

COMMONWEALTH OF KENTUCKY
SUPREME COURT OF KENTUCKY
NO. 2006-SC-000348-D

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CABINET FOR HEALTH AND FAMILY SERVICES

APPELLANT

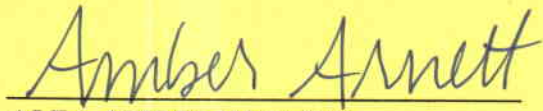
REPLY BRIEF FOR APPELLANT

EPI CORPORATION

APPELLEE

FROM THE COURT OF APPEALS
NO. 2005-CA-000274-MR

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



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CERTIFICATE

The undersigned hereby certifies that a copy of the foregoing was mailed via U.S. Mail, postage prepaid, this 7th day of August 2007 to: Frank F. Chuppe, Stephen R. Price, Sr., Virginia H. Snell, Wyatt, Tarrant & Combs, LLP, 500 West Jefferson Street, Louisville, Kentucky 40202-2898, counsel for EPI Corporation; Sam Givens, Clerk, Court of Appeals, 360 Democrat Drive, Frankfort, Kentucky 40601, and Judge William F. Stewart, Anderson Circuit Court, P.O. Box 1327, Lawrenceburg, Kentucky 40066. The undersigned further certifies that the record on appeal has not been withdrawn from the office of the Anderson Circuit Clerk.


ALEA AMBER ARNETT

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I. PURPOSE & PARTICULAR ISSUES

The Cabinet's Reply Brief will address EPI's misapplication of KRS 413.120, 907 KAR 1:110, and 42 CFR §405.1885, despite their plain language, and will distinguish the case law cited in its brief.

II. ARGUMENT

A. **907 KAR 1:110, Section 3 is only a time limit on payment plans for "exceptional hardship circumstances" and does not limit recoupment where the provider contests the amount.**

EPI argues that an agency must follow its regulations and that the regulations, specifically 907 KAR 1:110, Section 3, contain a time limit on recoupment. The Cabinet agrees that an agency must follow its own regulations, but that does not mean that an agency misapplies them, which is exactly what EPI advocates here. Although the regulation contains a time limit, it is only a time limit for recoupment in "exceptional hardship circumstances"; it does not apply to recoupment when the provider contests the amount overpaid. EPI has never mentioned or established "exceptional hardship circumstances," and there is no evidence of these circumstances in the record. Thus, the 21-month regulation, 907 KAR 1:110, Section 3, does not apply here.

1. **This regulation only limits the time a provider in "exceptional hardship circumstances" has to return an overpayment.**

907 KAR 1:110, Section 3 only applies to the time limit for payment plans made under "exceptional hardship circumstances," which the regulation clearly states in its first sentence:

Section 3. Exceptional Hardship Circumstances
When it is determined that a recoupment of an overpayment in accordance with Section 2 of this regulation would result in an exceptional hardship for the provider and have the direct or indirect effect of reducing

the availability of services to program recipients (e.g., by resulting in the bankruptcy and subsequent dissolution of the provider entity), the program may provide for a reasonable extension of the time period for recoupment.

The time period for recoupment will not exceed twelve (12) months from the date the overpayment is established, and must be accomplished within twenty-one (21) months from the end of the provider's cost reporting period or the receipt by the program of the billing invoice, request for payment or similar documents for providers not reimbursed on the basis of cost reports.¹

So an overpaid provider has 21 months to reimburse the Cabinet when the provider establishes "exceptional hardship circumstances." The record contains no evidence of "exceptional hardship circumstances" and EPI has never established them. Thus, this regulation does not apply here.

2. This regulation does not address recoupment when the provider challenges the overpayment amount.

This regulation also does not apply because it does not address recoupment when a provider disputes the amount of the overpayment.² Providers ordinarily did not

¹ 907 KAR 1:110 (1995, 1994, 1993, 1992, 1991, 1990, 1989, 1988).

² The regulation in its entirety does not address recoupment when the provider disputes the overpayment amount:

907 KAR 1:110

Section 1. Scope This regulation applies to all providers of medical assistance services where payments are made from Medical Assistance Program funds.

Section 2. Recoupment of Overpayments. When it is determined that a provider has been overpaid, a letter will be mailed to the provider requesting payment in full within thirty (30) days. If a provider demonstrates to the program within the thirty (30) day time limit that full payment would create an undue hardship, a payment plan not to exceed six (6) months from the notification date will be established. If the full payment or payment plan request is not received within thirty (30) days of notification, the amount due will be deducted from current payments until the full amount is recouped. Once the payment plan has been established and a payment is not received by the agreed date, the amount will be deducted from current payments.

reimburse the Cabinet for overpayments while contesting the amount of the overpayment. The plain words of the regulation do not address this situation and, thus, do not apply to this case.

3. The Cabinet does not exercise its recoupment rights until a provider exhausts its appeal rights.

The regulations are silent about recoupment when providers challenge the overpayment amount, meaning that providers could delay payment until they exhausted their appeal rights. This, in fact, has been EPI's position all along:

When an adjustment is proposed that is subject to disagreement, individual providers have a right to pursue administrative review of the proposed adjustment or disallowed cost that includes the right to program review as well as a hearing before an administrative law judge. After considering the administrative law judge's recommendation, the Secretary has final decision making authority concerning these matters. Consequently, proposed audit adjustment or disallowed cost is not final until this process is complete and a final decision issued by the Secretary.³

Section 3. Exceptional Hardship Circumstances. When it is determined that a recoupment of an overpayment in accordance with Section 2 of this regulation would result in an exceptional hardship for the provider and have the direct or indirect effect of reducing the availability of services to program recipients (e.g., by resulting in the bankruptcy and subsequent dissolution of the provider entity), the program may provide for a reasonable extension of the time period for recoupment. The time period for recoupment will not exceed twelve (12) months from the date the overpayment is established, and must be accomplished within twenty-one (21) months from the end of the provider's cost reporting period or the receipt by the program of the billing invoice, request for payment or similar documents for providers not reimbursed on the basis of cost reports.

³ EPI Corp. v. Commonwealth of Ky., Franklin Circuit Court, Division II, Case no. 97-CI-00425, Verified Complaint and Request for Declaration of Rights and Injunctive Relief ¶15 pg. 7, attached as Appendix 1 (emphasis added); see also Verified Complaint and Request for Declaration of Rights and Injunctive Relief ¶20 pg. 8 (“[T]he Secretary has the ability to recoup overpayments from providers of nursing facility services when the audit and review process is completed and a final decision is issued by the Secretary.”).

EPI agrees that recoupment rights don't even accrue until a provider has exhausted its administrative appeal rights, which leads to the same result as the Cabinet's position that its recoupment rights accrue after the audit, when it issues a demand letter to the provider, but that recovery of the amount is tolled while the provider pursues its appeal rights. In fact, both parties disagree with the Court of Appeal's opinion that recoupment rights accrue with the submission of the cost report. And the parties' position also conflicts with the 21-month time limit because the appeals process is unlikely to be completed within that time. Thus, also for this reason, this regulation does not apply.

B. The Cabinet, which was deprived of the opportunity to present evidence on its longstanding interpretation of the regulation, is surprised that EPI thinks this regulation applies here.

The Cabinet agrees that the regulation means what it says, but is surprised with the meaning EPI ascribes to it—that it applies to recoupment of a disputed amount despite the plain language that it only applies to repayment plans under “exceptional hardship circumstances.”

While the Cabinet had an opportunity to explain and present evidence of its longstanding interpretation and application of the regulation, EPI never thought that it applied. But once that opportunity was cut off, EPI “discovered” this new defense. Had EPI pursued this defense from the outset, the Cabinet could have introduced evidence of its longstanding interpretation and application of the regulation, which would have been afforded deference.⁴ As it stands, the Cabinet's evidence would now be outside the record and improper.

⁴ 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

EPI refers to Burton v. Foster Wheeler Corporation,⁵ which was cited by the Court of Appeals, to support its late introduction of the regulation. But Burton did not deal with an affirmative defense and there was no question of the regulation's applicability there. Also, in Burton, the injured party proved the necessary facts to which the newly-introduced regulation applied. On the other hand, here, EPI has asserted the regulation as an affirmative defense; the parties disagree on the regulation's applicability; the Cabinet was deprived of presenting evidence of its longstanding interpretation; and EPI failed to mention, much less prove, any facts to which the 21-month regulation applies. Thus, Burton cannot be used to support a new affirmative defense asserted during the appellate stages of this case, especially in light of the fact that EPI has not alleged, much less proven the facts necessary for the regulation to apply.⁶

C. A five-year statute of limitations⁷ conflicts with provisions of the Provider Agreements and is inapplicable because there is no statutory basis.

A five-year statute of limitations on recoupment is inconsistent with the parties' agreement that recognizes that disputed adjustments may take more than five years to resolve. The Provider Agreements require EPI to "maintain such records as are necessary

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.").

⁵ 72 S.W.3d 925 (Ky. 2002). The Cabinet incorrectly stated in its original brief that this was not an administrative law case. That was a description meant only for the companion case, First Nat'l Bank of Louisville v. Progressive Casualty Ins. Co., 517 S.W.2d 226 (Ky. 1974).

⁶ 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.").

to disclose the extent of services furnished to Title XIX recipients for a minimum of 5 years and for such additional time as may be necessary in the event of an audit exception or other dispute[.]”⁸ This necessarily implies that the parties may not arrive at a final amount in five years in the case of disputes or audit delays. But if disputes are cut off after five years of the cost report’s submission and to the prejudice of the Cabinet, as suggested by the Court of Appeals, then the courts have rendered a provision of the parties’ contract meaningless. The fact that standard rules of contract interpretation call for giving effect to all contractual provisions⁹ is just further evidence that the five-year limitation does not apply.

The five-year statute of limitations also does not apply because there is no statute on recoupment. Even though the Court of Appeals applied the five-year limitation, it still recognized that “there are no state statutes dealing with recoupment of Medicaid funds.”¹⁰ Yet, neither EPI nor the Court of Appeals has been able to explain how the statute of limitations (for rights created by statute with no limitations period) can apply here when there is no statute creating a right.

EPI continues to cite Carr v. Texas Eastern Transmission Corporation,¹¹ for the proposition that the five-year statute of limitations applies. But the vast factual differences between Carr and this case render it marginally instructive, at best. Carr dealt

⁷ KRS 413.120.

⁸ (See provider agreements, provided as Appendices 1 & 2 in Appendix to Brief for Appellant, filed April 30, 2007).

⁹ RESTATEMENT (FIRST) OF CONTRACTS §236 (1932).

¹⁰ Commonwealth v. EPI, Corp., No. 2005-CA-000274-MR, slip op. at 8 (Ky. App. 2006).

¹¹ 344 S.W.2d 619 (Ky. 1961)

with a claim for injuries to the plaintiff's cattle caused by the defendant's improper use of a contractual easement. The Court did not apply the contractual statute of limitations because the cause of action existed independent of the contract. In EPI's case, a claim for recoupment does not exist independent of the Provider Agreements and is in fact at the heart of the parties' agreement. Although the court in Carr examined the underlying theory of law in support of the claim, for Carr to be analogous to the situation here the plaintiff and defendant's contract would have had to have been about the cattle. In that situation there is no doubt that harm to the cattle would be a contractual matter similar to the matter between EPI and the Cabinet.

EPI also relies on Hollander v. Brezenoff,¹² to support a five-year limitation for Medicaid recoupment. Yet again, the factual differences of this case render it useless. The Medicaid provider agreement at issue in Hollander did not contain a provision calling for recoupment of overpayments,¹³ unlike here, where EPI's Provider Agreements required it to "refund any payments which result from claims being paid inappropriately or inaccurately."¹⁴ In Hollander there was also a state statute on recoupment to directly support the statute of limitations used. Thus, the five-year limitation is inapplicable here because it has no statutory foundation and is at odds with the terms of the Provider Agreements.

In a last ditch effort to avoid refunding taxpayer dollars to the Medicaid program, EPI argues that the Cabinet cannot recover overpayments for 1990 through 1992 because

¹² 787 F.2d 834 (2nd Cir. 1986)

¹³ Id. at 838.

¹⁴ (See provider agreements, provided as Appendices 1 & 2 in Appendix to Brief for Appellant, filed April 30, 2007).

of an alleged time limit imposed by 42 CFR §405.1885. The Court of Appeals determined that this federal regulation was not a limit on recoupment, but rather a time limit on revisiting a final administrative decision on audit adjustments: 42 CFR §405.1885 “imposes a three-year statute of limitation in which to reopen a determination of an intermediary or a decision by a hearing officer or panel of hearing officers, by the Board, or the Secretary.”¹⁵ Just like its reference to the state regulation on repayment plans, EPI also encourages the Court to misapply this regulation despite its plain language.

D. Without a statute or regulation, the terms of the Provider Agreements control and form the basis for a claim of recoupment.

EPI contracted with the Cabinet to participate in the Medicaid program. EPI agreed to abide by the applicable regulations and statutes and to reimburse the Cabinet for any overpayment. Since the regulations do not address the situation, and there are no statutes on it either, the parties must return to the Provider Agreements, which require EPI to “refund any payments which result from claims being paid inappropriately or inaccurately.”¹⁶

The Provider Agreements evidenced EPI’s intention to be bound by Medicaid terms, rules, and regulations. The Agreements set out the conditions under which EPI would be reimbursed for the services it provided and that EPI had to refund overpayments. They were essentially about the accounting between the two parties. And even EPI’s President and Chief Executive Officer understood the central role of these

¹⁵ Commonwealth v. EPI, Corp., No. 2005-CA-000274-MR, slip op. at 7 (Ky. App. 2006).

¹⁶ (See provider agreements, provided as Appendices 1 & 2 in Appendix to Brief for Appellant, filed April 30, 2007).

contracts: "EPI, through the testimony of its President and Chief Executive Officer, John Snyder, admitted both that the execution of a Provider Agreement was a requirement of participation in the program and that a provider could not participate in the program absent execution of a Provider Agreement."¹⁷

Since there are no regulations or statutes on recoupment that apply here, the parties are bound by the terms of the Provider Agreements. These Agreements require recoupment of overpayments, and in the absence of an applicable regulation, issues of recoupment deal with the contracts and are limited by the fifteen-year statute for contracts.¹⁸

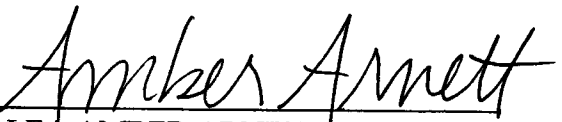
III. RELIEF SOUGHT

The Cabinet seeks to rightfully recoup the millions of taxpayer dollars overpaid to EPI as a provider in the Medicaid program. The Cabinet's recoupment right is based on the Provider Agreements and is thus subject to the fifteen-year statute of limitations for contracts. 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.

¹⁷ (See Cabinet for Health Services, Administrative Hearings Branch, Findings of Fact, Conclusions of Law and Recommended Order, ¶8 pg. 5, pleading filed February 9, 2004, provided as Appendix 4 in Appendix to Brief for Appellant, filed April 30, 2007). EPI and the Court of Appeals have criticized the Administrative Hearing Branch for its Findings of Fact, Conclusion of Law, and Recommended Order. But according to this Court, the AHB was not in error by adopting the findings drafted by someone else when both parties submit them. Prater v. Cabinet for Human Resources, 954 S.W.2d 954, 956; Bingham v. Bingham, 628 S.W.2d 628 (Ky. 1982).

¹⁸ KRS 413.090.

Respectfully submitted,



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1. EPI Corp. v. Commonwealth of Ky., Franklin Circuit Court, Division II, Case no. 97-CI-00425, Verified Complaint and Request for Declaration of Rights and Injunctive Relief