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To Defer or Not to Defer: When Must a Court Honor an Administrative Agency's Interpretation of Its Own Regulations?

by Patrick C. McGinley

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One of the most contentious debates in administrative law relates to the extent to which a court must defer to an administrative agency's interpretation of the laws and regulations it administers. This case permits the Supreme Court to distinguish more clearly those situations requiring judicial deference from those in which such deference is not required, thereby clarifying its prior decisions on the subject.

ISSUES

1. Was the Secretary of Health and Human Services authorized to promulgate a rule amortizing the reimbursement of a Medicare provider's debt-refinancing costs instead of reimbursing those costs in the year in which they were incurred and reported to Medicare?
2. If so, is the rule, nonetheless invalid, because it is a legislative rule and, as such, was not promulgated in accordance with the Federal Administrative Procedure Act?

FACTS

The facts in this case are not in dispute. Guernsey Memorial Hospital ("Guernsey" or the "Hospital") is a nonprofit, acute-care hospital located in Cambridge, Ohio, and is a

health-care provider participating in the federal Medicare program, a program providing health-care coverage for the elderly and disabled. In 1972, the Hospital issued \$7.6 million in bonds to finance capital improvements. In 1982, the Hospital issued another \$10.4 million in bonds for the same purpose. The interest rates payable on both bond issues were relatively high, reaching 12.5 percent in some cases.

In 1985, Guernsey participated in a third bond issue in the amount of \$15.38 million. The purpose of the third issue was to refinance the first two issues in order to take advantage of lower interest rates. By refinancing, the Hospital expected to save approximately \$12 million in debt service payments over the life of the two prior bond issues.

Because the refinancing occurred in 1985, Guernsey was required by applicable Medicare regulations to report the refinancing according to generally accepted accounting prin-

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DONNA E. SHALALA, SECRETARY OF HEALTH AND HUMAN SERVICES V. GUERNSEY MEMORIAL HOSPITAL
DOCKET No. 93-1251

ARGUMENT DATE:
OCTOBER 31, 1994
FROM: THE SIXTH CIRCUIT

Case at a Glance

Shalala v. Guernsey Memorial Hospital presents the question of how much deference a court must give to an administrative agency's interpretation of its own regulations. In prior cases, the Supreme Court has indicated that an agency's interpretation of its own regulations is generally entitled to substantial deference. This case presents an opportunity for the Court to delineate more precisely those situations in which deference is required from situations in which it is not.





ciples often referred to as "GAAPs." Under GAAPs, Guernsey was entitled to charge the full amount of its refinancing costs — \$672,581 — as an expense for 1985, the year in which the expense was incurred. Accordingly, Guernsey included \$672,581 as an operating cost for 1985 and asked for reimbursement of a portion of this amount, some \$314,000, under the Medicare program.

Following applicable Medicare regulations, Guernsey's request for reimbursement was channeled through a fiscal intermediary, Blue Cross and Blue Shield/Community Mutual Insurance Company ("Blue Cross"). (The Department of Health and Human Services does not handle the day-to-day administration of many of its programs such as Medicare but, instead, contracts with insurance companies or others with the appropriate expertise to provide necessary administrative services. Contract providers of administrative services are known as fiscal intermediaries and, in the case of Medicare for example, act for the Department in determining which costs of providing medical care are covered by Medicare and which are not.)

Using Medicare program guidelines contained in Medicare's Provider Reimbursement Manual ("Reimbursement Manual"), Blue Cross determined that the refinancing loss was not reimbursable in full for 1985 as a cost attributable only to 1985. In Blue Cross's view, the loss was required to be amortized, i.e., spread out, over a period of years.

Guernsey appealed this determination to the Provider Reimbursement Review Board (the "Board"), which overruled Blue Cross's decision. The Board was, in turn, reversed by the Administrator of the Healthcare Financing Administration (the "Administrator"). The Administrator

concluded that Guernsey's refinancing loss would have to be amortized.

Guernsey, not giving up, appealed the Administrator's decision to the United States District Court for the Southern District of Ohio. The district court rejected Guernsey's arguments and affirmed the decision of the Administrator. 796 F. Supp. 283 (S.D. Ohio, 1992).

The Hospital sought further judicial review in an appeal to the United States Court of Appeals for the Sixth Circuit which reversed. The Sixth Circuit held that applicable Medicare regulations required the use of GAAPs in determining the total amount of the Hospital's reimbursable costs for its refinancing and that, by applying GAAPs, all such costs should be reimbursed in 1985 rather than being amortized over a period of years. 996 F. 2d 830 (6th Cir. 1993).

The Sixth Circuit further held that the the Reimbursement Manual, which was the basis for denying Guernsey's reimbursement request, was being utilized by the Administrator as a legislative rule in violation of the Federal Administrative Procedure Act (the "APA"). The APA provides that legislative rules — rules having the force and effect of a law — are valid only if they are adopted through a public notice and comment procedure.

The Sixth Circuit rejected the Administrator's claim that Section 233 of the Reimbursement Manual, the specific provision relied on to reject Guernsey's reimbursement request, was merely an interpretive rule. (An interpretive rule does not have the force and effect of law but, rather, is a rule that simply explains existing law and regulations. As such, an interpretive rule is not subject to the APA's requirement of public notice and comment.) Thus, the

Sixth Circuit held that the Administrator, acting on behalf of the Secretary of Health and Human Services (the "Secretary"), had proceeded unlawfully by using Section 233 as a rule with the force and effect of law even though the rule had not gone through the required public notice and comment. 5 U.S.C § 553.

CASE ANALYSIS

Reduced to its essence, the conflict between the parties in this case is over the *time* when admittedly reimbursable health-care provider costs are actually paid by the Department of Health and Human Services (the "Department"). The Secretary argues that the Department's rules and regulations clearly require that the costs of bond refinancing be amortized over a period of years.

Guernsey disagrees and asserts that both the Department's own regulations and GAAPs mandate that costs be reimbursed in the year that GAAPs consider them to have been incurred, not amortizing them over several years as Section 233 of the Secretary's Reimbursement Manual instructs. Interestingly, the Hospital concedes that the amortization rule utilized by the Secretary in this case is within her authority to adopt; it simply maintains that Section 233 was not adopted in accordance with the APA's rule-making requirements and, thus, is unlawful as applied in this case.

This case calls on the Supreme Court to decide what the Department's regulations mean and, in construing those regulations, whether or not to give deference to the Department's interpretation of its own regulations. Finally, assuming that Section 233 of the Reimbursement Manual takes precedence over an apparently conflicting statutory requirement with respect to reimbursable costs, the Court may



decide if Section 233 was, or should have been, adopted in accordance with the APA.

The Secretary argues simply that the interpretation she has given to her Department's own regulations is a reasonable one and is consistent with the Department's statutory mandate. Accordingly, the Secretary contends that the Sixth Circuit was required by a long line of Supreme Court cases to give her interpretation controlling weight. *See, e.g., Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410 (1945); *Udall v. Tallman*, 380 U.S. 1 (1965); *Stinson v. United States*, 113 S. Ct. 1913 (1993). Such deference, the Secretary asserts, is particularly appropriate in this case, where the question of interpretation arises under "a complex and highly technical regulatory program" entailing "significant expertise, and . . . the exercise of judgment grounded in policy concerns." *Pauley v. Beth Energy Mines, Inc.*, 111 S. Ct. 2524 (1991).

The Secretary further maintains that neither the applicable Medicare statute, 42 U.S.C. § 1395, nor the regulations relied on by Guernsey, 42 C.F.R. §§ 413.20, 413.24, and 413.5, require her to utilize GAAPs in deciding the appropriate time to reimburse health-care providers for costs incurred in providing care to Medicare subscribers.

The Secretary asserts that, while agency regulations require hospitals such as Guernsey to use GAAPs and while GAAPs require a hospital to report reimbursable costs in the year the costs were incurred as that term is used by accountants, she, as Secretary, is not required to follow GAAPs in designating when reimbursement of such costs will be made. Thus, in deciding when to pay reimbursable costs, the Secretary argues that both the Medicare act

and the Department's regulations implementing the act afford her the discretion to take into account considerations other than the concerns advanced by accounting experts through GAAPs.

In requiring that Guernsey's refinancing costs be amortized over a period of years, the Secretary contends that the Department properly attempted to make the timing of reimbursement reflect the reasonable cost of services furnished to Medicare beneficiaries attributable to a given year. The Secretary asserts that this approach is intended to avoid the statutorily prohibited subsidization of non-Medicare patient services by Medicare funds. *See* 42 U.S.C. § 1395x(v)(1)(A) and (i).

The Secretary further maintains that the guidelines set forth in Section 233 of the Reimbursement Manual are merely interpretive rules, i.e., they simply explain Medicare provider legislation and regulations without imposing new substantive requirements beyond those found in existing law and regulations. Moreover, the Secretary argues that the Department's interpretation of applicable regulations relating to reimbursement and to the applicability of GAAPs has been consistent since the inception of the Medicare reimbursement program.

Guernsey responds by arguing that the Secretary's interpretation of the Department's Medicare reimbursement rules is not entitled to the usual deference given by courts to a Department's own interpretation of its regulations. The Hospital asserts that the Department has taken significantly conflicting positions regarding the proper interpretation of its reimbursement regulations over the years and, therefore, that its current interpretation should not be given judicial deference.

Guernsey also asserts that the Sixth Circuit was correct in holding that the plain language of the Medicare regulations contained in 42 C.F.R. §§ 413.20, 413.24, and 413.5 require the Department to utilize GAAPs in reporting the costs to be reimbursed to a health-care provider. In support of its position on this point, the Hospital emphasizes that each of the federal court cases addressing the issue of the proper timing of Medicare's reimbursement of refinancing costs have rejected the same arguments the Secretary makes in this case. *See, e.g., Mother Frances Hosp. v. Shalala*, 15 F.3d 423 (5th Cir. 1994); *Graham Hosp. Ass'n v. Sullivan*, 832 F. Supp. 1235 (C.D. Ill. 1993); *Baptist Hosp., East v. Sullivan*, 767 F. Supp. 139 (W.D. Ky. 1991); *Ravenswood Hosp. Medical Ctr. v. Schweiker*, 622 F. Supp. 338 (N.D. Ill. 1985).

The Hospital next focuses on the Secretary's reliance on Section 233 of the Reimbursement Manual as a guide in deciding when to reimburse allowable refinancing costs. The Hospital contends that Medicare regulations require that GAAPs be used in reporting reimbursable refinancing costs. When GAAPs are used for this purpose, the parties agree that the reimbursable costs of refinancing were properly reported by the Hospital as having accrued in 1985. From this reporting requirement, the Hospital argues that the Department must reimburse all such reported costs for the year in which they were incurred and not by spreading those costs over a period of years as Section 233 requires. In sum, it is Guernsey's position that the GAAPs control both the manner in which reimbursable refinancing costs must be reported by health-care providers and when reimbursement for those costs must be made by the Department.

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Guernsey closes by focusing on the relationship between Section 233 and the Medicare reimbursement regulations. To the extent that Section 233 requires amortization of reimbursable refinancing costs, Guernsey argues that Section 233 alters existing regulations that do not require amortization. Thus, the Hospital urges that the amortization of refinancing costs required under Section 233 is inconsistent with the plain language of Medicare's cost-reimbursement regulations. As noted above, the Hospital claims that those regulations, which adhere to GAAPs, require full reimbursement in the same year that GAAPs require refinancing costs to be reported as having been incurred. According to the Hospital, to the extent that Section 233 has been used by the Department to require amortization of refinancing costs, Section 233 constitutes a legislative rule, not a mere interpretation of existing and lawfully promulgated rules. Therefore, the hospital concludes that the Sixth Circuit correctly held that the Department's reliance on Section 233 was improper because, as a legislative rule, it had not been adopted in compliance with the public notice and comment procedures of the APA.

SIGNIFICANCE

This case involves rather arcane accounting and legal issues requiring interpretation of complex Medicare health-care provider reimbursement regulations in the context of debt refinancing. If the Supreme Court decides in favor of Guernsey, the Secretary remains

free to utilize her rule-making authority under the APA to adopt a rule that clearly states that GAAPs do not apply in debt-refinancing situations and that the reimbursement of such costs must be amortized, regardless of when they are reported or incurred. If the Secretary prevails, no further Department action is needed to require health-care providers to accept reimbursement of refinancing costs over a period of years.

Of broader significance is the possibility that the Court may provide helpful clarification for lower federal courts regarding judicial review of an administrative agency's interpretation of its own regulations. Moreover, the Court may amplify its rather sparse decisions relating to the interpretive rules of administrative agencies, clarifying for courts and litigants how to distinguish interpretive from substantive rules.

For Donna Shalala, Secretary of Health and Human Services
(Counsel of Record: Drew S. Days, III, Solicitor General; Department of Justice, Washington, DC 20530; (202) 514-2217:

1. The Secretary's Medicare regulations do not mandate provider reimbursement according to generally accepted accounting principles and, thus, the Secretary could require refinancing costs to be amortized.
2. Section 233 of the Secretary's Provider Reimbursement Manual is a valid interpretive rule for purposes of the Federal Administrative Procedure Act.

For Guernsey Memorial Hospital
(Counsel of Record: Scott W. Taebel; Brickler & Eckler; 100 South Third Street, Columbus, Ohio 43215; (614) 227-2300:

1. The plain language of Medicare regulations require reimbursement of refinancing costs in the year in which they were incurred and reported under generally accepted accounting principles.
2. Section 233 is a invalid legislative rule because it has the force and effect of law and was not promulgated in accordance with the Administrative Procedure Act.

AMICUS BRIEFS

In support of Guernsey Memorial Hospital

Joint brief of the American Hospital Association, the Federation of American Health Systems, the California Association of Hospitals and Health Systems, and the Texas Hospital Association (Counsel of Record: Robert A. Klein; Weissburg & Aronson; 2049 Century Park East, Suite 3200, Los Angeles, CA 90067; (310) 277-2223);

Joint brief of 28 hospitals participating in *St. John Hosp. v. Shalala*, a case pending before the Sixth Circuit and 14 hospitals involved in an appeal pending before the Department of Health and Human Services Provider Reimbursement Review Board (Counsel of Record: William G. Christopher; Honigman, Miller, Schwartz and Cohn; 2290 First National Bank Building, Detroit, MI 48226; (313) 256-7800);

Mother Frances Hospital and Osteopathic Medical Center of Texas (Counsel of Record: Dan M. Peterson; Fulbright and Jaworski; 801 Pennsylvania Avenue, NW, Washington, DC 20004; (202) 662-0200).