each state at least one legislative session to adapt came in response to a comment asking that the rule either not be enacted or be delayed entirely for one year to allow assessment of the impact on state budgets. In rejecting those requests, CMS emphasized that the "paramount interest" was in stemming the use of federal Medicaid funds drawn down for non-state government owned facilities by payments under the previous aggregate UPLs which CMS viewed as being diverted to non-Medicaid uses by IGT agreements and thereby impinging on the program's fiscal integrity. 66 Fed. Reg. at 3169.

We conclude that Missouri has not established that it actually relied to its detriment on an alternative reasonable interpretation of the "must not increase" provision. In the absence of a contemporaneous alternative reasonable interpretation supporting Missouri's payments, CMS's interpretation is entitled to our deference.

5. The APA does not require CMS to publish its interpretation of this regulatory language in separate notice-and-comment rulemaking.

Missouri's initial brief focuses heavily on the contention that CMS's interpretation of the "must not increase" provision amounted to substantive rulemaking which should itself have been

conducted through notice and comment rulemaking. Missouri Br. at 17-22.

Missouri argues that CMS's two-page draft guidance letter in November 2001 has "no linguistic connection – tight or otherwise" to the "twenty words in the regulation." Missouri Br. at 18. CMS's interpretation of the words "[t]he amount that a State's payment exceeded the upper payment limit . . . must not increase" is essentially that during any transition period the "excess payments" being made by the state are not permitted to get any larger. The draft guidance provides an explanation of how that goal is to be accomplished in light of increases in Medicare rates enacted by legislation in 2000 and elaborates through an example. Missouri Ex. 11, at 2. Such guidance on implementation of a regulation in light of practical events or through illustrative examples is normal administrative practice. This draft letter was never formally issued and is irrelevant to whether CMS's interpretation went so far afield from what was in its regulation as to require another rulemaking.

Canons of construction teach that all language in a regulation be given meaning. The instruction that the amount by which a state exceeded the new UPL must not increase must be given meaning, as must its characterization as a general rule applicable to all the transition periods. As we have concluded above, CMS's reading, while not compelled by the plain words, is nevertheless entirely consistent with the language, with the context, with the purpose of the regulation as a whole, and with the regulatory history. The description of proper interpretation cited by Missouri from a D.C. Circuit case seems applicable. CMS's interpretation "flow[s] fairly from the substance" of the regulatory language, deriving its proposition "from an existing document whose meaning compels or logically justifies the proposition." Missouri Br. at 18, quoting <u>Cent. Texas Tel. Coop., Inc. v. F.C.C.</u>, 402 F.3d 205, 212 (D.C. Cir. 2005).

Missouri also argues that the lack of a specific baseline period in the regulation means that CMS's use of the first quarter of 2001 as the baseline period in its example in the draft guidance amounts to legislation. Missouri Br. at 19. Why, asks Missouri, could one not use another baseline period such as the last quarter or the last year under the old rule or the first quarter or year of the transition period? This argument might have some force if CMS were insisting that the only acceptable baseline period was the first quarter of 2001, despite the absence of any specific requirement to that effect in the regulations. That, however, is not CMS's position. Instead, CMS asserts that the regulation provided "flexibility in the selection" of a baseline

period to measure the excess payment cap. CMS Response to Board Questions at 20. CMS states that a base year was specified only for phase-down states; non-phase down states (post-1999 states) "were free to devise their own method of calculating excess payment levels so long as they were reasonable and consistent with the policy CMS was seeking to enforce." Id. at 21-22.[21]

We conclude that the APA does not require CMS to have engaged in another round of notice-and-comment rulemaking before determining the meaning of the "must not increase" provision in the Final Rule or applying it to post-1999 states.[22]

6. CMS's interpretation does not support the amount of the disallowance as calculated here.

We have concluded that CMS could properly apply its interpretation of the "must not increase" provision to Missouri's transition period, in the absence of actual reliance by Missouri on a reasonable alternative interpretation. The remaining issue for us to address is whether CMS's interpretation supports the amount of the disallowance imposed here. We conclude that it does not.

Missouri points to several indicators of CMS's general approach to calculating the applicable cap from which excess payments must not increase in post-1999 states. First, Missouri refers to the example developed in the November 2001 draft guidance which is as follows:

> NF UPL for local government facilities in the first quarter of 2001 is $80.
> The state paid $180 to local government providers.

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[21] For this reason, we see no sense in which CMS's interpretation of the "must not increase" provision included in the Final Rule trenches on the concerns identified in cases like Pennhurst State Sch. & Hosp. v. Halderman, 451 U.S. 1 (1981), involving legislation that does not inform states in advance of their obligations if they accept federal funding. Permitting states flexibility in defining appropriate baseline periods to evaluate their level of excess payments before the Final Rule went into effect cannot be equated to enforcing a requirement stated too vaguely to be understood in advance.

[22] Given this resolution, we need not address CMS's assertion that Congress intended to preclude any application of the APA to the interpretation of the Final Rule.

> $100 is the amount above the UPL.
>
> This $100, sometimes referred to as the excessive payment amount, cannot be increased although the UPL itself may go up due to changes in Medicare payment systems . . . .

Missouri Ex. 11, at 2. Missouri also submits a final audit report relating to how the "must not increase" provision should have been applied in Kansas, also a post-1999 state. Missouri Br. at 26, citing Missouri Ex. 19. The Inspector General used the third quarter of SFY 2001 as the baseline period to calculate the limit on the amount by which Kansas's enhanced payments could exceed the new UPLs during its transition period. Missouri Ex. 9, at unnumbered 13. Missouri sets out the calculations performed for the quarter ended March 31, 2001 to determine the baseline period excess payment amount in the Kansas case as follows:

A.	Medicaid Per Diem Payments	$ 6,556,304
B.	Enhanced Payments	42,609,289
C.	Total Actual Payments (A+B)	49,165,593
D.	Upper Payment Limit	9,499,359
E.	**Excess Amount (C-D)**	**$39,666,234**

Missouri Br. at 26, citing Missouri Ex. 19, at unnumbered 15 (emphasis in original). Missouri then points out that both the example in the draft guidance and the Kansas audit report calculations compute the excess payments amount using "the amount the State *actually paid* to its non-State government-owned nursing facilities during the quarter in question." Id. at 26 (emphasis in original).

Missouri argues that the NIRT did not follow this approach of determining the amount by which Missouri's actual payments to non-State government NFs exceeded the amount of the UPL for such facilities, had the new separate UPL for such facilities been in effect during the quarter ended March 31, 2001. Missouri contends that applying the same approach in its case would lead to the following calculations:

A.	Medicaid Per Diem Payments	$ 20,773,959
	A.1 NF Efficiency Grants	1,324,237
B.	Enhanced Payments	82,684,115
C.	Total Actual Payments (A+B)	102,782,311
D.	Upper Payment Limit	25,557,918
E.	**Excess Amount (C-D)**	**$ 79,224,393**

Missouri Br. at 27 (footnotes omitted). Thus, Missouri concludes that, if a ceiling applied to it at all, then $79,224,393 should have been the maximum amount by which its payments to non-State government NFs could permissibly exceed the new UPL in each quarter of its transition period. Id.

The NIRT auditors instead determined that the excess payment amount available to non-State government NFs in the quarter ending March 31, 2001 was $54,126,803 (which it annualized to $216,507,211 and reduced by 1/12). The NIRT report does not provide a detailed narrative explanation of the rationale for this determination other than that one quarter was selected "in order to analyze a piece of the UPL program in order to determine the quarterly maximum excess payment allowable to non-State government NFs." Missouri Ex. 16, at unnumbered 6. NIRT's calculations for the non-State government NFs quarter ending March 31, 2001 are as follows:

1. Upper Payment Limit, Jan.-Mar. '01	$25,557,918
2. Medicaid Reimbursement, Jan.-Mar. '01	20,773,959
3. Nursing Facility Efficiency Grants	
A) Total SFY 2001 Grants	4,855,535
B) Prorated for Jan.-Mar. '01	1,324,237
4. Total Medicaid Reimbursement (2+3B)	22,098,196
5. Net Upper Payment Limit Available (1-4)	3,458,722

Id. at Att. B (unnumbered 12). The auditors also computed upper payment limits for State and "other" facilities, and subtracted total Medicaid reimbursement amounts to those facilities to arrive at net upper payment limits available to those facilities. Id. The auditors then added the State and other (including non-State) net available UPL amounts for a total of $54,128,803 which it treated as the "maximum quarterly excess available" to non-State government NFs (annualized to $216,507,211). Missouri argues that this approach "vastly overstates" the disallowance by underestimating the amount of excess payments in the selected quarter which are to be used as a ceiling on quarterly payments during the transition period. Missouri Br. at 25.

In its brief, CMS agrees that the total payments to non-State government NFs in the quarter ended March 31, 2002 less the new UPL payment amount "would normally represent the amount which could be used as the excess payment level to be used during the transition period . . . ." CMS Br. at 23 (emphasis added).[23]

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[23] CMS calculates the quarterly excess payment ceiling (continued...)

Nevertheless, CMS argues that the normal approach was properly rejected as "inappropriate" in Missouri's case because the totals paid by Missouri to all facilities in that quarter exceeded the UPL permitted for that quarter under the preexisting rules. Id. CMS states that Missouri exceeded the prior UPL amounts by $16,983,172. Id. at 23, 47. CMS asserts that it reduced the $71,109,975 which it calculated as "normal" excess payments by $16,983,172 to arrive at the $54,126,803 quarterly excess payment ceiling.

We do not find any basis in the regulations to support CMS's admitted deviation from its own normal practice in determining the amount of the ceiling imposed by the "must not increase" provision during Missouri's transition period. First, the problem identified by CMS is raised by the use of a single quarter as the base period rather than using a full year. As Missouri points out, and CMS agrees, the prior UPL amounts were set on an annual basis according to Missouri's state plan, and Missouri could permissibly exceed one-fourth of the annual UPL in any given quarter, as long as the difference could be made up in other quarters. Missouri Reply Br. at 13; CMS Response to Board Questions at 30. CMS attempts to address the absence of any actual quarterly UPL applicable to the quarter which CMS itself chose as the base period here by extrapolating part of the annual UPL to serve as a "quarterly UPL." This extrapolation has no support in the statute or regulation. Once an annual ceiling is reached, no additional payments may be made, but CMS has identified no authority or precedent for dividing the UPL into multiple quarterly ceilings and then treating amounts in excess of that quarterly ceiling as unallowable. Had CMS used a full SFY as the base period here, however, any annual UPL that included the fourth quarter of SFY 2001 or any later quarter would presumably have reflected the effect of the Medicare rate increase effective on April 1, 2001. This increase would have resulted in a higher "excess payment" amount during the baseline period to Missouri's benefit.

Second, the "must not increase" provision speaks of the amount that a state's payment exceeded" the new UPL. While the regulation presumably refers to state payments made consistent

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[23](...continued) using the "normal" method as $71,109,975, based on a total for per diem, efficiency grants and enhanced payments to non-State government NFs for the quarter of $96,667,893, instead of the $102,782,311 used in Missouri's calculations. We discuss this discrepancy later.

with the state plan and applicable federal regulations, the reference appears to be to actual payments made. As noted, CMS identified no requirement that a state divide its supplemental payments equally among all quarters, and indeed no basis to conclude that the payments made by Missouri during the third quarter of SFY 2001 violated any provision of the state plan or federal law. By permitting post-1999 states discretion about what base period to use, CMS necessarily accepted that a quarter might be chosen in which excess payments were higher than average for that year. Here, CMS argues that Missouri failed to exercise that discretion so that CMS was entitled to select a reasonable base period. Having selected the quarter ending March 31, 2001, CMS cannot fairly disregard the amount of actual payments made in accordance with the state plan and federal requirements during that quarter because CMS determines that the actual payments in that quarter exceeded 1/4 of the applicable annual UPL. This approach is particular unfair given that CMS accepted the actual payment approach for other states without any apparent adjustment for quarterly average share of annual UPLs.

CMS also argues, however, that it merely used "an alternative method for calculating the base period excess payment" because it was "an easier calculation and in no way prejudiced Missouri," since the same result would be derived from either method. CMS Responses to Board Questions at 29. Since this "easier calculation" appears to inject unnecessary issues into the determination of the appropriate disallowance amount, and CMS asserts that the result would be no different, we conclude that the method CMS describes as "normal" is a preferable approach.[24]

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[24] We do not preclude CMS from disallowing any Medicaid payments by Missouri in SFY 2001 that actually exceeded the annual UPL amount then in effect, but no such disallowance is presently before us. Nor do we express any opinion about what effect such a disallowance might have on the calculation of the amounts actually paid during any part of SFY 2001. We note, however, that nothing in the record before us indicates that Missouri exceeded the applicable annual UPL at any time before the end of the third quarter, so that it is unlikely that any disallowance of payments exceeding the annual UPL would be relevant to the allowability of the "excess payments" actually made in the third quarter. We also note that any disallowance in the fourth quarter of SFY 2001 for exceeding the applicable annual UPL should not duplicate the amount disallowed in that quarter for exceeding the "must not increase" cap which we have upheld in this decision.

This conclusion does not fully resolve the disagreement over the correct amount, however. As noted earlier, CMS reports a lower amount of actual enhanced payments for the quarter ended March 31, 2001, by approximately $9.6 million. CMS explains that this sum was paid for services rendered in earlier quarters and states that "CMS is required to match payment dates with dates of the services being paid for." CMS Response to Board Questions at 30. CMS did not identify the authority on which this claim was based or explain specifically how it applies to determining which State payments are to be considered in determining the amount of excess payments. Missouri responds that the $9.6 million was properly paid in the quarter ending March 31, 2001 as a prior period adjustment. Missouri's Response to Board Questions at 10. Missouri's position is based on the observation that the examples of "normal" excess payment calculations rely on actual payments made by a state during the baseline period without evident adjustments for those payments that correspond to services provided in other quarters.

The preamble does point out that UPLs must be based on reasonable estimates using Medicare payment principles in effect during the same period the services were furnished. 66 Fed. Reg. 3162. In requiring reporting of Medicaid payments by states benefitting from transition periods, CMS defined the payments to be reported as those "for services furnished during the entire State FY." 66 Fed. Reg. 3177 (section 447.272(f)). CMS did not specify in either discussion that only payments for services furnished during a particular quarter should be treated as payments made by the state in that quarter for present purposes. It is also notable that the auditors did not discuss any need to reassign payment amounts to the quarter in which the underlying services were provided. Missouri Ex. 15.

It is understandable that CMS would be concerned that the baseline "excess payment" amount not be subject to manipulation upward by a state shifting payments attributable to services rendered during prior periods into the period being used to determine the baseline excess payment amount. Such shifting would then result in permitting higher payment amounts throughout the transition period. This concern is somewhat less justified here where Missouri did not know in advance which period would be treated as baseline and where CMS itself chose the quarter ended March 31, 2001. Missouri notes, and CMS does not deny, that its "UPL program operated on an annual, not a quarterly, basis" and that it was "not unusual for payment levels to fluctuate from quarter to quarter, as long as the aggregate payments did not exceed the annual UPL." Missouri Responses to Board Questions at 10. Therefore, the mere fact that more enhanced payments may

have been actually paid in a particular quarter does not in itself raise any question of manipulation.

CMS's attempt to remove payment amounts from the quarter ending March 31, 2001 on the ground that they related to services provided in earlier periods also raises questions about whether all payments are being treated similarly. The Board asked the parties whether their calculations included Medicaid per diem payments and efficiency grant payments made in that quarter for services rendered in prior quarters. Missouri responds that some of the per diem payments "in a current quarter may function as prior period adjustments for services rendered in previous quarters," but that any such adjustments for the quarter ending March 31, 2001 have not been isolated, while none of the efficiency grants related to prior quarters. Missouri Response to Board Questions at 10. Yet, CMS asserts that, as to both per diem and efficiency grant payments, it "did not include those items in calculations for the third quarter [ending March 31, 2001] because those payments dealt with services provided in prior quarters" and CMS "has no reason to believe that Missouri applied a different or incorrect application." CMS Response to Board Questions at 30-31. CMS's cryptic response is inconsistent with Missouri's assertions and provides no clear assurance that all payments were reassigned to the quarters in which related services were provided. Further, it is not clear on this record that any supplemental payments made in later quarters that related to services provided during the quarter ending March 31, 2001 were reassigned to that quarter. If such payments existed and were not reassigned, the baseline amount of excess payments calculated by CMS after excluding payments relating to services provided in earlier quarters might be unreasonably low. Finally, it is not clear on this record that the payment amounts for the quarters during the transition period to which the "must not increase" cap were applied were similarly adjusted to reassign payments to the quarters in which related services were provided rather the quarters in which the State actually made the payments.

Given the multiple sources of uncertainty, we are not able to determine the correct amount of the disallowance. We therefore remand the determination of the final amount to CMS. CMS should promptly notify Missouri of a corrected amount reflecting our conclusion that no quarterly UPL applied to the quarter ending March 31, 2001 and either using the actual payments for that quarter without adjustment for amounts relating to services provided in earlier periods or ensuring that adjustments are made equitably to all relevant quarters. Missouri may (pursuant to 45 C.F.R. Part 16) return to the Board if it disagrees that the

corrected amount reflects this guidance, but any such appeal would be limited to that issue.

Conclusion

For the reasons explained above, we uphold the disallowance in principle but remand to CMS for recalculation of the appropriate amount of the disallowance in accordance with the Board's guidance.

/s/
Judith A. Ballard

/s/
Constance B. Tobias

/s/
Leslie A. Sussan
Presiding Board Member