COURT OF APPEALS DECISION DATED AND FILED

February 10, 1998

Marilyn L. Graves
Clerk, Court of Appeals
of Wisconsin

No. 96-2774

STATE OF WISCONSIN **IN COURT OF APPEALS DISTRICT I**

ST. JOHN'S HOME OF MILWAUKEE,

PLAINTIFF-APPELLANT,

V.

WISCONSIN DEPARTMENT OF HEALTH AND SOCIAL SERVICES,

DEFENDANT-RESPONDENT.

APPEAL from an order of the circuit court for Milwaukee County: LOUISE M. TESMER, Judge. *Reversed and cause remanded.*

Before Wedemeyer, P.J., Fine and Schudson, JJ.

WEDEMEYER, P.J. St. John's Home of Milwaukee appeals from a circuit court order affirming the decision of the Wisconsin Department of Health and Social Services, which concluded that the Bureau of Health Care Financing properly offset investment interest income from St. John's independent living facility fund against loan interest expense of its skilled nursing facility when setting the Medical Assistance reimbursement rate for the skilled nursing facility. St. John's claims DHSS acted arbitrarily and capriciously and exceeded its authority in reaching this determination because the rules and regulations binding the DHSS did not provide for the offset. Because the DHSS applied a rule/regulation that had not yet been properly enacted, we reverse and remand to DHSS to take actions consistent with this opinion.

I. BACKGROUND

St. John's is a non-profit corporation, consisting of five divisions, that provides various services to the elderly. One of these divisions provides independent living apartments and another provides a skilled nursing facility ("SNF"). The apartments are independently operated and do not receive any money from the Medical Assistance program or financial reimbursement from the SNF. The residents of the apartments pay a one-time entrance endowment fee and monthly maintenance fees. In return, the apartment residents receive "Life-Care," which includes occupancy of a particular apartment and care at the SNF should the individual be temporarily or permanently unable to continue independent apartment living. The SNF does not receive, and never has received, medical assistance reimbursement for services to residents who were admitted from the apartments. The costs associated with apartment residents admitted to the SNF are covered from a fund consisting of the one-time entrance endowment fee, the monthly maintenance fees, and interest income earned on such funds.

The SNF division of St. John's receives state and federally funded reimbursement from the DHSS for the reasonable, allowable costs of providing SNF services. The DHSS, through its Bureau, determines the medical reimbursement rate calculations based on a methodology set forth in a document entitled "The Methods of Implementation" (the "Methods"). Until 1994, the Methods were not interpreted by the DHSS to authorize the type of offset imposed by the Bureau and applied to St. John's in 1993. When a change in the Methods is made, the Bureau is required to communicate the change to Wisconsin's entire nursing home industry. *See* 42 C.F.R. § 447.205(a) (1995); METHODS, § 1.110, 1993-94.

The Bureau revises the Methods annually. As a part of the revision process, the Bureau sent a letter, dated November 24, 1987, to the Director of the Wisconsin Association of Homes and Services for the Aging. The 1987 letter indicated that the Bureau intended to rewrite the policies regarding interest income offsets to reflect two "major" changes. These included: (1) that interest income offsets would be limited to the extent that "the total property related expenses exceed the industry-wide 'EEO level'"; and (2) that interest income offsets would no longer be based on either "the source [or] the intended use of the investment funds or the related investment income." The second proposal in the 1987 letter was the basis for the type of offset in this case. The net effect of the second proposal would be that interest income from any and all sources would be offset against SNF interest expense. This would reduce the amount of money the SNF would receive from the DHSS. The first proposal of the 1987 letter was finalized and placed in the Methods. The second proposal was not finalized or put in the Methods. It was also not submitted to the federal government for approval.

Nevertheless, the DHSS auditor who reviewed St. John's financial statements for rate year 1993 noted that the Apartments Life-Care fund had earned interest. He determined that this interest income should be offset against the SNF's interest expense in accord with the second proposal of the 1987 letter. The result was an offset of $106,795 against the SNF's interest expense of $127,846, thus allowing only $21,051 of reimbursable interest expense. The effect of this offset was to reduce medical assistance payments to the SNF by approximately $30,000.

St. John's appealed the Bureau's decision to offset the income earned by the Apartment fund. A contested case hearing was held in November 1995. The administrative law judge held that St. John's failed to establish that the investment income could not be offset. The DHSS adopted the hearing examiner's decision with minor modifications and the circuit court affirmed. St. John's appeals from the circuit court order.

II. DISCUSSION

Our review is governed by Chapter 227, STATS. We will affirm the agency's action unless our review reveals a ground for setting aside, modifying, remanding or ordering agency action or ancillary relief under a specified provision of § 227.57(2), STATS. We will set aside or modify an agency's decision only if we determine that the agency has erroneously interpreted a provision of law and a correct interpretation compels a different result. *See* § 227.57(5). We will reverse or remand if the agency's action is inconsistent with an agency rule, an officially stated agency policy, or a prior agency practice. *See* § 227.57(8). We review the decision of DHSS, not the circuit court's decision. *See* ***Milwaukee Area Joint Plumbing Apprenticeship Comm. v. DILHR***, 172 Wis.2d 299, 314, 493 N.W.2d 744, 750 (Ct. App.1992).

In reviewing the agency's determination, we are not bound by its conclusions of law. *See* ***Keeler v. LIRC***, 154 Wis.2d 626, 632, 453 N.W.2d 902, 904 (Ct. App. 1990). However, appellate courts apply three levels of deference to conclusions of law and statutory interpretations in agency decisions. *See* ***Jicha v. DILHR***, 169 Wis.2d 284, 290, 485 N.W.2d 256, 258 (1992).

> The first level of review, "great weight," is applied where the "agency's experience, technical competence, and specialized knowledge aid the agency in its interpretation and application of the statute …." The second level, "due weight" or "great bearing," is applied if the decision is very nearly one of first impression. The lowest level of review, "de novo," "is applied where the case is one of first impression for the agency and the agency lacks special expertise or experience in determining the question presented."

Thompson v. DPI, 197 Wis.2d 688, 697, 541 N.W.2d 182, 185-86 (Ct. App. 1995) (citations omitted).

The issue in this case is whether the Bureau had the authority to offset investment interest income from the Apartment fund against loan interest expense of the SNF when it determined the proper medical assistance reimbursement rate for the SNF. The rates are determined based on the rules governing the agency, which are contained in the Methods. Interpretation of the applicable statutes, administrative rules and federal regulations involve questions of law that we review de novo. *See* ***Braatz v. LIRC***, 174 Wis.2d 286, 293, 496 N.W.2d 597, 600 (1993).

St. John's claims that the 1993 Methods did not contain specific provisions allowing the offset of investment income against interest expense and that the Bureau had never interpreted the rules to allow for such offset. The 1993 Methods provisions governing interest expenses state in pertinent part: "[i]nterest expense on loans for acquisition of plant assets and equipment is an allowable property-related expense.… Allowable interest expense will be reduced by interest income only to the extent that total property-related expenses exceed the target (T1) described in section 3.532." METHODS, § 3.526, 1993-94. Based on the Methods, the Bureau's review is limited to expenses related to nursing home patient care: "Only expenses related to nursing home patient care shall be allowable for payment. Expenses related to patient care include all necessary and proper expenses which are appropriate in developing and maintaining the operation of nursing home facilities and services." ***Id.***, § 1.210. Further, Methods § 1.270, "Interest Expense on Working Capital Debt," provides that "[o]nly interest expense on operating working capital loans *which are related to patient care* shall be allowed to be included in the calculation of the administration and general allowance." (Emphasis added). Based both on the plain language of these sections, and the 1987 letter evidencing the Board's intent to make a "major" change to the current interest-offsetting practices, we agree with St. John's contentions that the Methods did not allow the offset imposed on it and the Bureau had never interpreted the Methods to allow such an offset in the past. This is clearly supported by the Bureau's 1987 letter stating the proposed "major changes" to the Methods, which would allow the interest offset imposed in this case. We conclude that the agency acted arbitrarily and without authority when it imposed the offset on St. John's because the Methods did not contain a provision authorizing it to do so, and in imposing the offset in this case it applied a proposed change which had not yet been enacted.

It is a fundamental principle of administrative law that "an administrative agency is bound by the rules which it itself has promulgated ... and may not proceed without regard to its own rules." ***Larsen v. Munz Corp.***, 166 Wis.2d 751, 760, 480 N.W.2d 800, 803 (Ct. App. 1992), *rev'd on other grounds*, 167 Wis.2d 583, 482 N.W.2d 332 (1992). An agency "must be rigorously held to the standards by which it professes its action to be judged." ***Vitarelli v. Seaton***, 359 U.S. 535, 546 (1959) (Frankfurter, J., concurring and dissenting in part); *see also* ***State v. Griffin***, 126 Wis.2d 183, 197, 376 N.W.2d 62, 69 (Ct. App. 1985), *aff'd,* 131 Wis.2d 41, 388 N.W.2d 535 (1986), *aff'd,* 483 U.S. 868 (1987).

At the time the offset was imposed, the rules and regulations governing the DHSS and the Bureau did not allow for such action. The guidelines and interpretations provided that only medical assistance-generated income could be used to offset medical assistance-incurred expenses. Although the 1987 letter certainly indicates the Bureau's intent to change its rules with respect to offsetting income, the Bureau is not authorized to act upon the basis of the letter alone.[1]

Federal regulations require that the rules and standards developed by a state specify comprehensively how the state will set payment rates. *See* 42 C.F.R. §§ 447.252, 447.253(a) (1995). Whenever the state wishes to change its rules, the proposed amendment must be submitted for approval to the Federal Department of Health and Human Services and must include assurances that the proposed change will continue to comply with the statutory mandate for reasonable and adequate payment rates. *See* 42 C.F.R. § 447.255 (1995). The Bureau failed to follow this procedure. Instead, the Bureau unilaterally imposed the change without Federal approval or notice to the industry. The DHSS is

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[1] Although the rule was later properly promulgated, it was not in effect at the time the rate determination was made. Specifically, § 1.270 of the Methods was subsequently revised to state:

> Investment income earned by any home office, other corporate entity or organization, foundation or related party that has a purpose of furthering the goals of the nursing home or its related organizations, shall be offset against the nursing home's allowable interest expense. Long term interest expense and working capital interest expense shall be offset by investment income from all sources (including home office, other corporate entities and organizations, foundation and related parties).

required to provide public notice of any significant proposed changes in the methods and standards for setting payment rates. *See* 42 C.F.R. § 447.205(a) (1995).[2]

Because the Bureau violated the procedures for changing the state rules, it acted without authority when it imposed the offset on St. John's. Absent adherence to these procedures for implementing changes, any change to the Methods is impermissible and unenforceable. As a result, the offset was improper. Accordingly, we reverse the order of the circuit court and overturn DHSS's decision finding that the offset was proper. The case is remanded to the DHSS with instructions to re-evaluate St. John's figures to allow it to receive the proper medical assistance reimbursement rates without imposition of the improper offset.

By the Court.—Order reversed and cause remanded.

Not recommended for publication in the official reports.

[2] DHSS argues that its failure to adhere to proper notice procedures is irrelevant because St. John's had actual knowledge of the Bureau's intent to apply the type of offset imposed here. We reject this argument. DHSS was still required to follow the proper procedures to enact and formalize the new "major change" before it had authority to implement it.