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**UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF CALIFORNIA**

COUNTY OF FRESNO,

Plaintiff,

v.

**ALEX AZAR II, Secretary of the Department of
Health and Human Services,**

Defendant.

1:18-cv-00320-LJO-BAM

**MEMORANDUM DECISION AND
ORDER RE PARTIES' CROSS-
MOTIONS FOR SUMMARY
JUDGMENT**

(Docs. 25, 26)

I. INTRODUCTION

The County of Fresno (the "County") filed this action in March 2018 challenging a final decision of the Secretary of Health and Human Services (the "Secretary" or "HHS"), acting through the Departmental Appeals Board ("Appeals Board"), disallowing certain pension obligation bond costs incurred by the County in performing services that benefit federally funded programs. The parties filed cross-motions for summary judgment; upon completion of the parties' briefing, the matter was taken under submission, and the hearing on the parties' motions was vacated. For the reasons set forth below, the Secretary's motion for summary judgment is GRANTED, and the County's motion for summary judgment is DENIED.

1 **II. BACKGROUND**¹

2 **A. Federal Grant Costs and OMB Circular A-87**

3 Local governmental entities, including the County, perform a range of tasks that support programs
4 funded by the Federal Government, such as food and nutrition services, adult and children's health and
5 human services programs, housing and urban development programs, and justice service programs. The
6 costs incurred by the County for work performed by its employees on these federal programs are
7 reimbursable through the Federal Government. The principles for determining allowable costs of
8 programs under grants from the Federal Government were originally set forth in a circular issued by the
9 United States Bureau of the Budget, "Budget Bureau Circular A-87." In 1981, the Office of Budget
10 Management ("OMB") reissued the circular as "OMB Circular A-87" (Circular A-87") which is currently
11 codified at 2 C.F.R. Part 200.² Under Circular A-87, a single federal agency is designated as a "cognizant
12 agency" and bears responsibility for reviewing, negotiating, and approving cost allocation plans of
13 individual non-federal entities who receive federal grant funding. 2 C.F.R. § 200.19; 2 C.F.R. Part 22,
14 App. V(F)(1) (the "cognizant agency" is generally the federal agency with the largest dollar value of total
15 federal awards with a governmental unit). These plans control the non-federal entity's billing of central
16 service costs, which includes fringe benefit costs of all federal grants received by the non-federal entity.
17 HHS is the cognizant agency for the County's cost allocation plan that is disputed in this case. (AR 112.)

18 To be allowable under Circular A-87, costs must be necessary and reasonable for the proper and
19 efficient administration of the federal program, be allocable to the Program, and be net of all applicable
20 credits. 2 C.F.R. § 200.403(a) (2016); 2 C.F.R. Part 225, Appx. A(C)(1)(a) (2015).³ Employee

21 _____
22 ¹ The Background Section is assembled from the parties' briefs and the Administrative Record ("AR") and is meant only to
provide the context for the analysis and review of the Appeals Board's decision.

23 ² The history of Circular A-87 is set out in *Alabama v. Shalala*, 123 F. Supp. 2d 1250, 1253 (M.D. Ala. 2000).

24 ³ The relevant sections of Circular A-87 that are applicable to the parties' dispute have been reissued as regulations; in each
25 of the subsequent reorganization of Circular A-87's requirements into different sections of the Code of Federal Regulations,
the language of the relevant sections has not changed although minor non-substantive variations in wording exist. (*See* AR
1170.)

1 compensation, including the cost of fringe benefits such as pensions, is generally an allowable cost, but
2 only to the extent it satisfies the specific requirements of Circular A-87. 2 C.F.R. §§ 200.430, 200.431.

3 In this case, the parties' dispute centers around the allowability of pension funding costs.

4 **B. Underfunded Pension Plans and Catch-Up Payments**

5 Some non-federal entities, like the County, pay retired former employees a benefit that is set by
6 a defined formula – *i.e.*, defined benefit pensions. During an employee's career with the employer, he or
7 she accrues a benefit under the plan that will be payable upon retirement; there is often a long period
8 between when an employee accrues a benefit and when the benefit is ultimately paid (at retirement). To
9 assess the total liabilities of a pension plan at any specific point in time, plan actuaries must project the
10 value of the benefits the plan is obligated to pay in the future. These actuarial calculations are based on
11 certain known factors such as an employee's years of service to date and predictions of future occurrences
12 such as an employee's retirement date, lifespans, and the rate of return on invested assets. When the plan
13 liabilities, measured at a particular moment in time, exceed the assets held by the plan at that point, this
14 shortfall is called an unfunded accrued liability ("UAL").

15 A pension plan may have a UAL for a variety of reasons: the employer has created a new pension
16 plan that credits an employee for service that pre-dates the plan creation, the employee was awarded
17 additional benefits under an existing plan, the employer failed to deposit sufficient funds in prior years
18 to fund the benefits that accrued in that particular year, there was a lower-than-expected return on plan
19 investments, or assumptions made by actuaries in assessing plan liabilities proved incorrect – *e.g.*, the
20 retirees live longer than expected. When a UAL occurs, the sponsoring employer generally amortizes
21 the UAL and pays an actuarially-determined amount each year to correct the shortfall over time. The
22 Governmental Accounting Standards Board ("GASB") issues Generally Accepted Accounting Principles
23 ("GAAP"). To be eligible for reimbursement under Circular A-87, pension costs must be calculated
24 using GAAP. Under GASB principles, a pension plan's annual required contribution includes costs
25 related to pension benefits accrued in that year *and* payment for any amortized portion of an existing

1 UAL. (AR 586, GASB No. 27, ¶ 10(f).) The amortized UAL costs include payment on the UAL and
2 "interest" that is an actuarially-assumed percentage typically corresponding to the actuary's projected rate
3 of investment return on the pension plan assets. (AR 634, GASB No. 27, ¶ C-5 (defining amortization
4 payment); AR 1029-30, GASB Implementation Guide ¶ 39 (explaining amortization of the UAL).)

5 **C. Bond Financing for UALs as a Reimbursable Cost under Circular A-87**

6 Circular A-87 contains a specific prohibition on "[c]osts incurred for interest on borrowed
7 capital," unless those costs fall within certain limited exceptions not applicable here. 2 C.F.R.
8 § 200.449(a).⁴ In the 1990s, favorable interest rates incentivized state and local governments to reduce
9 their costs on UALs by selling bonds whose interest rates were lower rate than the actuarial-assumed
10 interest rate for UAL amortization. (AR 27.) By financing the UAL through bonds, the cost of amortizing
11 the UAL was lowered and the yearly UAL payments were reduced. The question with respect to these
12 bonds, however, was whether the bond interest paid by the non-federal entity each year would be
13 considered interest on borrowed capital and thus no longer an allowable cost under Circular A-87. State
14 and local governments argued to HHS and OMB that these bond payments should be allowable because
15 they would save the Federal Government money by reducing the costs associated with pension plans for
16 which reimbursement could be sought. (AR 27 ("State and local governments argue that, since interest
17 on [UALs] has been allowed by Federal agencies . . . interest on debt issued to fund the [UAL] should be
18 allowable if this financing mechanism reduces costs to the Federal Government.").)

19 In response to HHS' request whether payment on pension bonds could be exempted from Circular
20 A-87's prohibition on interest costs and considered an allowable pension cost, OMB issued a letter from
21 its Chief of Financial Standards and Reporting Branch to provide guidance on this issue: the 1994 OMB
22 guidance letter. (AR 27-28.) The 1994 OMB guidance letter states that interest on bonds issued to
23 finance UALs acts as "a surrogate for interest on the underfunded pension liability included in the annual
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25 ⁴ Between 1981 and 1995, Circular A-87's interest prohibition was located at Attachment B, Section D.7 (Disallowable Costs).

1 actuarially-determined pension contribution and, therefore, is allowable under . . . Circular A-87," if the
2 following criteria are met:

- 3 **1.** Debt financing of the [UAL] is not more costly to the Federal Government than regular
4 pension financing over the remaining amortized life of the UAL, considering bond
5 principle, interest, issuance costs, and any other relevant factors, as determined at the
6 time of financing. If this criterion is not met, interest on debt issued to finance the UAL
7 will be allowed only to the extent of the regular pension financing.
- 8 **2.** All net bond proceeds are made part of pension fund assets.
- 9 **3.** The funding for bond principal and interest is (a) included in each period's pension
10 requirement (e.g., annual, biennial, or other), (b) computed in the same manner as the
11 actuary's amortization of the UAL at the time of the conversion to debt financing, and
12 (c) calculated using the weighted average interest rate on the bonds for the period in
13 place of the actuarially-assumed interest rate. The period's pension requirement consists
14 of funding for bond principal and interest applicable to the period and the pension
15 contribution requirement computed by the actuary for normal costs and any UAL not
16 funded by the bonds. Alternatives to (b) and (c) may be used if they do not result in
17 substantially different pension charges.

12 (AR 28.)

13 In 1998 the County had a UAL of approximately \$300 million (including amortization costs). In
14 reliance on the 1994 OMB guidance letter, the County issued Pension Obligation Bonds ("POBs") to pay
15 the UAL at a reduced interest rate, saving the County nearly \$40 million in costs: the aggregate total of
16 the UAL (principal and amortization costs) was \$300,145,395; under the 1998 POBs, the aggregate total
17 was \$260,559,687. As the 1998 POBs represented a net cost savings, the interest and other associated
18 costs were allowable under the 1994 OMB guidance letter. (*See* AR 32.)

19 **D. Repurchase Pension Obligation Bonds: 2003 HHS Division of Cost Allocation ("DCA")**
20 **Letter**

21 At some point, payment for pension liabilities began to move toward "refunding POBs"; the
22 County maintains refunding POBs was a well-established practice by 1994.⁵ A refunding POB is
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25 ⁵ The County cites no support in the record for this proposition.

1 essentially refinancing an existing POB. In 2002, the County issued refunding/refinanced POBs totaling
2 \$117,055,000 to refinance a portion of its 1998 POBs ("2002 POBs"). The 2002 POBs reduced the
3 County's annual POB debt payments for the first seven years and then extended the refinanced portion of
4 the POB debt by an additional ten years. In very simplified terms, instead of making payments on the
5 1998 POBs from 1999 to 2009, the refunding POBs lowered payments from 2002 through 2008 to interest
6 only, and then raised payments from 2009 through 2018. (*See* AR 32, 2002 Refunding POBs summary).
7 Instead of the \$260,559,687 total cost associated with the 1998 POBs, the 2002 refunding POBs cost
8 (principal and interest) a total of \$338,208,189. As explained by the County in its brief to the Appeals
9 Board, the 2002 POBs lowered annual expenses to the County by reducing pension obligations for the
10 first seven years which enabled the County to continue delivering necessary governmental services. (AR
11 19-20.)

12 Meanwhile, also in 2002, the California County of Sacramento sought guidance from HHS on the
13 allowability of interest costs under Circular A-87 in the event Sacramento County refinanced its own
14 previously-issued POBs. (AR 112.) In response to this inquiry, the Director of HHS' Division of Cost
15 Allocation, Western Field Office, ("DCA") wrote a guidance letter as to the allowability of costs
16 associated with refunding/refinanced POBs. This 2003 DCA letter was written by David S. Low, then
17 DCA Western Field Office Director, and indicated the following in relevant part:

18 While the 1994 policy statement did not discuss refinancing of the POBs, it is our opinion
19 that if the aggregate cost of the refinanced POBs is less costly than the POBs that it
20 replaces, the refinanced POBs would be acceptable under the 1994 policy statement.
21 Conversely, if the aggregate cost of refinancing the POBs is more costly than the POBs it
22 replaces, the excess cost would not be allowable. This interpretation is consistent with
23 the 1994 policy that made the original POBs allowable if it accomplishes the same purpose
24 at a lower cost.

25 (AR 30.)

E. The Dispute Between the Parties and Procedural History

26 In October 2003, County representatives and representatives from the California State
27 Controller's office met to discuss the allowability of costs pertaining to the County's 2002 POBs. (AR

1 31.) On October 28, 2003, the DCA issued a letter to the County which provided the following, in
2 relevant part:

3 OMB Circular A-87 provides that interest on borrowed capital, however represented, is
4 not allowable. One exception was made by OMB in its 1994 policy interpretation on the
5 premise that interest on the POB is a surrogate for the interest on the UAAL and is
6 acceptable if it results in lower cost. Once a POB is issued to replace the UAAL, the cost
7 of the POB becomes the monetary benchmark. Thus, if a POB is refinanced and results
8 in greater cost, that additional cost is considered unallowable interest (i.e., not surrogate
9 interest as in the original POB because there is no longer a UAAL). Because of this, each
10 POB must be viewed as a separate transaction and must be kept distinct to assure
11 compliance with the lower cost requirement of the 1994 policy. This was the basis of the
12 DCA's clarification letter of February 13, 2003.

13 The County had refinanced the 1998 POB with the 2002 POB, however, for a longer term
14 and at a greater total cost. The County had indicated that if it had known the additional
15 cost would not be allowed, the County would not have gone through with the 2002
16 refinancing. We indicated that we could not accept this as a basis to allow the excess cost.

17 (AR 31.)

18 Pursuant to the 2003 DCA letter that permitted costs of refinanced/refunding POBs to the extent
19 they were not more costly than the POBs they were replacing, the costs associated with the County's 2002
20 POBs were not disallowed until they exceeded the 1998 POBs aggregate total which did not happen until
21 2015.

22 In February 2017, HHS' Cost Allocation Services ("CAS") division determined the County's POB
23 costs for fiscal years 2015 and 2016 were unallowable under Circular A-87 and would not be reimbursed.

24 (AR 23-26.) The basis for the denial was predicated on a comparison of the debt service costs on the
25 1998 POBs with the debt service costs on the 2002 POBs; HHS determined the 2002 POBs cost an
additional \$77,648,502 over the costs of the 1998 POBs. (AR 24.) HHS maintained its position that
while the 1994 OMB guidance letter did not apply to refunding/refinanced POBs, if the aggregate cost
of the refinanced POBs was less costly than the POBs they replace, the costs of the refinanced POBs
would be allowable under the 2003 DCA letter. However, if the aggregate cost of the POBs was more
costly than the POBs they replace, the excess costs would not be allowable. (AR 24.) By fiscal year
2015, the County had incurred \$260,559,687 in POB costs (principal plus interest) – the amount of the

1 1998 POBs total cost (principal and interest). Once that threshold was reached, HHS determined no
2 additional costs incurred on the 2002 POBs were allowable.

3 The County appealed this determination (AR 36) to HHS' Appeals Board. The Appeals Board
4 affirmed CAS' decision to disallow \$6,271,287 the County claimed for FY 2015 and 2016 in pension
5 costs. (AR 1-18.) The Appeals Board first determined neither Circular A-87 nor current existing
6 regulations permit reimbursement for the cost of interest paid on borrowed capital. As for the exception
7 outlined in the 1994 OMB guidance letter, the Appeals Board found the exception is limited to POBs
8 issued "to finance an unfunded pension liability." Here, the County employee pension plan had no
9 unfunded pension liability or UAL when the County issued the 2002 POBs because the prior 1998 POBs
10 had completely eliminated the UAL; thus, the OMB 1994 guidance letter exception did not apply.

11 The Appeals Board also noted the policy basis for the 1994 OMB guidance letter exception was
12 to reduce costs to the Federal Government. To that end, the 1994 OMB guidance letter required that
13 POBs not be "more costly to the Federal Government than regular pension financing." (AR 15.) The
14 County's 2002 POBs did not meet this requirement because the 2002 refunding/refinanced POBs "were
15 [] more costly than the original UAL that had been financed by the 1998 POBs; total costs over the
16 lifetime of the 2002 refunding POBs are \$38,062,794 greater than the costs of the original UAL." (AR
17 15.)

18 As it pertained to the 2003 DCA letter, the Appeals Board determined it was not the basis for the
19 denial of the County's 2002 POB costs; instead, the 2003 DCA letter expanded the ability to claim POB
20 costs granted in the 1994 OMB guidance letter to refunded/refinanced POBs which did *not* fund UALs.
21 According to the Appeals Board, the 2003 DCA letter did not create a new substantive rule or change the
22 law defining allowable costs associated with pension plan costs. Rather, it created a new exception from
23 the restrictions in Circular A-87 that was not encompassed by the 1994 OMB guidance letter exception.

24 For these reasons, the Appeals Board upheld CAS' denial of the County's 2015 and 2016 costs
25 associated with the 2002 POBs. The County challenges that determination and seeks judicial review

1 pursuant to the Administrative Procedures Act ("APA"), 5 U.S.C. § 702. It is this decision the County
2 challenges before this Court.

3 **III. STANDARD OF DECISION**

4 In an action brought pursuant to the APA, a reviewing court may "hold unlawful and set aside
5 agency action, findings, and conclusions found to be . . . arbitrary, capricious, an abuse of discretion, or
6 otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). "It is well established that once an agency
7 has taken final agency action under the APA, a reviewing court analyzes that decision under the 'arbitrary
8 and capricious' standard of review." *Mt. St. Helens Mining & Recovery Ltd. P'ship v. United States*, 384
9 F.3d 721, 727 (9th Cir. 2004) (citations omitted).

10 "Under the arbitrary and capricious standard, a reviewing court must determine whether an
11 agency's decision was based on a consideration of the relevant factors and whether there has been a clear
12 error of judgment." *Mt. St. Helens*, 384 F.3d at 728 (citation omitted). "This standard is narrow and [a
13 reviewing court] may not substitute [its] judgment for that of the agency. Applying the arbitrary and
14 capricious standard, [the] court must determine whether the agency articulated a rational connection
15 between the facts and the choice made." *Id.* (citations omitted). "This standard of review is highly
16 deferential, presuming the agency action to be valid and affirming the agency action if a reasonable basis
17 exists for its decision." *Ranchers Cattlemen Action Legal Fund v. U.S. Dep't of Agric.*, 499 F.3d 1108,
18 1115 (9th Cir. 2007) (quotations omitted). "In its paradigmatic statement of this standard, the Supreme
19 Court explained that an agency violates the APA if it has 'relied on factors which Congress has not
20 intended it to consider, entirely failed to consider an important aspect of the problem, offered an
21 explanation for its decision that runs counter to the evidence before the agency, or is so implausible that
22 it could not be ascribed to a difference in view or the product of agency expertise.'" *Id.* (quoting *Motor*
23 *Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43, 103 S.Ct. 2856, 77 L.Ed.2d 443
24 (1983)).

25 Under the APA, the district court's review of an agency's decision is usually limited to the

1 administrative record. 5 U.S.C. § 706; *see also* *Cnty. of Los Angeles v. Shalala*, 192 F.3d 1005, 1011
2 (D.C. Cir. 1999) (when reviewing final agency action, the district court is not managing a "garden variety
3 civil suit," but rather "sits as an appellate tribunal"). Therefore, the usual "genuine dispute of material
4 fact" standard for summary judgment normally does not apply in an APA case. *San Joaquin River Group*
5 *Auth. v. Nat'l Marine Fisheries Serv.*, 819 F. Supp. 2d 1077, 1083–84 (E.D. Cal. 2011). In other words,
6 in the context of reviewing an administrative decision under the APA, there are normally no "disputed
7 facts that the district court must resolve." *Occidental Eng'g Co. v. I.N.S.*, 753 F.2d 766, 769 (9th Cir.
8 1985). "[T]he function of the district court is to determine whether or not as a matter of law the evidence
9 in the administrative record permitted the agency to make the decision it did." *Id.*; *see also* *City & Cnty.*
10 *of San Francisco v. United States*, 130 F.3d 873, 877 (9th Cir. 1997). "[S]ummary judgment is an
11 appropriate mechanism for deciding the legal question of whether the agency could reasonably have
12 found the facts as it did." *Occidental*, 753 F.2d at 770. Summary judgment is proper if the movant shows
13 "there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of
14 law." Fed. R. Civ. P. 56(a).

15 **IV. ANALYSIS**

16 **A. The Parties' Arguments**

17 **1. The County's Motion for Summary Judgment**

18 The County argues the plain language of the 1994 OMB policy guidance makes clear that interest
19 on POBs is an allowable cost as a surrogate for the original UAL amortization costs for which the County
20 may properly seek reimbursement. Under the 1994 OMB guidance letter, the County contends the
21 appropriate cap for any POB cost reimbursement – no matter how many times the original POBs may be
22 refinanced through subsequent POBs – is the County's originally calculated UAL. Because the total cost
23 of the 2002 Refunding POBs was less than the County's originally calculated UAL through Fiscal Year
24 2016, those costs are reimbursable. Rather than awarding this reimbursement, however, the County
25 argues HHS disregarded the 1994 OBM guidance letter that made POB interest costs allowable and

1 substituted its own interpretation to disallow those costs. The County argues the Secretary rested this
2 determination on (1) a conclusion that the County's UAL was extinguished in 1998 when the original
3 POBs were issued, and (2) a new rule HHS implemented through the 2003 DCA letter that determined
4 allowable interest on refinanced POBs is capped by the amount of costs associated with the initial POBs
5 rather than the costs associated with the original UAL. According to the County, this new rule by HHS
6 was not based on any statute or regulation but on an informal interpretation issued by HHS' DCA in 2003.
7 This 2003 DCA letter, the County argues, is not based on statutory or regulatory authority, and it makes
8 a material change to the 1994 OMB guidance letter by treating POBs and refunding POBs differently
9 without any opportunity for public notice and comment. Moreover, maintains the County, even if the
10 2003 DCA letter is construed as an interpretive rule, it is not based on any underlying law.⁶ HHS made
11 substantive changes to the allowability of POB costs as nothing in the 2003 DCA letter "contains or
12 explains a substantial justification for reversing the 1994 OMB interpretation authorizing reimbursement
13 for interest on POBs." For this reason, the County argues the Secretary's reliance on the 2003 DCA letter
14 to deny the County reimbursement for costs stemming from the 2002 POBs for the 2015 and 2016 fiscal
15 years is arbitrary and capricious.

16 The County also argues the Secretary's interpretation of the 1994 OMB guidance letter is entitled
17 to no deference because that interpretation is wrong: the 1994 OMB guidance letter should not be
18 interpreted literally by limiting cost reimbursement only to POBs that replaced the original UAL, nor
19 does the 1994 OMB guidance letter state that it is to be construed narrowly. According to the County,
20 the 1994 OMB guidance letter expressly provided for reimbursement of interest on debt used to finance
21 a UAL so long as it did not exceed regular pension financing. The Secretary's contrary interpretation of
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24 ⁶ Under the APA, federal agencies must use "rule making" processes for any "rule" that constitutes a statement of general or
25 particular applicability and future effect that is designed to implement, interpret, or prescribe law or policy. 5 U.S.C. § 551(4).
This rule-making process is generally called "notice-and-comment rulemaking." 5 U.S.C. § 553. This notice-and-comment
requirement "does not apply" to "interpretive rules, general statements of policy, or rules of agency organization, procedure,
or practice." *Id.* at § 553(b)(A).

1 the 1994 OMB guidance letter is not entitled to any deference. Rather, the OMB's own 1994 guidance
2 letter controls, and HHS' contrary interpretation of that guidance letter is not entitled to any kind of
3 deference. Finally, the Secretary's decision to apply the 2003 DCA letter was an unauthorized retroactive
4 application to POBs that issued in 2002.

5 **2. The Secretary's Motion for Summary Judgment**

6 The Secretary maintains the Board's decision was supported by substantial evidence and correctly
7 applied the relevant regulations and guidance. According to the Secretary, Circular A-87 provides that
8 costs incurred for interest on borrowed capital, however represented, are unallowable. 2 C.F.R. §
9 200.449(a). While Circular A-87 provides exceptions for certain types of interest, those are inapplicable
10 here. The 1994 OMB guidance letter creates only a limited exception to the general unallowability of
11 interest on borrowed capital and sets out specific requirements that must be met before interest on POBs
12 may be deemed allowable. The Secretary maintains the County's 2002 POBs do not meet those
13 requirements.

14 First, the 1994 OMB guidance letter limits reimbursement to POBs issued "to finance an unfunded
15 pension liability." (*See* AR 28.) The County's UAL was extinguished in 1998 when the 1998 POBs were
16 made assets of the pension plan – as required by the 1994 OMB guidance letter. Because the 2002 POBs
17 were issued to refinance the existing 1998 POBs rather than to finance a pension plan UAL, the 2002
18 POBs do not meet the threshold requirement for the exception outlined in 1994 OMB guidance letter.
19 Second, the 2002 POBs do not meet the requirements of the 1994 OMB guidance letter because the 2002
20 POBs increased costs compared to the pension financing that was in place at the time the 2002 POBs
21 were issued. The central reason for allowing reimbursement of these costs in the first place was to
22 decrease costs to the Federal Government. The 2002 POBs here do not meet this requirement that any
23 POBs decrease costs to the Federal Government as assessed at the time the POBs are issued. At the time
24 the County financed the 2002 POBs, they were not only more expensive than the 1998 POBs, they were
25 more expensive than the original UAL.

1 As for the County's argument that the 2003 DCA letter was illegitimate because of its lack of
2 adherence to notice-and-comment rulemaking procedures and its alleged retroactive application, the
3 Secretary maintains the Appeals Board correctly declined to address these arguments. According to the
4 Secretary, the Appeals Board properly found the County's arguments were premised on the erroneous
5 assumption the 2003 DCA letter articulated a more restrictive approach to interest stemming from
6 refunding/refinancing POBs than the 1994 OMB guidance letter. According to the Secretary, because
7 the disputed costs stemming from the 2002 POBs would not have been allowed even in the absence of
8 the 2003 DCA letter, whether the 2003 DCA letter should have been adopted pursuant to notice-and-
9 comment procedures under the APA is irrelevant to the resolution of this case. Nevertheless, even if this
10 issue were considered, the Secretary maintains the record amply demonstrates the issuance of the 2003
11 DCA letter was proper: the 2003 DCA letter was issued pursuant to HHS' authority to interpret and apply
12 Circular A-87 and the exception allowed by the 1994 OMB guidance letter. Circular A-87 has always
13 unambiguously disallowed interest costs from financing and/or borrowed capital. The Secretary argues
14 OMB exercised its discretion in 1994 to create a narrow exception for the allowability of costs associated
15 with POBs. As the cognizant agency, HHS has the authority to interpret Circular A-87 along with the
16 OMB 1994 guidance letter and make determinations about the allowability of pension financing costs.
17 Circular A-87 was incorporated into HHS' regulations, and HHS' subsequent interpretation of those
18 regulations is well within its authority to interpret its own regulations, and that interpretation is entitled
19 to deference.

20 Moreover, the County's presumption the 1994 OMB guidance letter did not constitute substantive
21 rulemaking subject to notice-and-comment requirements under the APA, but the 2003 DCA letter *was*
22 substantive rulemaking subject to APA notice-and-comment requirements, is inconsistent. Further, the
23 County has been enjoying the benefits of the exception outlined in the 2003 DCA letter since it began
24 incurring costs on the 2002 POBs – under both the terms of Circular A-87 and the 1994 OMB guidance
25 letter, the Secretary maintains *none* of the interest costs on the 2002 POBs would have been reimbursable:

1 under Circular A-87, the interests costs were incurred from borrowed capital; under the 1994 OMB
2 guidance letter, the 2002 POBs did not pay off an existing UAL which had been completely extinguished
3 in 1998, they simply refinanced the original POBs. However, under the 2003 DCA letter, to the extent
4 the 2002 POBs incurred interest costs that were less than the 1998 POBs, it was considered reimbursable
5 by HHS – something neither Circular A-87 nor the 1994 OMB guidance letter permitted. Until the
6 County reached the cost threshold that would have been incurred on the 1998 POBs, the interest incurred
7 on the 2002 POBs was allowable. When the costs of the 2002 POBs *exceeded* the costs of the 1998
8 POBs, those excess costs were not be allowable for reimbursement. Thus, in 2015 when the aggregate
9 cost of the 2002 POBs surpassed what the aggregate costs of the 1998 POBs would have been, those
10 excess costs were disallowed. According to the Secretary, even if the 2003 DCA letter were found to be
11 an improper exercise of HHS' authority, the County's reimbursement requests would still be denied under
12 the terms of Circular A-87 and the 1994 OMB guidance letter – in fact, none of the interests costs the
13 County has been reimbursed since the 2002 POBs were issued would be allowed.

14 **B. The Appeal Board's Disallowance of the County's Fiscal Year 2015 and 2016 Pension**
15 **Costs Pursuant to Circular A-87 and the 1994 OMB Guidance Letter Is Legally Correct**

16 As an initial matter, the parties present various arguments regarding the deference the Court
17 should or should not ascribe to HHS' interpretation of the 1994 OMB guidance letter – either as stated in
18 the DCA 2003 letter or as the Appeals Board interpreted and applied the 1994 OMB guidance letter in
19 its 2018 decision.

20 **1. Auer Deference to the 1994 OMB Guidance Letter and Interpretations Thereof is**
21 **Not Warranted**

22 The County maintains no deference should apply to HHS' interpretation of the 1994 OMB
23 guidance letter because that 1994 letter is an interpretation of OMB's own regulation – *i.e.*, Circular A-
24 87. According to the County, *Auer* deference cannot apply to an agency's interpretation of a different
25 agency's interpretation of its own regulation. Moreover, the County contends the 1994 OMB guidance

1 letter is a policy interpretation of Circular A-87 and is itself entitled to *Auer* deference. (Doc. 25-1, 25:9-
2 29:11.)

3 The Secretary responds there is no dispute as to OMB's authority to issue the 1994 OMB guidance
4 letter, but *Auer* deference is inapposite because there is no ambiguity in the A-87 Circular to be
5 interpreted by the 1994 OMB guidance letter. As for the 2003 DCA letter, the Secretary argues that letter
6 is an interpretation of Circular A-87 that should be given deference as discussed by the courts in *State of*
7 *New York v. Shalala*, 959 F. Supp. 614, 620 (S.D.N.Y 1997), *Alabama v. Shalala*, 124 F. Supp. 2d 1250,
8 1263 (M.D. Ala. 2000), and *Arizona v. Shalala*, 121 F. Supp. 2d 40, 53 (D.D.C. 2000). (Doc. 30, 5:24-
9 9:4.)

10 Some agency determinations of law are entitled to heightened judicial deference. *Auer* deference,
11 also referred to as *Seminole Rock* deference, calls for a court to defer to an agency's interpretation of its
12 own ambiguous regulation unless that interpretation is "plainly erroneous or inconsistent with the
13 regulation." *Auer v. Robbins*, 519 U.S. 452, 464 (1997); see *Bowles v. Seminole Rock & Sand Co.*, 325
14 U.S. 410, 414 (1945); see also *Christopher v. SmithKline Beecham Corp.*, 567 U.S. 142, 155 (2012).
15 There are several situations where *Auer* deference may be withheld: when the agency's interpretation is
16 plainly inconsistent with the regulation, when there is reason to suspect the agency's interpretation does
17 not reflect the agency's fair and considered judgment on the matter in question, when the agency's
18 interpretation conflicts with a prior interpretation, or when the agency's interpretation is nothing more
19 than a "convenient litigating position." *Christopher*, 567 U.S. at 155 (citations omitted).

20 There is no basis to apply *Auer* deference to either the 1994 OMB guidance letter itself (as the
21 County asserts) or to apply it to HHS' interpretation of the 1994 OMB guidance letter as stated in the
22 Appeal Board's decision or the 2003 DCA letter. *Auer* deference involves an agency interpretation of its
23 own *ambiguous* regulation. *Christensen v. Harris County*, 529 U.S. 576 588 (2000) ("*Auer* deference is
24 warranted only when the language of the regulation is ambiguous . . . To defer to the agency's position
25 [where the regulation is not ambiguous] would be to permit the agency, under the guise of interpreting a

1 regulation, to create *de facto* a new regulation."). Assuming OMB Circular A-87 is an OMB "regulation"⁷
2 and has been subject to notice-and-comment rulemaking procedures under the APA, *see, e.g.*, 60 Fed.
3 Reg. 26484 (1995), there is no basis to conclude Circular A-87 is ambiguous such that it was subject to
4 interpretation in the 1994 OMB guidance letter.

5 The 1981 version of Circular A-87 was in effect in 1994 when OMB issued its 1994 guidance
6 letter.⁸ The 1981 Circular A-87, Attachment B, Section D.7 (Disallowable Costs) expressly prohibits
7 interest on financing or refinancing as a reimburseable cost:

8 7. Interest and other financial costs. Interest on borrowings (however represented), bond
9 discounts, cost of financing and refinancing operations, and legal and professional fees
10 paid in connection therewith, are unallowable except when authorized by Federal
11 legislation and except as provided for in paragraph C.2.a⁹ of this Attachment.

12 Traditionally, cognizant federal agencies had not considered the "interest" on amortized UALs to
13 be precluded under this section because that "interest" did not stem from "borrowings" or "financing" –
14 it was an actuarial calculation of the cost of funding a UAL over time. (*See* AR 27 (1994 OMB guidance
15 letter).) Rather, payments on a pension fund's UAL and the costs of amortization were considered
16 reimburseable under Attachment B, Section B.13.b (allowable costs) as the costs stemming from pension
17 plans:

18 Employee benefits in the form of employers' contribution or expenses for social security,
19 employees' life and health insurance plans, unemployment insurance coverage, workmen's
20 compensation insurance, pension plans, severance pay, and the like, provided such
21 benefits are granted under approved plans and are distributed equitably to grant programs
22 and to other activities.

23 ⁷ "In carrying out its responsibilities, the Office of Management and Budget issues policy guidelines to Federal agencies to
24 promote efficiency and uniformity in Government activities. These guidelines are normally in the form of circulars." 5 C.F.R.
25 § 1310.1. The circulars issued by OMB cover a variety of topics related to the administration of federal programs. 5 C.F.R.
§ 1310.5; *see also* 31 U.S.C. § 503(a) (Deputy Director of Management shall establish governmentwide financial management
policies for executive agencies and shall provide overall direction and leadership to the executive branch on financial
management matters by establishing financial management policies and requirements).

⁸ The 1981 version of Circular A-87 was in the process of revision in 1994, and it was reissued in 1995 after notice-and-
comment procedures. 60 Fed. Reg. 26484 (1995).

⁹ Section C.2.a relates to financing for building space and is inapplicable to bond interest costs.

1 (AR 211, Circular A-87, Attachment B.)

2 The issuance of POBs is "financing" and the interest costs stemming therefrom are clearly
3 prohibited by Circular A-87, Attachment B, Section D.7. As the Secretary notes, *Auer* deference is
4 applicable only where the regulation interpreted is ambiguous; if an agency regulation is not ambiguous,
5 a court is to forego deference and apply the plain language of the regulation as written. *Christiansen*,
6 529 U.S. at 588. Circular A-87's preclusion on interest as an allowable cost is not ambiguous, so any
7 contrary "interpretation" of that plain language would not be subject to *Auer* deference.¹⁰

8 Circular A-87's terms, however, allow OMB to make exceptions to the Circular's provisions.
9 Circular A-87, 46 Fed. Reg. 9548-01 (1981) ("applicability and scope" section of Circular A-87 indicates
10 that "[a]ny other exceptions will be approved by the [OMB] in particular cases where adequate
11 justification is presented"); *see also* 2 C.F.R. § 200.102(a) (2014) ("OMB may allow exceptions for . . .
12 non-Federal entities subject to the requirements of this part when exceptions are not prohibited by
13 statute"). While the 1994 OMB guidance letter does not cite this exception power as authority for issuing
14 the 1994 letter, OMB has the power to make exceptions to the cost principles set out in Circular A-87,
15 46 Fed. Reg. 9548-01 (1981); 2 C.F.R. § 200.102(a) (2014), and as Circular A-87 is not a statute, carving
16 out exceptions from its prohibitions is permitted. The exception articulated in the 1994 OMB guidance
17 letter permits POB costs to be considered an allowable pension cost under Circular A-87, Attachment B,
18 Section B.13.b, with a policy goal of reducing costs to the Federal Government. Whatever deference
19 may be owed to OMB's exception to Circular A-87 articulated in the 1994 OMB guidance letter, it is not
20 deference arising under *Auer*.

21 Turning to HHS' *interpretation* of the 1994 OMB guidance letter (as stated in the 2003 DCA letter
22 and in the Appeals Board's 2018 decision), the County argues no deference to that interpretation under
23

24
25 ¹⁰ This applies in equal measure to the 2003 DCA letter to the extent it is characterized as an interpretation of an ambiguity in Circular A-87.

1 *Auer* can be afforded because it is an interpretation by HHS of an interpretation by OMB of OMB's
2 Circular. (Doc. 25-1, 25:10-:29:10) ("No deference is due to the Secretary's position that the Refunding
3 POBs are somehow outside the scope of the 1994 policy interpretation" . . . "no deference is due the
4 Secretary's final decision disallowing the Refunding POB interest costs that were below the UAL cap" .
5 . . "the Secretary was not interpreting his own regulations, but was attempting to revise OMB's uniform
6 rules that apply to multiple federal agencies").

7 *Auer* deference is simply not relevant to HHS' interpretation of the 1994 OMB guidance letter.
8 First, there is no ambiguity in Circular A-87 for the 1994 OMB guidance letter to interpret; the 1994
9 OMB guidance letter created an exception, it did not offer an interpretation. Second, even if it were
10 characterized as an interpretation, HHS would have been interpreting OMB guidance that in turn
11 purportedly interpreted a regulation. There is no authority for the proposition that any subsequent
12 interpretation – even by OMB itself – of the 1994 OMB letter guidance interpreting Circular A-87 could
13 be afforded deference let alone that deference could be afforded to *another* agency's interpretation of
14 OMB's 1994 letter guidance interpreting Circular A-87. Even assuming there were ambiguities to be
15 interpreted, which there are not, application of deference in these circumstances would be something
16 along the lines of *Auer* "squared deference," see *Elgin Nursing & Rehab. Center v. U.S. Dept. of Health*
17 *& Human Resources*, 718 F.3d 488, 493 (5th Cir. 2013),¹¹ but also once removed (agency's interpretation
18 of a *different* agency's interpretation of a regulation), which is a completely unrecognizable extension of
19 *Auer*.

20 Ultimately, however, it is irrelevant whether some level of deference to the 1994 OMB guidance
21 letter or HHS' interpretation of that letter is appropriate: for all the reasons discussed below, even
22

23
24 ¹¹ *Id.* ("All of our decisions applying [*Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945)] and *Auer*, however,
25 have addressed only an agency's direct interpretation of its published regulations. DHHS, it seems, asks us to go a step further
and defer to its interpretation of the SOM; essentially, it seeks '*Seminole Rock* squared' deference—deferring to its
interpretation of its manual interpreting its interpretive regulation. We have never granted such extraordinary deference to an
agency, and we decline to do so now.").

1 considered de novo, the 1994 OMB guidance letter unambiguously does not encompass
2 refinanced/refunded POBs, and HHS' application of the 1994 OMB guidance letter to that effect is
3 reasonable, persuasive, and legally correct. Because application of the 1994 OMB guidance letter is
4 dispositive to the issues presented, the Court turns now to the exception for POB interest created by OMB
5 in 1994.

6 **2. The Plain Language of the 1994 OMB Guidance Letter Exception Does Not**
7 **Encompass the County's 2002 Refinanced/Refunded POBs**

8 The parties' primary dispute centers on whether the 1994 OMB guidance letter encompasses
9 refunding/refinanced POBs – specifically, the County's 2002 POBs. The parties each claim the plain
10 language of the 1994 OMB guidance letter unambiguously supports their respective positions, which
11 stand in stark contrast. The County argues the 1994 OMB guidance letter unambiguously encompasses
12 refinanced POBs as allowable under Circular A-87. (*See* Doc. 25-1, 24:5-25:7 ("The County's claims to
13 be reimbursed in full for its 2002 Refunding POB costs for Fiscal Years 2015 and 2016 are supported by
14 the plain language of OMB Circular A-87, as interpreted by OMB in its 1994 policy interpretation that
15 made the interest on all POBs allowable up to the limit of the County's UAL.")) The Secretary contends
16 the 1994 OMB guidance letter unambiguously indicates *refinanced* POBs were never contemplated by
17 the OMB in 1994 as an exception for interest on borrowed capital; the Secretary maintains the Appeals
18 Board correctly applied the OMB 1994 guidance letter exception and denied the County's claims for
19 reimbursement of pension costs in fiscal years 2015 and 2016.

20 **a. The 1994 OMB Guidance Letter Exception Pertains Only to Bond**
21 **Financing that "Funds an Unfunded Actuarial Liability"**

22 The 1994 OMB guidance letter considered state and local government's contention made to HHS
23 that interest on debt issued to fund an unfunded liability should be allowable under Circular A-87 if this
24 financing mechanism reduced costs to the Federal Government. (AR 27.) The OMB found that interest
25 on bonds issued to finance a UAL was a surrogate for the actuarially-calculated "interest" on amortized

1 UALs and would be "allowable under paragraph B.13.b of Circular A-87 [Attachment B], if the following
2 criteria are met:"

3
4 1. Debt financing of the unfunded actuarial liability (UAL) is not more costly to the
5 Federal Government than regular pension financing over the remaining unamortized life
6 of the UAL, considering bond principal, interest, issuance costs, and any other relevant
7 factors, as determined at the time of financing. If this criterion is not met, interest on debt
8 issued to finance the UAL will be allowed only to the extent of the regular pension
9 financing.

10
11 2. All net bond proceeds are made part of pension fund assets.

12
13 3. The funding for bond principal and interest is (a) included in each period's pension
14 requirement (e.g., annual, biennial, or other), (b) computed in the same manner as the
15 actuary's amortization of the UAL at the time of the conversion to debt financing, and (c)
16 calculated using the weighted average interest rate on the bonds for the period in place of
17 the actuarially-assumed interest rate

18 (AR 27-28.)

19
20 Employing the canons of statutory and regulatory construction as interpretive tools here, the 1994
21 OMB guidance letter squarely and unambiguously relates only to the original financing/funding of a
22 UAL through pension bonds, not subsequent refinancing or refunding of another POB. First, the 1994
23 OMB guidance letter was issued in response to HHS' very specific question about the costs associated
24 with pension bonds that fund an unfunded pension liability, not about bond financing that *either* funds
25 an unfunded pension liability *or* refinances a previously issued POBs. *See Robinson v. Shell Oil Co.*,
519 U.S. 337, 341 (1997) (courts look to "the specific context in which that language is used, and the
broader context of the statute as a whole"). As expressly noted in the 1994 OMB guidance letter, HHS
indicated to OMB that HHS and other federal agencies had interpreted Circular A-87 to allow
reimbursement of actuarially-calculated interest on UALs (regular pension funding).¹² State and local
governments had argued to HHS that since actuarially-calculated "interest" on the UAL had been allowed

¹² The reasoning for this seems to be that actuarially-calculated interest to fund pension UALs was not considered by federal agencies to be a product of "financing" or borrowed capital; it was a calculation of the amortization required for catch-up payments on an underfunded pension fund.

1 as a reimbursable cost under A-87, interest from debt financing issued to fund the UAL should be
2 allowable if this financing mechanism reduces costs to the Federal government. (AR 27.) The question
3 posed to OMB did not relate to *any/every* type of financing pertaining in some tangential way to a UAL
4 payoff – it very specifically encompassed *only* "bonds issued to finance an unfunded pension liability."
5 (AR 27.) The answer provided in the 1994 OMB guidance letter was tailored to the express and specific
6 situation posed by HHS' question.

7 Second, the language of OMB's answer to HHS' question on this issue, as set out in the 1994
8 guidance letter, very clearly addressed only the initial issuance of POBs to fund an existing UAL. To
9 make an exception for interest (financing costs) on POBs as a reimbursable cost not precluded by
10 Circular A-87, Attachment B, Section D.7, OMB required that "[d]ebt financing of the unfunded actuarial
11 liability (UAL) is not more costly to the Federal Government than regular pension financing . . . " and
12 required that "[a]ll net bond proceeds [be] made part of pension fund assets." Where initial POBs are
13 issued to fund a UAL, the UAL is paid off because the net POB proceeds are made part of the pension
14 fund assets. This is like obtaining a mortgage to pay the contract purchase price to the seller of a home.
15 Once the seller is paid by money issued from the mortgagor, the sales contract on the house is satisfied –
16 any subsequent refinancing of the mortgage no longer involves the sales contract or the seller. In the
17 same way, once the pension bond proceeds are made part of the pension assets, the UAL is extinguished.
18 GASB standards make this clear: a UAL is calculated by taking the excess of the Actuarial Accrued
19 Liability over the Actuarial Value of Assets. Once POBs funding the entire UAL are added to the assets
20 of the pension plan, any shortfall in the Actuarial Value of Assets compared to the Actuarial Accrued
21 Liability is alleviated, and from an accounting standpoint, the UAL ceases to exist. (AR 628 (GASB No.
22 27, 40(A-5), (A-6).) When the 1994 OMB guidance letter specifically and repeatedly references debt
23 financing used to fund a UAL, it is clear it is *not* discussing debt financing that occurs *after* the UAL has
24 been extinguished. OMB's exception deals only with POBs used to pay/fund a UAL – once that UAL
25 has been funded, no subsequent refinancing will be used to fund that UAL any more than a refinanced

1 mortgage will be used to satisfy the original sales contract. In the context of the specific question raised
2 and the language OMB used to set criteria for the exception for the allowability of POB interest costs,
3 the exception only encompasses POB issuances that pay off an existing UAL – in full or in part.

4 The County maintains the OMB guidance letter states the interest on bonds to finance a UAL is
5 a "surrogate" for the actuarially-determined interest on the UAL (AR 27). According to the County, both
6 original and refinanced POBs stand in the shoes of the actuarially-calculated UAL interest as a surrogate.
7 The County contends that to interpret the 1994 letter as only applicable to original POBs creates a
8 distinction for different types of bond financing that OMB never intended: any type of bond financing
9 *relating to* the underlying UAL acts as a surrogate for the actuarially-calculated UAL interest.

10 The County's focus on the term "surrogate" in the 1994 OMB guidance letter and the argument
11 that original and refinanced/refunded POBs are both surrogates in equal measure for the actuarially-
12 calculated interest on the UAL ignores the express requirements of the exception set out in the 1994
13 OMB guidance letter. Despite that the County maintains refinancing/refunding POBs were a well-
14 established practice at the time the 1994 OMB guidance letter was issued, the requirements set out in the
15 guidance letter are not broadly worded and do not refer to *any* bond financing that acts as a "surrogate."
16 Rather, the criteria expressly refer to "financing of the [UAL]" and require that all net bond proceeds
17 become part of the pension fund assets, which in turn extinguishes the UAL or portion thereof it was
18 intended to fund. A refinanced/refunded POB does not finance a UAL that has already been extinguished
19 by an original POB. If refinanced/refunded POBs had been contemplated by OMB in the 1994 guidance
20 letter, the wording of the criteria for the exception would not have referenced financing a UAL and paying
21 it off by making all net bond proceeds part of the pension fund assets. The County points to no evidence
22 in the record that the 2002 POB proceeds were made part of the pension fund assets or that any portion
23 of the UAL remained unpaid in 1998 when the first POBs were issued.

24 In a similar vein, the County also argues if the original 1998 POBs extinguished the UAL, then a
25 "government entity such as the County could never claim any POB interest as a reimburseable expense

1 [which] would render the 1994 policy interpretation a nullity." (Doc. 27, 7:4, n.1.) As the Court
2 understands it, this argument apparently assumes that if the UAL is extinguished when it is first funded
3 with POBs, the interest paid on the POBs no longer serves as a surrogate for the amortization costs on
4 the UAL which are not considered a product of borrowing or financing, and thus not in contravention of
5 Circular A-87's prohibition on interest as an allowable cost. However, the authority to carve out an
6 exception for POB interest that replaces UAL amortization costs was not predicated on creating a fiction
7 that the UAL somehow still existed so that the interest on the POBs could be allowable as a surrogate for
8 UAL amortization costs. Circular A-87 allowed OMB to make exceptions, and POB interest as an
9 allowable pension cost is an exception. 46 Fed. Reg. 9548-01 (1981), ¶ 5 (Applicability and scope)
10 (allowing OMB to make other exceptions to the application of the Circular's provisions); 2 C.F.R. §
11 200.102(a) (2014). In other words, it is not this concept of serving as a "surrogate" that made POB
12 interest allowable. POB interest is considered a surrogate for UAL amortization costs *and* allowable only
13 *if* it meets the criteria outlined by the 1994 OMB guidance letter, the first two of which included financing
14 a UAL and then paying the UAL off by making the POB proceeds part of the pension fund assets. (AR
15 27 ("interest on bonds issued to finance [a UAL] is a surrogate for interest on the [UAL] . . . [and] is
16 allowable . . . if the following criteria are met: . . . ").) A refunded POB cannot accomplish those
17 requirements no matter whether the interest thereon still could be considered a "surrogate" in a figurative
18 sense for the original UAL amortization costs.

19
20 **b. The County's 2002 POBs Were More Costly to the Federal Government
than the Regular Pension Financing**

21 As identified by the 1994 OMB guidance letter, the only reason to except POBs from Circular A-
22 87's prohibition on financing costs and consider them a surrogate for actuarially-calculated "interest" on
23 a UAL is "if the debt financing mechanism reduces cost to the Federal Government." (AR 27.) To that
24 end, the first of the three requirements set out in the 1994 OMB guidance letter mandates that debt
25 financing not be more costly to the Federal Government than regular pension financing "*as determined*

1 *at the time of financing*":

2 Debt financing of the unfunded actuarial liability (UAL) is not more costly to the Federal
3 Government than regular pension financing over the remaining unamortized life of the
4 UAL, considering bond principal, interest, issuance costs, and any other relevant factors,
as determined at the time of financing. If this criterion is not met, interest on debt issued
to finance the UAL will be allowed only to the extent of the regular pension financing.

5 (AR 28.) The final sentence of this requirement contains a proviso that, in context, is a backstop if the
6 cost of debt financing *after* the time of financing *ultimately* becomes more expensive than the cost of
7 regular pension financing it had replaced; in that case, only interest costs up to the costs of regular pension
8 financing will be reimburseable. This proviso cannot be read to mean that if debt financing is more
9 expensive than regular pension financing as calculated *at the time of financing*, interest on that debt
10 financing may be allowed to the extent of regular pension financing. That interpretation creates an absurd
11 result by countering the express purpose of the exception for POB interest (reducing costs to the Federal
12 Government) and vitiates the first criteria for the exception requiring that debt financing of the UAL *not*
13 be more costly than regular pension financing *as determined at the time of financing*. In other words, if
14 a pension bond issuance is calculated to be more expensive than regular pension financing at the time of
15 financing, the 1994 OMB guidance letter's express requirements for the exception are not met and the
16 interest costs associated with that bond issuance are not allowable.

17 Thus, even if the 1994 OMB guidance letter encompassed refinanced/refunded POBs despite the
18 guidance letter's repeated references to funding a UAL and replacing regular pension financing which
19 refinanced POBs could not accomplish, the County's 2002 POBs would *still* not qualify for the exception:
20 at the time of financing in 2002, the total cost and principle of the 2002 refinanced POBs was
21 \$338,208,189 compared to the original UAL total of \$300,145,395. There is nothing in the record
22 indicating the 2002 POBs were not more costly than the original UAL at the time they were financed in
23 2002. Moreover, as discussed above, the proviso cannot be interpreted to mean that if POBs are more
24 costly than the UAL as determined at the time of financing, they still could be reimbursed up to the total
25 of the original UAL (principal and amortization costs). The County's 2002 POBs could not be reimbursed

1 up to the original UAL cost benchmark because, at the time of financing in 2002, those 2002 POBs were
2 already known to be more costly than the original UAL.¹³ The 2002 POBs do not qualify for the 1994
3 OMB guidance letter exception, and they do not achieve any cost savings to the Federal Government
4 which the exception was designed to create.

5 **3. The Appeals Board's Application of the 1994 OMB Guidance Letter is Supported by**
6 **Substantial Evidence**

7 The Appeals Board correctly determined the 1994 OMB guidance letter exception pertained only
8 to POBs issued to eliminate the unfunded liabilities of employee pension funds. (AR 13-15.) The
9 Appeals Board found that when the County issued its refinanced/refunded POBs in 2002, there was no
10 underlying UAL to pay off – it had already been extinguished in 1998. This is supported by GASB
11 accounting principles explaining how a UAL is calculated. (AR 628, No. 27, (A-6).) As discussed above,
12 GASB accounting principles define an Actuarial Value of Assets as "[t]he value of cash, investments and
13 other property belonging to a pension plan, as used by the actuary for the purpose of an Actuarial
14 Valuation." (*Id.*) A UAL, in turn, is defined under GASB principles as "The excess of the Actuarial
15 Accrued Liability over the actuarial Value of Assets." Under these principles, once the 1998 POBs were
16 made part of the net assets of the pension plan, the excess of the Actuarial Accrued Liability over the
17 Actuarial Value of Assets would have shown the UAL existing before the 1998 POB issuance was
18 eliminated. As the UAL was extinguished, the 2002 POBs could not be considered "debt financing of
19 the unfunded actuarial liability" as described in the 1994 OMB guidance letter.

20 The Appeals Board also correctly concluded the County's 2002 POBs were inconsistent with the
21 purpose of the 1994 OMB guidance letter because the 2002 POBs were more costly than both the original
22 amortized UAL and the 1998 POBs. The evidence in the record supports this finding. (*See* AR 32.) The
23

24 ¹³ And, at the time of financing the 2002 POBs, the existing debt structure was the 1998 POBs, which were approximately
25 \$77 million less costly than the 2002 POBs. (*See* AR 32.) No matter what benchmark the 2002 POBs are measured against,
they were more expensive than *any* previous financing at the time they were issued.

1 total UAL in March 1998 was \$300,145,395; the 1998 POBs principle and costs totaled \$260,559,687.
2 The 2002 POBs principle and costs were \$338,208,198. (AR 32.) The 2002 POBs were over \$77 million
3 more costly than the 1998 POBs and over \$38 million more costly than the original UAL – by either
4 benchmark, the 2002 POBs were more costly. As such, the 2002 POBs did not meet either the express
5 requirement of the 1994 OMB guidance letter that debt financing not be more costly than regular pension
6 financing or the underlying policy basis on which the OMB 1994 exception rested: reducing costs to the
7 Federal Government.

8 **4. The 2003 DCA Letter**

9 The County argues the Appeals Board disregarded the OMB's 1994 guidance letter "that made
10 the POB interest costs allowable costs and substituted its own interpretation to disallow those costs."
11 (Doc. 25-1, 15:27-16:1.) According to the County, the Appeals Board based its decision on an informal
12 interpretation issued in the 2003 DCA letter: the 2003 DCA letter "made a material change in the 1994
13 OMB policy interpretation by treating POBs and Refunding POBs differently without any opportunity
14 for public notice and comment, nor is there any indication that the changes made by the DCA letter would
15 be published in the Federal Register or the Code of Federal Regulations." (Doc. 25-1, 17:25-18:1.) The
16 County maintains the 2003 DCA letter constitutes a substantive change in the law (by distinguishing
17 between POBs and Refunding POBs and treats them differently for reimbursement purposes), but HHS
18 failed to comply with the fundamental procedures for issuing a legislative rule – notice-and-comment
19 requirements pursuant to the APA. The County also maintains the 2003 DCA letter had impermissible
20 retroactive effect on the 2002 POBs.

21 The Secretary contends the 2003 DCA letter is essentially irrelevant to the disallowance of the
22 County's 2015 and 2016 fiscal year costs. According to the Secretary, neither Circular A-87 nor the 1994
23 OMB guidance letter provided any reimbursement for the County's 2002 POBs; thus, the 2003 DCA
24 letter did not articulate a more restrictive approach to allowing costs related to refunding/refinanced POBs
25 than the 1994 OMB guidance letter. The 1994 OMB guidance letter, by its terms, did not apply to

1 refunding/refinanced POBs. The only way *any* costs pertaining to County's 2002 POBs could be
2 reimbursed was if there was an *additional* exception. The Secretary maintains HHS created such an
3 exception through the issuance of the 2003 DCA letter, which was a proper exercise of HHS' authority
4 to interpret Circular A-87 and make determinations about allowable costs.

5 The Appeals Board concluded the 2003 DCA letter provided no basis to reverse or lower the
6 disallowance of the County's 2002 refunding/refinancing POB costs:

7 . . . the 1994 OMB Letter was a narrow, limited exception to those cost principles that, as
8 such, did not provide blanket authority to claim interest costs of all POBs. As such, the
9 2003 DCA Letter expanded the ability to claim POB costs granted in the 1994 OMB Letter
10 by permitting types of POBs not addressed in that document and continuing its
11 requirement that bond issuance not increase pension costs claimed for federal funding.
12 Thus, the 2003 DCA Letter did not 'create a new substantive rule' or 'change[] the law
13 defining allowable costs association with pension plan costs' or 'establish a standard that
14 goes beyond the statute, HHS' cost allocation regulations, and even beyond the 1994 OMB
15 [Letter]," as Fresno maintains

16 (AR 17.)

17 As discussed at length above, the Appeals Board correctly determined Circular A-87
18 unambiguously disallowed interest costs stemming from POBs; further, the Appeals Board correctly
19 determined the 1994 OMB guidance letter created an exception to Circular A-87 that was unambiguously
20 limited to POBs that funded an existing UAL, not refunding/refinanced POBs that funded existing POBs.
21 The 2003 DCA letter was not the basis of the Appeals Board's refusal to allow costs association with the
22 County's 2002 POBs. Also, because the County's 2002 POB costs were not reimburseable under Circular
23 A-87 or the 1994 OMB guidance letter, the 2003 DCA letter was not a more restrictive cost allowance
24 policy. As the Appeals Board correctly determined, there is no reason to consider whether the 2003 DCA
25 letter was an improper exercise of HHS' authority: even if it were, the County's 2002 POBs costs for FY
2015 and 2016 would remain disallowed. Thus, the Court declines to consider whether the 2003 DCA
letter was a proper exercise of HHS' authority.

1 **5. Conclusion**

2 In sum, the Appeals Board's December 28, 2017, decision is supported by substantial evidence,
3 its findings are not arbitrary or capricious, and its interpretation and application of Circular A-87 and the
4 1994 OMB guidance letter is persuasive and legally correct.

5 **V. CONCLUSION AND ORDER**

6 For the reasons set forth above, IT IS HEREBY ORDERED that:

- 7 **1.** The Appeals Board's December 28, 2017, decision is supported by substantial evidence
8 and is not arbitrary or capricious;
9 **2.** The County's motion for summary judgment is DENIED;
10 **3.** The Secretary's motion for summary judgment is GRANTED; and
11 **4.** The Clerk of Court is DIRECTED to enter judgment for the Secretary and this case
 shall be closed.

12 IT IS SO ORDERED.

13 Dated: April 30, 2019

/s/ Lawrence J. O’Neill
UNITED STATES CHIEF DISTRICT JUDGE