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CABINET FOR HEALTH AND FAMILY SERVICES

APPELLANT

ON APPEAL FROM ANDERSON CIRCUIT COURT
CIVIL ACTION NO. 04-CI-00101

ON APPEAL FROM COURT OF APPEALS OF KENTUCKY
APPEAL NO. 2005-CA-0274

EPI CORPORATION

APPELLEE

BRIEF FOR APPELLANT

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CERTIFICATE

The undersigned hereby certifies that a copy of the foregoing was mailed via U.S. Mail, postage prepaid, this 30th day of April, 2007 to: Frank F. Chuppe and Stephen R. Price, Sr., Wyatt, Tarrant & Combs, LLP, 500 West Jefferson Street, Louisville, Kentucky 40202-2898, counsel for EPI Corporation and Judge William F. Stewart, Anderson Circuit Court, P.O. Box 1327, Lawrenceburg, Kentucky 40342. The undersigned further certifies that the record on appeal has not been withdrawn.

Amber Arnett

ALEA AMBER ARNETT

I. INTRODUCTION

This case involves a determination of the proper statute of limitations for the Cabinet for Health and Family Services' efforts to recoup overpayments made pursuant to a contractual Medicaid provider agreement.

II. STATEMENT CONCERNING ORAL ARGUMENT

This case involves two issues of first impression, and Appellant anticipates that it will not be able to adequately respond to Appellee's arguments in the allotted ten pages for a Reply Brief. Appellant accordingly submits that oral argument will be helpful to the Court by allowing an opportunity to further elucidate the issues herein.

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I. STATEMENT OF THE CASE

EPI, Inc. operates nursing homes throughout Kentucky and receives reimbursement from the Cabinet for Health and Family Services ("Cabinet") through the Medicaid program. To receive Medicaid reimbursement, EPI was required to execute a contractual provider agreement with the Cabinet.¹ The contracts in effect from 1988 through 1996 required EPI to refund any overpayments resulting from inappropriate or inaccurate claims as calculated by federal and state law, including Medicaid regulations.² During the years in question here Medicaid used a prospective payment system—it periodically advanced funds to providers to cover their estimated costs and later made adjustments based on the providers' reports of their actual costs. Recoupment, which is basically a set off against future payments to providers, is how Medicaid recovered overpayments.³

After auditing EPI's claims for 1988 through 1996, the Cabinet discovered \$6,866,881.00 in overpayments, and by letter dated February 5, 2002, informed EPI of the amount and of the Cabinet's intent to recoup.⁴ EPI pursued an administrative appeal

¹ 42 U.S.C. 1396a, et seq.; 907 KAR 1:672.

² See provider agreements, provided as Appendices 1 & 2 in Appendix to Brief for Appellant. Most of the documents in the record that are cited to herein are contained in the sixteen boxes of materials transmitted to the Anderson Circuit Court from the agency. Since these documents were not paginated by the Anderson Circuit Clerk (nor should they be), the Cabinet cannot make citations to the record when referring to these documents. Where this has occurred, the documents have either been provided in the Appendix to this brief or been given a detailed citation.

³ 907 KAR 1:110, Section 2 (1988-1995); 907 KAR 1:671, Section 2 (1996), provided as Appendix 3.

⁴ The cause of the delay in issuing the recoupment notice was disputed. The Cabinet contended that EPI continually frustrated its efforts to complete necessary audits,

under KRS Chapter 13B, disputing the amount of the overpayment and claiming that, because the amount was calculated by regulation, recoupment was barred by the five-year statute of limitations within KRS 413.120 for actions based on a statute where the statute provides no limitations period.⁵

The administrative hearing officer confirmed the amount of the overpayment and determined that recoupment rights originated in the provider agreements. Thus, the hearing officer applied the fifteen-year statute of limitations for contract actions⁶ and concluded that the recoupment efforts were timely.⁷ EPI appealed to the Anderson Circuit Court, where Judge William Stewart granted EPI's motion for partial summary judgment and held, in a one-paragraph order containing no explanation of the basis, that the recoupment was barred by the five-year statute of limitations in KRS 413.120.⁸

The Cabinet sought review at the Court of Appeals. There, EPI argued for the first time that the proper statute of limitations for the years 1988 through 1995 was a regulation in effect during that time which permitted providers in "exceptional hardship circumstances"⁹ to spread out recoupment of overpayments over a twenty-one-month period. The Court of Appeals accepted this argument, despite EPI's failure to raise it in

while EPI argued that the fault lay with the Cabinet. This dispute is not relevant to the issues before the Court.

⁵ EPI ignored the fact that KRS 413.120 only mentioned rights created by statute, not regulation, and failed to make any argument about when the right of recoupment accrued or what effect EPI's right to appeal has on the running of time against the Cabinet's recoupment rights.

⁶ KRS 413.090.

⁷ Cabinet for Health Services, Administrative Hearings Branch, Findings of Fact, Conclusions of Law and Recommended Order, pages 66-67, pleading filed February 9, 2004, provided as Appendix 4.

⁸ (Transcript of the Record, 437, 461[hereinafter T.R.]).

the administrative proceeding or the Anderson Circuit Court, and contrary to this Court's holding in Rapier v. Philpot,¹⁰ that such an argument must be presented to the administrative hearing officer in order to be preserved on appeal.

As to the recoupment claim for 1996, which accrued after repeal of the regulation on "exceptional hardship circumstances," the Court of Appeals affirmed the Anderson Circuit Court's holding that the five-year statute of limitations in KRS 413.120 barred recovery. In doing so, the Court simply ignored its own precedent in Watkins v. Oldham,¹¹ which held that the fifteen-year, contract statute of limitations governed claims for damages calculated by statute, but payable only because of an underlying contract. The Cabinet moved for discretionary review, which was granted by this Court on February 14, 2007.

II. ARGUMENT

A. Argument Summary, Preservation, and Standard of Review.

The Cabinet advances two primary contentions herein. The first is that the Cabinet's right of recoupment derives from the contractual provider agreements, and the appropriate statute of limitations is that for actions based on contract: KRS 413.090. The Cabinet preserved this issue for review by presenting it to the hearing officer,¹² to the Anderson Circuit Court,¹³ and to the Court of Appeals.¹⁴ The second argument is that

⁹ 907 KAR 1:110 (1988-1995), provided as Appendix 3.

¹⁰ 130 S.W.3d 560 (Ky. 2004).

¹¹ 731 S.W.2d 829 (Ky. App. 1987).

¹² Cabinet for Health Services, Administrative Hearings Branch, Proposed Findings of Fact and Conclusions of Law Submitted on Behalf of the Department of Medicaid Services, pleading filed May 27, 2003.

¹³ (T.R. at 388-416).

EPI's failure to raise the putative limitations period within the regulation on "exceptional hardship circumstances" in the administrative proceeding barred it from later relying on that regulation in the Court of Appeals. Obviously, it was impossible for the Cabinet to preserve this argument since it emerged for the first time in the Court of Appeals. Both of the Cabinet's contentions involve pure issues of law, and review is therefore de novo.¹⁵

B. Statute of Limitations: Since the right of recoupment derives from the contracts, the fifteen-year statute of limitations for contract actions in KRS 413.090 applies.

A provider must execute a provider agreement to enroll in the Medicaid program.¹⁶ Without this agreement, the provider has no right to payment, and the State has no right to recoup overpayments.¹⁷ In the provider agreements, EPI agreed to abide

¹⁴ Brief for Appellant, filed with the Court of Appeals on May 31, 2005.

¹⁵ Lipsteuer v. CSX Transportation, Inc., 37 S.W.3d 732, 737 (Ky. 2000) (where the question of whether notice was within the statute of limitations is a question of law.); Cuppy v. General Accident Fire & Life Assurance Corp., 378 S.W.2d 629, 631 (Ky. 1964) ("Whether an action is barred by the statute of limitations is a question of law to be decided by the courts[.]"); Ritcher v. Commonwealth, 180 Ky. 4, 201 S.W. 456, 457 (1918) ("Now when does the statute begin to run . . . because the statute begins to run when the cause of action accrues[.] The solution of this question depends on the proper construction of the applicable parts of the inheritance tax law[.]"); Louisville & N.R. Co. v. Burkhart, 154 Ky. 92, 157 S.W. 18, 19 (1913) (where the question of which of two statutes of limitation applies is a "question of law to be determined from the admitted facts presented by the pleadings.").

¹⁶ 42 U.S.C. §1396a, et seq.; 907 KAR 1:672.

¹⁷ See, e.g., Wayside Farm, Inc. v. U.S. Dept. of Health & Human Services, 863 F.2d 447, 448 (6th Cir. 1988) ("Only if the facility has obtained its state agency's certification that it has met these requirements and thus qualifies as an intermediate care facility may the facility enter into a 'provider agreement' with the state entitling it to reimbursement for providing covered services to Medicaid recipients. 42 C.F.R. § 442.150."); Ohio v. Madeline Marie Nursing Homes No. 1 and No. 2, 694 F.2d 449, 456 (Ohio Ct. App. 1982) (where the state of Ohio could refuse to provide reimbursement to a provider which did not have a provider agreement with the state); O'Bannon v. Town Court Nursing Center, 447 U.S. 773, 775, 100 S.Ct. 2467, 2470, 65 L.Ed.2d 506 (1980) (footnote omitted)("Town Court entered into formal 'provider agreements' with both HEW and DPW. In those agreements HEW and DPW agreed to reimburse Town Court for a period of one year for care provided to persons eligible for Medicare or Medicaid

by federal and state law, including Medicaid regulations, and to refund overpayments as calculated by those laws.¹⁸

The question in this case is: what statute of limitations applies to the Cabinet's efforts to recoup overpayments pursuant to the provider agreements? Fortunately, this Court has already described the way to answer this question: "the underlying theory of law asserted in the petition determines which statute of limitations should apply."¹⁹ In other words, the basis of the party's claim dictates which statute of limitation applies. Although the Cabinet has not filed a petition for recoupment,²⁰ the analysis boils down to determining what would be the Cabinet's basis if it had filed a petition.

EPI argues that the basis is a statute and applies the five-year limitation period, while the Cabinet argues that the fifteen-year period applies because the basis of the right is the contracts—the provider agreements. Although this question has never been asked

benefits under the Social Security Act, on the condition that Town Court continue to qualify as a skilled nursing facility.").

¹⁸ Appendices 1 & 2.

¹⁹ Million v. Raymer, 139 S.W.3d 914, 918 (Ky. 2004).

²⁰ Recoupment is an administrative action and does not ordinarily involve courts or civil proceedings. 907 KAR 1:110, Section 2 (1988-1995); 907 KAR 1:671, Section 2 (1996). Statutes of limitation are designed to limit the commencement of civil proceedings, and have no bearing on administrative actions. See Robert F. Kennedy Medical Center v. Department of Health Services, 72 Cal.Rptr.2d 180 (Cal. Ct. App. 1998); Little Company of Mary Hospital v. Belshe, 61 Cal.Rptr.2d 626 (Cal. Ct. App. 1997) (where the California Department of Health Services sought to offset overpaid Medicaid/Medicare payments with future provider payments and the courts determined that the statutes of limitation, which apply to the commencement of civil proceedings, do not apply to administrative actions). Thus, technically, statutes of limitation do not apply to a state's recoupment efforts because those efforts are purely administrative. Although courts faced with the question of what statute of limitations applies to Medicaid recoupment efforts have made this conclusion, these same courts, nevertheless, fueled by principles of equity, proceeded to seek the most analogous statute of limitations to apply to the parties' claims.

in Kentucky's courts, this Court's reasoning, and the Court of Appeals' reasoning (in a case that it ignored here), in choosing between the five-year and the fifteen-year limitations periods leaves no doubt that the fifteen-year period applies because the Cabinet's right to recoup Medicaid overpayments derives from and depends upon the contracts. A synopsis of those cases and the reasoning follows.

In Watkins v. Oldham,²¹ a teacher sued the Board of Education for his statutorily mandated additional service credit for time he spent in the United States Army. The Board argued that the five-year statute of limitations barred his claim because the entitlement to service credit was created by statute. The Court of Appeals reasoned that even though the credit was calculated by statute, the action and the right to get the credit was based on the teacher's employment contracts with the Board. Thus, the action was governed by the fifteen-year statute of limitations for contract:

[t]he contracts clearly incorporate the laws governing the State Board, but it is just as clear that absent these written contracts, the appellee would have no claim. Thus, the appellants' liability arises through the contracts, not simply because of the statutes. We conclude then that the fifteen-year statute in KRS 413.090 applied and the claim is not barred.²²

Likewise, the Cabinet's recoupment rights here would not exist without the provider agreements²³; therefore, the same statute of limitations applies.

In Spurlin v. Ranier,²⁴ a construction company owner purchased various insurance policies from the Wabash Fire and Casualty Insurance Company. When the owner

²¹ 731 S.W.2d 829 (Ky. App. 1987).

²² Id. at 831 (emphasis added).

²³ See supra note 17.

discovered that he had overpaid his premium, he sued Wabash to recover the overpayment. Wabash argued that the fifteen-year period did not apply because the suit was not about the insurance policy. But this Court determined that not only did Wabash have a contractual relationship with the owner, but that “the ultimate accounting between Wabash and [the owner] respecting the correct premium was an integral part of the insurance policy.”²⁵ Thus, “the cause of action was predicated upon a contract in writing, [and] the limitation period for the commencement of the action was fifteen years.”²⁶ Similarly, the entire purpose of the provider agreements between the Cabinet and EPI is the reimbursement and recoupment—the accounting between the parties to which the fifteen-year period applies.

In a suit filed against a city by its paving contractor to recover amounts under a statutory assessment, this Court’s predecessor chose the fifteen-year period over the five-year period, noting that although the city proceeded under statutes to solicit bids and to enter into the contract, the city was not liable without the contract: “The statute was as much a part of the contract as if it had been written therein, but it is the contract, and not the statute, which fixes the liability of the city to these appellants.”²⁷ In explaining the importance of the contract, the Court analogized the situation to suits about insurance policies that incorporate the insurance regulations:

²⁴ 457 S.W.2d 491 (Ky. 1970).

²⁵ Id. at 492 (emphasis added).

²⁶ Id.

²⁷ Hunt v. Ashland, 274 Ky. 567, 119 S.W.2d 640, 641 (1938) (emphasis added); see also Ashland v. Brown’s Adm’x, 290 Ky. 740, 162 S.W.2d 552 (1942) (holding that it is the contract and not the statute that fixes the city’s liability and quoting Hunt with approval).

An analogy appears in actions against insurance companies wherein some provision of the policy involved contravenes the mandates of the laws regulating insurance. In those cases it has been held that the statutes regulating the insurance business are read into and become a part of policies issued in this state In each of these cases it has been held that the insurance company was liable on the policy. It seems equally true here that the liability of the city, while fixed by the statute, is on the written contract, and not by virtue of the general law.²⁸

In other words, “the gist of the action is on the contract, and the five-year limitation does not apply.”²⁹ Once again, without the provider agreements, the Cabinet has no claim for recoupment here,³⁰ so “the gist of the action is on the contract.”

Even in cases from other jurisdictions, where the opinion was squarely about the basis, and the statute of limitations, for a Medicare recoupment action, the courts’ reasoning follows that used in the Commonwealth. Overwhelmingly, these other jurisdictions apply the statute of limitations for contract actions because, in the words of the U.S. Court of Appeals for the Fifth Circuit, “[t]he action for Medicare overpayments is one that sounds in contract.”³¹

This straightforward conclusion was adopted by the Massachusetts Bankruptcy Court: “the essential nature of the Commonwealth’s right to recover for overpayments

²⁸ Hunt, 119 S.W.2d at 641 (emphasis added).

²⁹ Id. at 642; see also Louisville v. McNaughton, 114 Ky. 333, 70 S.W. 841, 842 (1902) (where the fifteen-year limitations period applied because “[t]he city could only be bound when it was authorized to and did make a contract in writing.”); Corbin v. Becker, 297 Ky. 485, 180 S.W.2d 419, 487 (1944) (where action against city for violation of its written obligation to assess, collect, and apply funds was an action upon a written contract with a fifteen-year statute of limitations); Herd v. Lyttle, 310 Ky. 788, 222 S.W.2d 834, 838 (1949) (where suit upon warrants issued for money was based upon a contract in writing controlled by the fifteen-year statute).

³⁰ See supra note 17.

³¹ U.S. v. Upper Valley Clinic Hospital, Inc., 615 F.2d 302, 306 (5th Cir. 1980).

made to a provider of health services under the Medicaid program is contractual[.]”³² And this reasoning is conspicuously similar to the reasoning discussed in Kentucky’s cases above. A comparison of the following quote with Kentucky’s cases shows that the statute of limitations analysis universally boils down to identifying the underlying legal theory of the claim:

In the instant case, the plaintiff’s claims are based on the defendants’ obligation to repay alleged overpayments. This obligation arises from the vendee-vendor relationship entered into by the Commonwealth and the defendants. As a provider of nursing home services to Medicaid recipients, the defendants were required to “agree to comply with all laws, rules and regulations governing the operation of the [Medicaid] program.” [] These “laws, rules and regulations” included the defendant’s liability for any overpayment.³³

Not only is this reasoning followed in the Massachusetts Bankruptcy Court and the Fifth Circuit,³⁴ but it is also followed in the Third, Seventh, and Eighth Circuits of the U.S. Court of Appeals—the government’s action to recoup Medicaid overpayments from a provider is governed by the statute of limitations for contracts.³⁵

The U.S. District Court for the Northern District of Georgia recognized this contractual relationship and explained that a “provider agreement is best construed as a business contract between the State and each provider by which their participation in the

³² Massachusetts v. Quaboag Lodge Nursing Home, Inc., 42 B.R. 954, 958 (Bankr. D. Mass. 1984).

³³ Id. at 958 (emphasis added)(citation omitted).

³⁴ U.S. v. Upper Valley Clinic Hospital, Inc., 615 F.2d 302, 306 (5th Cir. 1980).

³⁵ U.S. v. Pisani, 646 F.2d 83 (3d Cir. 1981); U.S. v. Robert’s Nursing Home, Inc., 710 F.2d 1275 (7th Cir. 1983); U.S. v. Gravette Manor Homes, Inc., 642 F.2d 231 (8th Cir. 1981).

Georgia Medicaid program is defined.”³⁶ The same holds true for the Medicaid program in Indiana, where the Indiana Court of Appeals treats provider agreements as contracts,³⁷ and in California, where its Court of Appeals applied the statute of limitations for an action based on a written contract to the government’s recoupment efforts.³⁸

The consensus of these decisions is that an action for recoupment is based on contractual law. Like these cases, the parties herein have a contractual relationship. The provider agreements executed by EPI’s facilities provide that EPI agrees to return any overpayment as calculated by the statutes and regulations promulgated for the administration of the Medicaid program. The liability of either party is fixed by the contract, which adopts applicable statutes and regulations. Without the contract, EPI has no claim for reimbursement and the Cabinet has no claim for recoupment.³⁹

Just as the accounting between an insured and an insurance company is an integral part of the policy, so too is the accounting between a provider and the Cabinet an integral part of the provider agreement. Although EPI contends that this action is governed by the five-year statute of limitations for actions “created by statute,” it fails to cite a single Kentucky statute as the basis for a recoupment action. Even 907 KAR 1:110, which EPI relied on extensively, sets forth only procedural steps for recoupment rather than “creating” a cause of action. To say that a claim of recoupment is based solely on statutes or regulations, and thus, the five-year statute of limitations applies ignores the

³⁶ Briarcliff Haven, Inc. v. Department of Human Resources, 403 F.Supp. 1355, 1358 (N.D. Ga. 1975).

³⁷ Indiana State Department of Health v. Legacy Healthcare, Inc., 752 N.E.2d 185, 186 (Ind. App. 2001).

³⁸ Robert F. Kennedy Medical Center v. Department of Health Services, 72 Cal.Rptr.2d 180, 183 (Cal. Ct. App. 1998).

precedent established by State, federal, and other jurisdictions and ignores the basic premises of contract law.

The Court of Appeals certainly made this important distinction in identifying the underlying theory of law in Watkins v. Oldham, but neglected to mention it in its opinion. In addition to ignoring Watkins, as well as analogous authority from this Court, the federal courts, and other states, the Court of Appeals also cited no authority whatsoever in reaching its terse conclusion that the five-year statute of limitations applied:

Following a review of the voluminous record, the Cabinet consistently primarily relied upon violations of either federal or state Medicaid and Medicare regulations in seeking to recoup alleged Medicaid overpayments. As such, we believe this entire action does not sound in contract as argued by the Cabinet.⁴⁰

It is true enough that EPI's reimbursement was calculated pursuant to regulation, but that in no way changes the fact that EPI would never have had a right to reimbursement absent the contractual provider agreement.⁴¹ Thus, as in Watkins, "absent these written contracts" there would be no claim.⁴²

Although this logic is clear, there is additional guidance for choosing which statute of limitation applies. This Court has said before that "when doubt exists as to

³⁹ See supra note 17.

⁴⁰ Commonwealth v. EPI, Corp., No. 2005-CA-000274-MR, slip op. at 12 (Ky. App. 2006). The Court did cite Million v. Raymer, 139 S.W.3d 914 (Ky. 2004), immediately prior to this quote, but that case stands only for the general proposition that the theory of law asserted in the petition determines the applicable statute of limitations. There was no petition in this case, and at any rate, a cause of action for recoupment is based upon contract.

⁴¹ See supra note 17.

⁴² Watkins v. Oldham, 731 S.W.2d 829, 831 (Ky. App. 1987).

which statute should prevail, the longer period should be applied.”⁴³ And in choosing the longer statute of limitations, the Court is promoting the policy of protecting public funds: “The protection of public funds is of such paramount interest that the courts have uniformly recognized and approved greater rights for governmental entities where the issue was the time in which the sovereign could sue.”⁴⁴

The gist of an action for recoupment is contractual—a conclusion easily drawn from the reasoning of the Commonwealth’s courts and other jurisdictions and supported by public policy. Without the provider agreements there is no right to reimbursement or recoupment. Thus, if any statute of limitations applies, it is the period prescribed for contract actions.

C. Issues on appeal from administrative hearings: Can a party in a case that originated as a KRS Chapter 13B proceeding raise a regulation as a new statute of limitations on appeal?

“Citizens in a civilized society cannot lead orderly lives or make plans for the future unless there is some stability in the law.”⁴⁵ Until the Court of Appeals decision in this case, the law generally⁴⁶ prohibited parties from raising issues before appellate courts that they had not presented to the trial court for consideration.⁴⁷ This was simply because

⁴³ Munday v. Mayfair Diagnostic Laboratory, 831 S.W.2d 912, 914 (Ky. 1992) (citing Troxell v. Trammell, 730 S.W.2d 525 (Ky. 1987)).

⁴⁴ Commissioner of Welfare v. Jones, 343 N.Y.S.2d 661, 667 (N.Y. Fam. Ct. 1973).

⁴⁵ Curry v. Fireman’s Fund Ins. Co., 784 S.W.2d 176, 179 (Ky. 1989)(Lambert, dissenting).

⁴⁶ See CR 61.02; see *infra* note 69.

⁴⁷ See, e.g., Regional Jail Authority v. Tackett, 770 S.W.2d 225, 228 (Ky. 1989)(“The Court of Appeals is without authority to review issues not raised in or decided by the trial court.”)(citing Matthews v. Ward, 350 S.W.2d 500 (Ky. 1961); Combs v. Knott Co. Fiscal Court, 283 Ky. 456, 141 S.W.2d 859 (1940); Tipton v. Brown,

“the appellate court reviews for error, and a nonruling cannot be erroneous when the issue has not been presented to the trial court for decision.”⁴⁸ In addition, when the case originates as a KRS Chapter 13B proceeding, like the case here, the appellate courts have refused to review issues a party did not preserve in exceptions to the agency head.⁴⁹

With its decision in this case, the Court of Appeals has muddied the water by allowing EPI to raise a regulation as an affirmative defense for the first time on appeal.⁵⁰ The problem with this is twofold. First, it defies Rapier v. Philpot⁵¹ by allowing EPI to raise an issue on appeal in court that it did not present to the agency head in the administrative proceeding. And, second, it deprives the Cabinet of the opportunity to present its interpretation of the regulation, which would have been given deference.⁵² The fact that the new issue is also an affirmative defense, which is waived if not presented,⁵³ only further compounds the confusion created here by the Court of Appeals.

Since this Court’s practice in administrative law cases is to review only those issues presented to the agency head, and the Rules of Civil Procedure require the pleading of affirmative defenses,⁵⁴ the Court of Appeals decision should be reversed

273 Ky. 496, 117 S.W.2d 217 (1938)); Jackson v. State Automobile Mutual Ins. Co., 837 S.W.2d 496, 498 (Ky. 1992)(“As the question of constitutionality was first referenced in appellant’s brief and oral argument to this Court, we hold that it was never properly raised or preserved by any party.”).

⁴⁸ Hatton v. Commonwealth, 409 S.W.2d 818, 819-820 (Ky. 1967).

⁴⁹ Rapier v. Philpot, 130 S.W.3d 560 (Ky. 2004).

⁵⁰ Does the twenty-one month payment-plan period in 907 KAR 1:110, Section 3, bar the Cabinet’s recoupment?

⁵¹ 130 S.W.3d 560 (Ky. 2004).

⁵² See discussion infra Part C.2.

⁵³ CR 8.03.

⁵⁴ Id.

because it adopts an affirmative defense that EPI never presented to the administrative hearing officer,⁵⁵ the agency head,⁵⁶ or the Anderson Circuit Court.⁵⁷

1. Judicial review of KRS Chapter 13B proceedings is limited to issues preserved for appeal and the issue of whether the regulation applies was not preserved.

For appeals of KRS Chapter 13B administrative hearings—the procedural posture of this case—this Court announced in Rapier v. Philpot⁵⁸ that judicial review is limited to issues preserved in exceptions at the administrative hearing level. “In other words, in administrative law cases, a party who disagrees with the hearing officer’s recommended order must bring that disagreement to the attention of the agency head or be precluded from raising the issue in court.”⁵⁹

In this case, EPI argued for the first time, in its brief at the Court of Appeals, that the Cabinet’s recoupment was barred by a twenty-one-month, payment-plan regulation titled “Exceptional Hardship Circumstances.”⁶⁰ EPI did not argue this before the hearing officer,⁶¹ in its exceptions,⁶² before the Anderson Circuit Court,⁶³ or in its Civil Appeal

⁵⁵ Cabinet for Health Services, Administrative Hearings Branch, EPI’s Proposed Findings of Fact, Conclusions of Law, and Recommended Decision, pleading filed May 27, 2003.

⁵⁶ Cabinet for Health Services, Administrative Hearings Branch, EPI’s Exceptions to the Hearing Officer’s Findings of Fact, Conclusions of Law, and Recommended Order, pleading filed February 24, 2004.

⁵⁷ (T.R. at 1-29).

⁵⁸ 130 S.W.3d 560 (Ky. 2004).

⁵⁹ Herndon v. Herndon, 139 S.W.3d 822, 825 (Ky. 2004) (explaining the Court’s holding in Rapier v. Philpot, 130 S.W.3d 560 (Ky. 2004)).

⁶⁰ 907 KAR 1:110, section 3 (1988-1995); 907 KAR 1:671, Section 2(4)(1996), provided as Appendix 3.

⁶¹ Cabinet for Health Services, Administrative Hearings Branch, EPI’s Proposed Findings of Fact, Conclusions of Law, and Recommended Decision, pleading filed May 27, 2003.

Prehearing Statement at the Court of Appeals.⁶⁴ The Cabinet, therefore, contended that this Court's holding in Rapier v. Philpot⁶⁵ and the CR 8.03 requirement that affirmative defenses must be pled precluded EPI from raising the regulation as a "statute of limitations" for the first time on appeal.

Instead, the Court of Appeals held that Rapier did not apply because the newly-raised Cabinet regulation constituted "legal authority" rather than "evidence," which can be "resorted to at any stage of the proceedings whether cited by the litigants or simply applied, *sua sponte*, by the adjudicators."⁶⁶ Although the Court of Appeals cited Burton v. Foster Wheeler Corporation⁶⁷ in support of this proposition, it clearly misapplied that case because neither Burton nor the other case cited, First National Bank of Louisville v. Progressive Casualty Insurance Co.,⁶⁸ involved an administrative law case or an attempt to raise an affirmative defense for the first time on appeal.⁶⁹

⁶² Cabinet for Health Services, Administrative Hearings Branch, EPI's Exceptions to the Hearing Officer's Findings of Fact, Conclusions of Law, and Recommended Order, pleading filed February 24, 2004.

⁶³ (T.R. at 1-29).

⁶⁴ EPI's Civil Appeal Prehearing Statement, pleading filed with the Court of Appeals on March 7, 2005.

⁶⁵ 130 S.W.3d 560 (Ky. 2004).

⁶⁶ Commonwealth v. EPI, Corp., No. 2005-CA-000274-MR, slip op. at 11 (Ky. App. 2006).

⁶⁷ 72 S.W.3d 925 (Ky. 2002).

⁶⁸ 517 S.W.2d 226 (Ky. 1974).

⁶⁹ There is a growing debate about an appellate court's role when faced with an issue not preserved for appellate review—no doubt stemming from cases like Burton v. Foster Wheeler Corporation, 72 S.W.3d 925 (Ky. 2002), that create exceptions to the law on preservation of issues for appellate review that threaten to swallow the rule. In a dissenting opinion where he criticized the majority of this Court for deciding an issue that was not preserved, Justice Stephenson said, "[t]he language 'not preserved for appellate review' is to be found in a multitude of opinions but, apparently now and in the future,

According to the Court of Appeals, any defendant can raise an affirmative defense (such as the statute of limitations) for the first time on appeal since it would only be arguing “applicable legal authority.” A statute of limitations, however, “is a personal privilege of a defendant. If it fails to take advantage of that privilege in the manner provided by law, it is waived [A]nd the court had no right to apply the statute of limitations sua sponte.”⁷⁰ Furthermore, the United States Supreme Court has noted that a statute of limitations is a different kind of legal authority: “limitation does not operate by its own force as a bar, but is a defense, and [] the party making such a defense must plead the statute if he wishes the benefit of its provision.”⁷¹ By applying the regulation as a new statute of limitations when EPI waived its application and did not preserve it for appeal, the Court of Appeals then effectively abolished the doctrines of waiver and issue preservation, at least with respect to legal, as opposed to factual, issues.

we will be treated to a selective system of application of the rule. When it feels good, the rule can be ignored in an obscure footnote.” Tabler v. Wallace, 704 S.W.2d 179, 189 (Ky. 1985) (Stephenson, J., dissenting). Justice Scalia, while on the D.C. Circuit, had an opportunity to elucidate on the importance of declining review of unpreserved issues: “The premise of our adversarial system is that appellate courts do not sit as self-directed boards of legal inquiry and research, but essentially as arbiters of legal questions presented and argued by the parties before them.” Carducci v. Regan, 714 F.2d 171, 177 (D.C. Cir. 1983). See also, Adam A. Milani & Michael R. Smith, Playing God: A Critical Look at Sua Sponte Decisions by Appellate Courts, 69 TENN. L. REV. 245, 247 (2002) (“The rule that points not argued will not be considered is more than just a prudential rule of convenience; its observance, at least in the vast majority of cases, distinguishes our adversary system of justice from the inquisitorial one.”).

⁷⁰ Wagner v. Fawcett Publications, 307 F.2d 409, 412 (7th Cir. 1962), cert. denied, 372 U.S. 909, 83 S.Ct. 723, 9 L.Ed.2d 718 (1963) (emphasis added).

⁷¹ Finn v. U.S., 123 U.S. 227, 232-233, 8 S.Ct. 82, 85, 31 L.Ed. 128 (1887); see also Retzer v. Wood, 109 U.S. 185, 187, 3 S.Ct. 164, 27 L.Ed. 900 (1883) (“[A] defendant who desires to avail himself of a statute of limitation as a defense must raise the question either in pleading, or on the trial, or before judgment.”).

Although this legal issue—the regulation’s applicability as a statute of limitations—was available to EPI from the outset of the administrative proceeding, EPI did not assert it until its brief at the Court of Appeals, the second level of appellate review. From the beginning of the administrative proceeding through its Civil Appeal Prehearing Statement, EPI has maintained that the five-year statute of limitations in KRS 413.120 applies. Even though EPI properly raised the five-year statute of limitations as an affirmative defense, EPI cannot now argue a different affirmative defense on appeal⁷² because as this Court has recognized, a party “will not be permitted to feed one can of worms to the trial judge and another to the appellate court.”⁷³

⁷² See, e.g., Collis v. Hoskins, 306 Ky. 391, 208 S.W.2d 70 (Ky. 1948)(affirmative defense cannot be raised for first time on appeal); Skaggs v. Assad, 712 S.W.2d 947, 952 (Ky. 1986)(where giving instruction on contributory negligence did not preserve error of failure to give instruction on comparative negligence)(“It goes without saying that errors to be considered for appellate review must be precisely preserved and identified in the lower court.”); Clemmons v. Commonwealth, 152 S.W.3d 256, 260 (Ky. App. 2004)(citing Todd v. Commonwealth, 716 S.W.2d 242, 248 (Ky. 1986))(“It is the responsibility of counsel ‘to present to the trial court those questions of law which may become issues on appeal.’”); Keel v. Hoggard, 590 S.W.2d 939, 945 (Tex. Civ. App. 1979) (“Defendant-Appellants did not plead the two year statute of limitations, and now raise same for the first time on appeal, and have therefore waived same.”); Downey v. Atchison, T. & S.F.R. Co., 57 P. 101, 103 (Kan. 1899) (“The appellant, having relied upon a statute not applicable, cannot invoke the protection of another not pleaded. The party who pleads or replies to a statute of limitations not appropriate to the action, must abide the result.”); Blunck v. Blunck, 44 P.2d 963, 964-965 (Okla. 1935) (“Where a statute of limitations is pleaded which is not applicable to the cause of action claimed to be barred, the plea is bad, and as a general rule the protection of another statute which is not pleaded cannot be invoked, except where all the facts necessary to bring the case within the proper statute are alleged.”). Contra Lawyers Cooperative Publishing Company v. Muething, 603 N.E.2d 969 (Ohio 1992) (where issue before trial court was whether an attorney’s counterclaim against book publisher was barred by statute of limitations, Supreme Court had right to consider statute of limitations set forth in Ohio Uniform Commercial Code, even though question of applicability of that statute had not been raised in the trial court or Court of Appeal.).

⁷³ Kennedy v. Commonwealth, 544 S.W.2d 219, 222 (Ky. 1977).

2. EPI cannot raise the regulation for the first time on appeal because it denies the Cabinet due process by eliminating its right to present evidence of its interpretation of the regulation.

In addition to trying to feed a different can of worms to the appellate court, EPI's delay in raising the regulation as a new affirmative defense deprived the Cabinet of due process. The new "legal authority," being a regulation instead of a statute, creates a different situation from that in Burton⁷⁴ because the Cabinet's interpretation of its regulations is accorded a certain degree of deference.⁷⁵ Had EPI properly raised this issue in the administrative proceeding, the Cabinet could have "introduced evidence to contest or refute the assertions made on appeal."⁷⁶ But by springing this issue on the Cabinet at the appellate level, EPI deprived the Cabinet of the opportunity to present evidence at the administrative hearing of its interpretation of the regulation, and deprived the agency head of the opportunity to consider the argument. Thus, the issue was not preserved for appellate review, and the Court of Appeals should not have reviewed it.

While the Cabinet is not disputing the holding in Burton, the situation is entirely different when the "applicable legal authority" is an affirmative defense that is waivable, such as statutes of limitation. The situation is also different when the "legal authority" is a regulation, since the Cabinet was deprived of the opportunity to present evidence of the agency's interpretation of the regulation, which would have been accorded a certain

⁷⁴ Burton v. Foster Wheeler Corporation, 72 S.W.3d 925 (Ky. 2002).

⁷⁵ Camera Center, Inc. v. Revenue Cabinet, 34 S.W.3d 39, 41 (Ky. 2001) ("We honor the long-time phrase that an appellate court must defer to an administrative agency's interpretation of its own regulations."); University of Kentucky v. Shalala, 858 F.Supp. 639, 647 (E.D. Ky. 1994) ("[T]he Court must accord deference to the interpretation of the agency charged with the administration of a statute. . . . The foregoing principles of statutory construction apply with particular force in the field of Medicare reimbursement.").

⁷⁶ In re the marriage of Rodriguez, 545 N.E.2d 731, 733 (Ill. 1989).

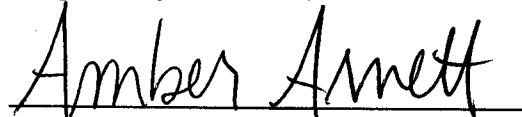
degree of deference. These differences completely undercut the value of Burton here. And the Court should refuse to resurrect, under the guise of legal authority, an affirmative defense that EPI buried at the outset of the administrative proceedings by failing to raise it.

III. CONCLUSION

If any statute of limitations applies to the Cabinet's recoupment efforts, it is the fifteen-year limitation period for contracts because recoupment is merely a request to perform under the contract; and without the contract, the Cabinet could not recoup. The issue of whether the twenty-one month, payment-plan regulation applies cannot be reviewed because the Cabinet has been deprived of its right to present evidence on the issue and EPI, having never presented it during the KRS Chapter 13B proceedings nor to the Anderson Circuit Court on the first level of appellate review, did not preserve the issue for appeal.

Thus, the Cabinet respectfully requests that this Court reverse the Court of Appeals decision and remand the case to the Anderson Circuit Court with instructions to apply the fifteen-year statute of limitations.

Respectfully submitted,



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IV. APPENDIX

See index of Appendix contents in separate volume.