THE STATE OF SOUTH CAROLINA
IN THE COURT OF APPEALS



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APPEAL FROM THE ADMINISTRATIVE LAW COURT
The Honorable Deborah Brooks Durden, Administrative Law Judge

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Appellate Case No. 2015-001986

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Countrywood Nursing, LLC, ..... Appellant,

v.

South Carolina Department of Health and Human Services, ..... Respondent.

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# FINAL BRIEF OF APPELLANT COUNTRYWOOD NURSING, LLC

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## STATEMENT OF ISSUES ON APPEAL

1. Can DHHS recoup funds from Countrywood based on audits of three cost report periods, when DHHS's contract with the SAO limits such audits to two periods, given that Countrywood is a third-party beneficiary to the contract and has standing to assert rights under the contract under the public importance exception?

2. Can DHHS recoup funds from Countrywood when the SAO failed to issue timely audit reports in violation of both the DHHS-SAO contract and the contract between DHHS and Countrywood?

## STATEMENT OF THE CASE

On December 16, 2011 DHHS established an accounts receivable to recoup Medicaid funds from Countrywood based on three audit reports from the SAO. R. 526. Pursuant to S.C. Code Ann. § 1-23-310, *et seq.* and S. C. Code Ann. R. 126-150, *et seq.*, Countrywood filed an administrative appeal with DHHS on December 16, 2011. R. 245-251. An evidentiary hearing was held before a DHHS Hearing Officer on September 17, 2014. R. 119. The Hearing Officer issued an order denying the appeal on December 16, 2014. R. 12-26. Countrywood filed a motion to alter or amend on December 29, 2014, R. 86-89, which the Hearing Officer denied on January 23, 2015. R. 9-11. Countrywood filed the present appeal on September 18, 2015. R. 27

## ARGUMENT

### I. Except for Fraud Investigations, the SAO Contract Prohibits Audits of Three Cost Report Periods.

#### A. Statement of Facts

DHHS is the state agency charged with administering the South Carolina Medicaid program. DHHS contracts with the SAO to audit Medicaid providers. On November 22, 2011 the SAO issued three final Medicaid audit reports to Countrywood: AC#3-RDM-E8, based on cost report period 11/29/07-5/31/08, R. 387-405; AC#3-RDM-J8, based on cost report period 11/29/07-9/30/08, R. 407-420; and AC#3-RDM-J9, based on cost report period 10/1/08-9/30/09, R. 422-435. Relying on these three audit reports, DHHS demands a recoupment from Countrywood of $546,968 in Medicaid reimbursement. R. 526.

DHHS is party to a contract with the SAO "for the Purchase and Provision of Agreed-Upon Procedure Activities Related to Medicaid Institutional Providers" ("SAO Contract"). R. 437-459. "Agreed-upon procedure activities" includes audits and audit reports, such as the November 22, 2011 final audit reports SAO issued on Countrywood. R. 144:24-26; 387-435. DHHS's Jeff Saxon is a program manager who oversees Medicaid rates and activities for all Medicaid contracting in South Carolina. R. 142:25-27. Mr. Saxon testified that several years ago DHHS entered into a series of discussions with the South Carolina Health Care Association (the "Association") concerning the number of cost report periods the SAO could audit. R. 144:27-145:1. The Association is a nonprofit, professional association whose members include most of the state's nursing homes, including Countrywood. R. 145:2-5. According to Mr. Saxon, both DHHS's Director and Deputy Director participated in these discussions, which lasted for weeks or months and involved both face-to-face meetings and

telephone conferences. R. 145:6-14. As a result of these discussions Article II, Section D(1) of the SAO Contract was revised to its present form: "The SAO will perform agreed-upon procedures involving ***two*** cost report periods." R. 144:22-23; 145:15-18; 205:27-206:7 (emphasis added). Before this revision, the SAO Contract did not contain the two cost report limitation.[1] R. 578:24-579:7, R. 582:18-583:15, R. 584:7-585:25, R. 205:25-206:7.

Article III, Section D (1) of the SAO Contract specifies which two cost report periods the SAO may audit:

> For non-hospital based/related nursing facilities, the periods will be defined as the cost report period which was used to set the provider's Medicaid rate in effect at the time the field work for the engagement is initiated, plus the preceding cost report period.

R. 443; *see* R. 938 (Article III, Section E(1) of 1998 SAO Contract identifies the same two cost report periods).

The SAO initiated the field work for the Countrywood audits on August 10, 2011. R. 460; R. 147:23-148:7. The cost report period used to set Countrywood's Medicaid rate in effect when field work was initiated was the period of 10/1/08-9/30/09. R.148:19-24. The preceding cost report period was 11/29/07-9/30/08. R. 148:25-27.

The only limitation the SAO Contract imposes on the two-cost report restriction is set forth in Article III, Section D(4): "These restrictions do not apply in relation to any procedures initiated subsequent to or in relation to any investigation of fraud." R. 443. On the day before the final hearing, in an email from DHHS's counsel to Countrywood's counsel, DHHS raised for the first time an allegation that Countrywood had improperly omitted listing

[1] Mr. Saxon could not remember when DHHS's discussions with the Association occurred, only that it was "several years ago," R. 579:5-10, "maybe, early 2000s, I'm guessing. I don't know." R. 579:15-16. Countrywood's expert witness, accountant Terry Schmoyer, also recalled these negotiations, but testified that they occurred in "the late 1990s." R. 227:17-20. The 1997 SAO Contract had no limitation on the number of cost reports the SAO could audit, R. 922-931, while the 1998 SAO Contract limited the SAO to auditing two cost report periods, R. 938, consistent with Mr. Schmoyer's testimony.

in a cost report certain related-party costs. R. 199:16-200:2. Mr. Schmoyer testified at the hearing that this omission was an unintentional mistake that had no impact on the amount of reimbursement Countrywood received. R. 199:16-202:10. DHHS offered nothing to rebut Mr. Schmoyer's testimony, presented no evidence that the SAO audits were based on or related to such omissions, and presented no evidence that any of the audits at issue were initiated subsequent to or in relation to any investigation of fraud.

## B. Argument

### 1. The SAO Contract Prohibits Audits of Three Cost Report Periods, Absent Allegations of Fraud.

Article III, Section D(1) of the SAO Contract states in plain terms that the SAO "will perform agreed-upon procedures involving ***two*** cost report periods." R. 443 (emphasis added). DHHS argues that this language should somehow be construed as allowing the SAO to perform agreed-upon procedures involving "a minimum" of two cost report periods, but the word "minimum" is not to be found in Section D(1). Rather than a "minimum," Article III, Section D(4) of the SAO Contract characterizes the two cost report provision as a "restriction," which applies in all cases except those involving allegations of fraud. R. 443. Section D(1) even specifies which two cost report periods the SAO may audit: (1) the one used to set the rate in effect at the time the field work is initiated; and (2) the preceding cost report period. R. 443. To drive home the point, a few lines later in the same section the contract states "the SAO will be required to issue the final reports for ***the two cost report periods*** no later than three (3) years after the end of the closed rate period that is associated with the preceding cost report period." R. 443 (emphasis added).

In this case, the SAO audited three cost report periods:

1. 11/29/07-5/31/08 (the "First Cost Report Period");

2. 11/29/07-9/30/08 (the "Second Cost Report Period"); and

3. 10/1/08-9/30/09 (the "Third Cost Report Period").

R. 526. The SAO did not initiate field work until August 10, 2011. The cost report period used to set the rate in effect in August 2011 was the Third Cost Report Period (10/1/08-9/30/09). R. 148:19-24. The preceding period was the Second Cost Report Period (11/29/07-9/30/08). R. 148:25-27. Under the plain terms of the SAO Contract, the SAO had no right to audit the First Cost Report Period (11/29/07-5/31/08).

Mr. Saxon testified that the SAO routinely audits six-month cost reports, but even if that is the SAO's practice, it is beside the point. There is no evidence the SAO initiated its audits "subsequent to or in relation to any investigation of fraud." *See* R. 443 (Art. III § D(4) of SAO Contract). The SAO Contract therefore restricts the SAO from auditing more than two cost report periods.

**2. Countrywood is a Third-Party Beneficiary to the SAO Contract.**

Although it is clear that the SAO Contract prohibits the SAO from auditing more than two cost reports absent allegations of fraud, DHHS argues that Countrywood is not a party to the contract and has no right to enforce it. A third party has the right to enforce a contract if the third party is the contract's intended, rather than incidental, beneficiary. *Helms Realty, Inc. v. Gibson-Wall Co.,* 363 S.C. 344, 340, 611 S.E.2d 485, 487 (2005). When a state agency enters into a statutorily authorized contract it waives sovereign immunity and can be sued on its contractual obligations. *Kinsey Constr. Co. vs. S.C. Dep't of Mental Health,* 272 S.C. 168, 172, 249 S.E.2d 900, 903 (1978). Intended beneficiaries of state contracts may sue to enforce

the contract. *Sloan Constr. Co. v. Southco Grassing, Inc.*, 377 S.C. 108, 120, 659 S.E.2d 158, 165 (2008).

Section 44-6-50 of the South Carolina Code authorizes DHHS to enter into contracts in order to carry out its statutory duties. One such duty is to ensure the equitable administration of DHHS programs. S.C. Code Ann. § 44-6-40(5). In the present case, Medicaid nursing homes such as Countrywood are the obvious intended beneficiaries of DHHS's duty to equitably administer Medicaid audits. This is especially true under the circumstances of this case, when, following negotiations with the South Carolina Health Care Association, DHHS acceded to the Association's demands and revised the SAO Contract in a way that specifically benefits Association members.

### 3. Countrywood Has Standing Under the Public Importance Exception.

Even if Countrywood were not a third-party beneficiary to the SAO Contract, it would have standing to allege a breach of that contract pursuant to the public importance doctrine. South Carolina courts have long recognized the public importance exception to standing requirements. *ATC South, Inc v. Charleston County*, 380 S.C. 191, 198, 669 S.E.2d 337, 341. "Standing is not inflexible and standing may be conferred upon a party when an issue is of such public importance as to require its resolution for future guidance." *Id.* (quoting *Davis v. Richland County Council*, 372 S.C. 497, 500, 642 S.E.2d 740, 741 (2007)). Whether an issue is of sufficient public importance requires an "appropriate balance" by the court of "competing policy concerns." *Sloan v. Sanford*, 357 S.C. 431, 434, 593 S.E.2d 470, 472 (2004).

While the nature of the public importance exception "resists a formulaic approach," the "key" to the analysis is "whether a resolution is needed for future guidance." *ATC South*, 380 S.C. at 199, 669 S.E.2d at 341. "It is this concept of 'future guidance' that gives meaning to

an issue which transcends a purely private matter and rises to the level of public importance." *Id.*

Over the years, South Carolina courts have held that the public importance exception conferred standing on plaintiffs in a variety of cases. *See, e.g., Davis* (county commissioners have standing to challenge the constitutionality of legislation that authorized their removal from office); *Sloan v. Dep't of Transportation*; 365 S.C. 299, 618 S.E.2d 876 (2005) (taxpayer had standing to sue Department over alleged statutory bidding violations); *Baird v. Charleston County*, 333 S.C. 519, 530, 511 S.E.2d 69 (1999) (doctors have standing to sue county to enjoin issuance of bonds for purchase and renovation of hospital); *Thompson v. S.C. Comm'n on Alcohol and Drug Abuse*; 267 S.C. 463, 229 S.E.2d 718 (1976) (law enforcement officials have standing to challenge constitutionality of the Uniform Alcohol and Intoxication Treatment Act).

The present case is particularly appropriate for application of the public importance exception. Rather than promulgate regulations, two state agencies have entered into a contract which purportedly regulates how Medicaid audits are to be conducted. These two agencies have violated their own contract, however, by ignoring its restriction that, except for fraud investigations, only two cost report periods may be audited. This practice has a significant impact not only on Countrywood, but on other providers, patients, and the entire Medicaid program. DHHS and the SAO have performed this practice in the past and apparently intend to perform it in the future. For all these reasons, a resolution is needed for future guidance. *See ATC South,* 380 S.C. at 199, 669 S.E.2d at 341.

## II. The SAO Failed to Issue Timely Audit Reports, in Violation of the SAO Contract and Facility Contract.

### A. Statement of Facts

In addition to limiting the SAO to auditing two cost report periods, Article III, Section D(1) of the SAO Contract places time limits on the SAO to issue final audit reports:

> For non-hospital based/related nursing facilities, the SAO will be required to issue the final reports of the two cost report period no later than three (3) years after the end of the closed rate period that is associated with the preceding cost report period.

R. 443. As demonstrated above, the "preceding cost report period" in this case was 11/29/07-9/30/08. R. 148:25-27.

At all times relevant to his action, Countrywood and DHHS have been parties to a contract dated October 1, 2006 (the "Facility Contract").[2] R. 462-484. Article V, Section F of the Facility Contract is entitled "Time Limit for Issuance of the Final Audit Report." It provides, consistent with the SAO Contract: "Any disallowance made pursuant to an on-site audit shall be made in the final audit report, which shall be issued within three (3) years of the close of the contract period. . . ." R. 472.

The Facility Contract defines "contract period" in three ways, but each definition applies only to a specific section of the contract. R.466. For Article V, Section F, "contract period" means "the rate period as defined by the South Carolina State Plan." R. 466. The South Carolina State Plan (the "Plan"), however, does not define "rate period."[3] R. 485-525.

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[2] The original parties to the Facility Contract were DHHS and Ridgeview of the Midlands, which was purchased by Countrywood. R. 152:9-13; 192:25-30.

[3] The Plan describes a "rate cycle" as lasting "from October 1 through September 30 and will be recomputed every twelve (12) months." R. 496. However, a "rate cycle" and "rate period" have different meanings. R. 156:11-12.

In the present case, the earliest Countrywood cost report audited by the SAO was a six-month report from 11/29/07-5/31/08. R. 526. The Plan provides that a six-month cost report establishes a rate for the first six months of operations. R. 505. Effective on the first day of the seventh month of operation, an inflation factor is added and "a new prospective rate" is determined. R. 506, 508, 159:14-160:5. As Mr. Saxon testified, ordinarily the rate changes again every October 1, due to a variety of annual revisions to the Plan. R. 158:21-31.

Consistent with Plan requirements, Countrywood's Medicaid rate during its first six months of operation (11/29/07-5/31/08) remained unchanged at $129.21. R. 526, 121:27-122:12. As the Plan dictates, on the first day of Countrywood's seventh month of operation (6/1/08), DHHS changed its rate to $134.74. R. 526. The rate did not change again until October 1, 2008, when DHHS raised it to $135.11. R. 526, 158:13-23.

Accordingly, in its desk audits the SAO identified 11/29/07-5/31/08, 6/1/08-9/30/08, and 10/1/08-9/30/09 as three separate "rate periods." R. 528, 530, 538, 550. The SAO's final audit reports also identified these three periods as separate "contract periods," R. 387-420, a term the Facility Contract equates with "rate periods." R. 446. On December 16, 2011, Debra Myers, DHHS's Director of the Division of Long Term Care Reimbursements and Mr. Saxon's "right hand person," R. 156:19-26, wrote DHHS's recoupment letter to Countrywood in which she, too, identified these same three periods as three separate "rate periods." R. 526-527.

**B. Argument**

DHHS argues that the rate period for Countrywood's First Cost Report Period – the six month period from 11/29/07-5/31/08 – is an "extended period" of 22 months, from 11/29/07-

9/30/09. Nothing in the Plan, the SAO Contract, the Facility Contract, or any other document references "extended" rate periods or otherwise supports DHHS's position.

Consistent with the Plan and as evidenced by the desk audit reports, final audit reports, and the December 16, 2011 recoupment letter, both DHHS and the SAO considered 11/29/07-5/31/08, 6/1/08-9/30/08, and 10/1/08-9/30/09 as three separate rate periods, not one grand extended period. R. 387-409, 463-540, 526-527. The reason these are three separate rate periods is simple – in each period Countrywood had a different rate.

The Facility Contract requires the SAO to issue its final audit report within three years of the close of the rate period. R. 418. In this case, the close of the first rate period was May 31, 2008. R. 526. The close of the second rate period was September 30, 2008. R. 526. The SAO, however, did not issue its final audit reports until November 22, 2011, R. 387-435, clearly missing deadlines for the first two rate periods and violating both the Facility Contract and the SAO Contract.

The South Carolina Supreme Court issued a decision in a situation similar to this matter in *C.A.N. Enterprises, Inc. v. S.C. Health and Human Services Finance Commission*, 296 S.C. 373, 373 S.E.2d 584 (1988). In *C.A.N. Enterprises* a nursing home and the South Carolina Health and Human Services Finance Commission ("State") entered into a contract which provided for payment and reimbursement for Medicaid benefits. *See id.* at 375, 373 S.E.2d at 585. The contract allowed for audits during the contract period and for a period of three years after the contract. *Id.* The State conducted a post-contract audit of the nursing home's cost information but did not issue its final audit report, disallowing over $24,000, until over three years after the contract period. *Id.*

The supreme court ruled that "[b]ecause the contract provides that audits, which we interpret to mean audit reports, must be completed within three years from the termination of the contract, and since the audit report was not submitted to Oakmont until after the three years expired, we hold the State is not entitled to recoup the funds disallowed in its final audit report." *Id.* at 378-79, 373 S.E.2d at 587.

The facts in *C.A.N. Enterprises* are analogous to those in the present case. DHHS is not entitled to recoup funds based on untimely audit reports issued in violation of the SAO Contract and the Facility Contract.

## CONCLUSION

DHHS violated the SAO Contract by basing its recoupment demand on the SAO's audits of three cost report periods, rather than two. DHHS further violated the SAO Contract, as well as the Facility Contract, by basing its recoupment demand on a final audit report issued over three years after the close of two relevant rate periods. For these reasons, DHHS is not entitled to any recoupment from Countrywood and the agency decision should be reversed.

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**CERTIFICATE OF COUNSEL**

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The undersigned certifies that the Final Brief contains no matter which is irrelevant to the appeal pursuant to Rule 211(b), SCACR and complies with South Carolina Supreme Court Order dated August 13, 2007.

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CERTIFICATE OF SERVICE

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I, the undersigned Administrative Assistant of the law offices of Nelson Mullins Riley & Scarborough LLP, attorneys for Countrywood Nursing, LLC, do hereby certify that I have served all counsel in this action with a copy of the pleading(s) hereinbelow specified by hand delivering a copy of the same to the following address(es):

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January 22, 2016