RENDERED: AUGUST 23, 2019; 10:00 A.M.
NOT TO BE PUBLISHED

Commonwealth of Kentucky

Court of Appeals

NO. 2016-CA-001141-MR

COMMONWEALTH OF KENTUCKY,
CABINET FOR HEALTH AND FAMILY SERVICES — APPELLANT

v. — APPEAL FROM FRANKLIN CIRCUIT COURT
HONORABLE PHILLIP J. SHEPHERD, JUDGE
ACTION NO. 09-CI-00797

RIVERVALLEY BEHAVIORAL HEALTH — APPELLEE

NO. 2017-CA-000855-MR

RIVERVALLEY BEHAVIORAL HEALTH — CROSS-APPELLANT

v. — CROSS-APPEAL FROM FRANKLIN CIRCUIT COURT
HONORABLE PHILLIP J. SHEPHERD, JUDGE
ACTION NO. 09-CI-00797

COMMONWEALTH OF KENTUCKY,
CABINET FOR HEALTH AND FAMILY SERVICES;
AND VICKI YATES BROWN GLISSON,
SECRETARY OF CABINET FOR HEALTH
AND FAMILY SERVICES — CROSS-APPELLEES

OPINION
AFFIRMING

** ** ** ** **

BEFORE: CLAYTON, CHIEF JUDGE; COMBS AND KRAMER, JUDGES.

COMBS, JUDGE: The Commonwealth of Kentucky, Cabinet for Health and Family Services (the Cabinet), and the Cabinet Secretary appeal from a July 7, 2016, opinion and order of the Franklin Circuit Court that denied the Cabinet's motion to dismiss the proceedings and reversed the Cabinet's determination that certain Medicaid reimbursements to RiverValley Behavioral Health ("RiverValley") were adequate. RiverValley cross-appeals from the order denying it an award of interest on the reimbursements held to have been properly calculated. After our review, we affirm.

RiverValley is a not-for-profit mental health provider offering in-patient services to juveniles. It has been in operation for more than fifty years. The Cabinet's Department for Medicaid Services (hereinafter DMS) regularly reimburses mental health providers, including RiverValley, for in-patient psychiatric services for Medicaid patients. Reimbursement calculations are governed both by state and federal statutes and by administrative regulations. The Cabinet implements the governing provisions by setting reimbursement rates to qualifying Medicaid providers, updating -- or "rebasing" -- those rates periodically.

The parties were initially before this Court in 2014 pursuant to the provisions of Kentucky's Administrative Procedure Act, Kentucky Revised Statutes (KRS) Chapter 13B. In our earlier opinion, we noted the circuit court's description of the procedural history of the matter up to that point as having been protracted and unconventional. *Commonwealth, Cabinet for Health and Family Services v. RiverValley Behavioral Health*, 465 S.W.3d 460 (Ky. App. 2014). That characterization continues to be an apt assessment of the current proceedings.

At issue in the initial appeal to this Court were Medicaid reimbursements owed to RiverValley for the period of July 1, 2000, through October 14, 2007. In May 2009, RiverValley filed a petition in the Franklin Circuit Court for a writ of mandamus and a complaint pursuant to our declaratory judgment act. KRS Chapter 418. RiverValley alleged that the rates of reimbursement set by DMS for services provided were not reasonable or adequate and were not related to the actual cost of providing care as required by state and federal law. RiverValley claimed that the Cabinet's failure to calculate reimbursement rates in accordance with federal and state law constituted a breach of the parties' written agreement. It also alleged that the Cabinet had failed to adjudicate the dispute as to reimbursement rates on a timely basis. RiverValley asked the court to compel the Secretary to issue a final order so that it could

"proceed to the next step and request an administrative hearing governed by the provisions of KRS Chapter 13B . . . ."

The Cabinet argued that RiverValley had failed to complete the administrative process for proper review of its decision. However, after considering that argument, the Franklin Circuit Court determined that RiverValley had attempted to exhaust its administrative remedies -- but to no avail. Convinced that it was in the public interest to resolve RiverValley's claims expeditiously, the circuit court consulted with the parties. With their agreement, the matter was referred to mediation. The parties also agreed -- and the court so ordered -- that the mediation, if unsuccessful, would be followed by a summary administrative proceeding to be conducted in lieu of a remand for an exhaustion of administrative remedies. The circuit court appointed Hon. Roger Crittenden as mediator. The parties agreed that Judge Crittenden would also serve as the hearing officer and would make a recommended order to the Cabinet Secretary in the event that mediation was unsuccessful.

After mediation failed to resolve the dispute, Judge Crittenden conducted an administrative hearing in June 2011. The parties presented testimony and documentary evidence and made their legal arguments. Following the hearing, Judge Crittenden issued findings of fact, conclusions of law, and a recommended decision. Judge Crittenden concluded that RiverValley was entitled to receive

$9,636,000 in Medicaid reimbursements for the disputed period. DMS filed exceptions to the recommended decision, and RiverValley responded.

On November 22, 2011, the Cabinet issued a final order that rejected Judge Crittenden's recommendation and instead calculated a reimbursement to RiverValley in the amount of $3,966,165.44. This order was tendered to the Franklin Circuit Court by the Cabinet and was filed on November 23, 2011.

On December 21, 2011, RiverValley filed a motion for leave to file a proposed supplemental complaint as well as a petition for mandamus. The proferred pleading purported to assert a statutory appeal of the Cabinet's final order pursuant to the provisions of our Administrative Procedure Act (KRS Chapter 13B). Additionally, it raised a new challenge to the reimbursement rates set by DMS for 2011 (and subsequently the new rates set by DMS for 2012). RiverValley alleged that the final order failed to articulate any rationale for the Cabinet's deviation from Judge Crittenden's recommended order and that it was not supported by substantial evidence. In this pleading, RiverValley also requested the circuit court to direct the Cabinet to process its challenge to the 2011 reimbursement rate on a timely basis.

Citing to the Kentucky Supreme Court's decision in *Popplewell's Alligator Dock No. 1 v. Revenue Cabinet,* 133 S.W.3d 456 (Ky. 2004), the Cabinet objected to the filing of the proposed supplemental complaint and the petition for a

writ, contending that this procedure constituted premature judicial interference with executive branch processes. By order entered on January 3, 2012, the Franklin Circuit Court granted RiverValley's motion, and the pleading was filed. The Cabinet and Secretary answered the complaint on January 12, 2012. They asserted again that the circuit court lacked the jurisdiction necessary to adjudicate the issue.

In an order entered on February 20, 2012, the Franklin Circuit Court directed the Cabinet to pay RiverValley $3,966,165.44 by March 1, 2012. The Cabinet failed to do so -- even though the Cabinet Secretary had ruled that this amount was indisputably owed to RiverValley. After RiverValley filed a motion to show cause on March 15, 2012, the Cabinet entered a special appearance to re-assert its contention that the circuit court lacked subject matter jurisdiction. (The Cabinet filed an appeal of the court's February 20 order compelling payment, but we dismissed it as interlocutory by order entered in June 2012.). The Cabinet eventually reimbursed RiverValley the sum of $3,966,165.44.

The appeal of the Cabinet's administrative decision with respect to the reimbursement rates for 2001-2007 was submitted for the circuit court's final decision in March 2012. RiverValley contended that having heard the testimony and reviewed the documentary evidence, the hearing officer accurately determined that RiverValley should recover $9,636,000.00. RiverValley argued that it was

entitled to this sum -- plus interest. The Cabinet contended that the Secretary's final order should be affirmed, contending that the Cabinet's reimbursement methodology was consistent with state and federal law and its own administrative regulations.

In an opinion and order entered on May 31, 2013, the circuit court reversed the Cabinet's final order. The circuit court concluded that the order was not supported by substantial evidence and that the reimbursement rates set by the Secretary were arbitrary and insufficiently related to RiverValley's actual costs in violation of the provisions of KRS 205.560(2) and federal law. The circuit court found that Judge Crittenden's recommended order was supported by substantial evidence and that he had correctly applied the controlling law. Accordingly, the circuit court directed the Cabinet to pay to RiverValley $9,636,000 in total reimbursements for the time period at issue with a credit for the $3,966,165.44 that had already been paid pursuant to its earlier order. After their motion to alter, amend, or vacate was denied, the Cabinet and its Secretary filed a notice of appeal to this Court on July 12, 2013.

In our decision rendered on August 29, 2014, we held that the Cabinet clearly erred in its determination that the reimbursement rates that it set for RiverValley were "not inadequate." We observed that in addition to the requirements of KRS 205.560, federal law requires DMS to make sufficient

findings to ensure that its Medicaid reimbursement rates fall "within a range of what could be considered reasonable and adequate." We noted that neither the Secretary nor the Cabinet had made **any attempt** to explain how the methodology adopted by DMS complied with the express language of KRS 205.560 or the controlling federal statutes and regulations. Nor had the Cabinet made an attempt to explain how its methodology related to RiverValley's actual and allowable provider costs.

In light of the undisputed factual findings, the Secretary's clearly erroneous determinations of law, and the Cabinet's arbitrary and capricious behavior in the matter, we concluded that the circuit court had correctly held that the final administrative order must be set aside. Furthermore, we agreed with the circuit court that the recommended order should be adopted in full as it set out a complete and accurate statement of the facts and the applicable law in the case. The Cabinet filed a petition for discretionary review with the Kentucky Supreme Court.

While judicial review of the matter continued, RiverValley pursued (through an administrative process overseen by the circuit court) a challenge to the new reimbursement rates set by DMS for 2011 (and eventually 2012). It contended that the Cabinet's rate-setting regulations were *ultra vires* and

contended that the 2011 reimbursement rate had been revised outside the agency's regulatory time-frame.

An administrative hearing was conducted, and a recommended order was issued by the agency's hearing officer on September 25, 2014. The hearing officer concluded that he was without authority to decide whether the first disputed regulation was *ultra vires*. However, relying on our holding in *Cabinet for Health and Family Services v. Appalachian Regional Healthcare, Inc. d/b/a Harlan ARH Hospital*, No. 2010-CA-001319-MR, 2013 WL 4508205 (Ky. App. 2013), an unpublished opinion, the hearing officer concluded that the Cabinet had confessed the invalidity of the second disputed regulation. Lastly, the hearing officer concluded that the Cabinet had prematurely revised RiverValley's reimbursement rate in violation of the provisions of the third disputed regulation.

The Cabinet issued a final order on March 4, 2015. It adopted the hearing officer's recommended order only insofar as it did not invalidate the first disputed regulation as *ultra vires*. Otherwise, the Cabinet rejected the hearing officer's recommendations.

On March 20, 2015, RiverValley filed a motion for leave to file a second proposed supplemental complaint and another petition pursuant to the Administrative Procedure Act in circuit court. RiverValley sought judicial review

of the Cabinet's March 4, 2015, final order concerning the 2011 and 2012 reimbursement rate revisions.

Pursuant to the motion, the parties appeared in court on April 13, 2015. The proposed complaint and petition were ordered filed, and the Cabinet and Secretary were given twenty days to answer. In their answer, the Cabinet and Secretary contended that the appeal did not precisely conform to the requirements of KRS 13B.140. The Cabinet argued that the provisions of Kentucky's Administrative Procedure Act require a party seeking judicial review of its administrative decision to file a petition in the circuit court within 30 days of the agency's final order. It argued that RiverValley had not filed an original petition but sought instead to amend an existing petition **outside** the 30-day statutory limitation. It noted that no summons had issued or been served upon the Cabinet following the filing of RiverValley's second supplemental complaint. The Cabinet argued that judicial review of the agency's final order was not available under these circumstances because the circuit court lacked the necessary jurisdiction. The Cabinet filed a motion to dismiss the supplemental complaint.

Meanwhile, the Cabinet's petition for discretionary review of our opinion of August 29, 2014, was denied by the Supreme Court of Kentucky, and our opinion became final on August 18, 2015. The following day, the Cabinet issued a final order acknowledging the remand from the circuit court's order and

adopting Judge Crittenden's recommended decision. The Cabinet issued a check to RiverValley in the amount of $5,669,834.56. RiverValley immediately asserted its right under the provisions of KRS 360.040 to post-judgment interest on this amount. The Secretary issued a final order rejecting RiverValley's demand for post-judgment interest on the award.

On September 2, 2015, RiverValley filed a motion for leave to file a third proposed supplemental complaint and yet another KRS 13B.140(1) petition. It sought declaratory relief establishing the Cabinet's liability for post-judgment interest on the award made by the circuit court on May 30, 2012, and judicial review of the Cabinet's final order that had denied liability for it. The circuit court granted the motion, and the supplemental complaint and petition were ordered filed. In a motion to dismiss the complaint, the Cabinet argued that RiverValley had not preserved its right to judicial review of this issue by filing objections to Judge Crittenden's recommended order, had not provided for post-judgment interest. It also contended that as a state agency, it is not liable for interest.

In an order entered on July 7, 2016, the Franklin Circuit Court rejected the Cabinet's argument that RiverValley was precluded from seeking judicial review of the final order issued on August 19, 2015. It concluded that RiverValley's 2009 petition for judicial review perfected the appeal brought pursuant to our Administrative Procedure Act. It also rejected the argument that

RiverValley had failed to preserve any issues for judicial review by failing to file exceptions to Judge Crittenden's recommended decision since RiverValley **had agreed** with the provisions of that order. Next, the circuit court reversed the Cabinet's final order of March 4, 2015, concerning RiverValley's 2011 and 2012 reimbursement rates, holding that the challenged regulations were invalid and unenforceable and that the Cabinet had prematurely recalculated the reimbursement rate for 2011. Finally, the circuit court concluded that the Cabinet is **not liable** for post-judgment interest. The court remanded the matter to the Cabinet for further administrative action concerning the calculation of RiverValley's reimbursement rates -- this time without reference to the regulations declared by the court to be invalid.

The Cabinet and its Secretary filed a notice of appeal on August 4, 2016. Following disposition of its motion to alter, amend, or vacate on May 2, 2017, RiverValley filed a notice of cross-appeal.

Before we address the merits of the appeal and cross-appeal, we must first consider the parties' responses to a show cause order issued on September 5, 2018. The show cause order was issued *sua sponte* by the original panel[1] assigned to consider this appeal and was entered after the appellate briefs were filed. In the

[1] Judge C. Shea Nickell recused as presiding judge on this case on December 3, 2018, and Judge Sara Combs was subsequently appointed as his replacement.

show-cause order, we noted that the administrative record has not been certified to this Court as part of the appellate record as would be done routinely in conjunction with a review by the court of an administrative agency's decision. As a result, the material that we have from the administrative action is limited to only that which has been filed in – or otherwise placed into – the circuit court record.

In our show cause order, we questioned whether the complaint filed by RiverValley in 2009 vested the Franklin Circuit Court with jurisdiction over a declaratory judgment action under the provisions of KRS 418.040 and a KRS Chapter 13B appeal. We asked the parties to show cause why the appeal and cross-appeal should not be dismissed for lack of jurisdiction. We specifically ordered the parties to explain how and when the circuit court acquired jurisdiction of a KRS Chapter 13B appeal -- and how and when RiverValley exhausted its administrative remedies. The parties responded by filing a full complement of briefs.

We have found the Supreme Court of Kentucky's discussion of subject matter jurisdiction in *Masters v. Masters*, 415 S.W.3d 621 (Ky. 2013), to be particularly instructive. In *Masters,* the court revisited its decision in *Daugherty v. Telek,* 366 S.W.3d 463 (Ky. 2012). A summary of *Daugherty* is necessary.

In *Daugherty*, this Court concluded that a family court lost subject matter jurisdiction to enter a domestic violence order once a fourteen-day time

requirement found in the provisions of KRS 403.740(4) had elapsed. 366 S.W.3d at 465–66. Our decision was based "upon the premise that the family court's failure to follow a statutory procedure left it without subject matter jurisdiction to issue a domestic violence order." *Id.* at 466. However, the Supreme Court of Kentucky disagreed, reasoning as follows:

> [S]ubject matter jurisdiction does not mean this case but *"this kind of case."* . . . [Accordingly,] [t]he court has subject matter jurisdiction when the "kind of case" identified in the pleadings is one which the court has been empowered, by statute or constitutional provision, to adjudicate. "Once a court has acquired subject matter and personal jurisdiction, challenges to its subsequent rulings and judgment are questions incident to the exercise of jurisdiction rather than to the *existence* of jurisdiction." . . . [Thus,] while a failure to comply with KRS 403.740 would not have divested the family court of subject matter jurisdiction to enter a DVO, [Appellee] still may be afforded relief from the DVO if its entry after the expiration of the time constraints identified in KRS 403.740 was otherwise an improper exercise by the family court of its judicial power.

Id. at 466-67 (citations and footnotes omitted).

Because the family court had, by statute, been granted jurisdiction over "this kind of case," the Kentucky Supreme Court reasoned that an error with respect to the provisions of KRS 403.740 did not divest the trial court of subject matter jurisdiction. The Kentucky Supreme Court concluded that the circuit court's failure to comply with the statute simply gave the aggrieved party the

opportunity for relief based upon the court's improper exercise of its judicial power.

In its motion for leave to file a second proposed supplemental complaint and another petition pursuant to the provisions of our Administrative Procedure Act (filed in the circuit court on March 20, 2015), RiverValley sought judicial review of the Cabinet's March 4, 2015, final order concerning the 2011 and 2012 reimbursement rate revisions. Subsequently, the motion was granted and the petition was ordered filed. In its motion for leave to file a third proposed supplemental complaint and yet another petition pursuant to the provisions of our Administrative Procedure Act (filed on September 2, 2015), RiverValley sought relief to establish the Cabinet's liability for post-judgment interest on the award made by the circuit court's order of May 30, 2012, and judicial review of the Cabinet's final order that denied liability for it. The circuit court granted the motions, and the supplemental complaints and KRS 13B petitions were ordered filed "to keep all of the claims under one umbrella and avoid multiplicity of lawsuits." Meanwhile, the circuit court's resolution of the parties' initial dispute was still under review in the appellate courts.

"There is an inherent right of appeal from orders of administrative agencies where constitutional rights are involved, and section (2) of the Constitution prohibits the exercise of arbitrary power." *American Beauty Homes*

Corp. v. Louisville & Jefferson County Planning & Zoning Comm'n, 379 S.W.2d 450, 456 (Ky. 1964) (internal footnotes omitted). Given the unique procedural posture of this case, we conclude that subject matter jurisdiction vested in the Franklin Circuit Court regardless of the failure of RiverValley (when its several supplemental complaints were filed) to comply with provisions of our Administrative Procedure Act requiring a summons to issue and be served upon the Cabinet. The alleged error would potentially render the circuit court's decision only voidable, not *void ab initio*. *See Dix v. Dix,* 310 Ky. 818, 222 S.W.2d 839, 842 (1949). Consequently, the circuit court did not err by failing to dismiss the action outright.

Moreover, we are not persuaded that the failure to file an original action and to have summons issued and served resulted in any *improper exercise* of the circuit court's judicial power. We have reviewed the Administrative Procedure Act as a whole and assessed the byzantine procedural facts of this case -- including the parties' initial consent to proceed with an unusual administrative process that included an extraordinary degree of judicial oversight. In light of our analysis, we cannot conclude that the circuit court permitted a deviation in the statute so egregious as to nullify its subsequent orders. The alleged procedural deficiency was not jurisdictional, and the circuit court was vested with the authority necessary to decide the statutory appeal. Furthermore, the circuit court clearly retained

jurisdiction to consider the right to the post-judgment interest issue raised in RiverValley's third supplemental complaint. Following the appellate decisions affirming its opinion and order of May 2013 that resolved the administrative law issues, the circuit court properly exercised its jurisdiction to make a decision with respect to RiverValley's demand for post-judgment interest on its Medicaid reimbursements.

With that preliminary procedural issue resolved, we turn now to consider the substantive issues presented by the appeal and cross-appeal. First, we review the arguments of the Cabinet and its Secretary concerning the circuit court's rejection of the application of two regulations pertaining to its Medicaid reimbursement-rate calculations.

As noted above, judicial review of administrative action is concerned primarily with arbitrariness. *American Beauty Homes Corp., supra.* The scope of our review is prescribed by the provisions of KRS 13B.150(2). The statute provides that a reviewing court "shall not substitute its judgment for that of the agency as to the weight of the evidence on questions of fact." In our review, we are ordinarily limited to a determination of whether the decision of an administrative agency was supported by substantial evidence. However, with respect to issues of law, our review of administrative agency decisions is not so narrowly circumscribed. We conduct our review of decisions involving an issue of

law on a *de novo* basis. *Aubrey v. Office of the Attorney General,* 994 S.W.2d 516 (Ky. App. 1998). We are not bound by an administrative agency's interpretation of the legislation pertaining to its decisions. *Liquor Outlet, LLC v. Alcoholic Beverage Control Bd.,* 141 S.W.3d 378 (Ky. App. 2004).

The Cabinet argues that the circuit court erred by declaring that the "parity adjustment" defined by the provisions of 907 KAR[2] 10:815 section 3(2)(e) is arbitrary. It also addresses the issue of the "capital cost adjustment" discussed in the provisions of 907 KAR 10:815 section 14. The Cabinet's hearing officer had determined that provision to be invalid. The Cabinet disagreed and believed that the provision is valid and now contends that the hearing officer erred and furthermore that the circuit court erred in upholding the determination of the hearing officer rather than that of the Cabinet.

First, we address the Cabinet's decision to apply its "parity adjustment" to reduce RiverValley's rate of reimbursement. In *Northern Kentucky Mental Health-Mental Retardation Regional Board, Inc. v. Commonwealth Cabinet for Health and Family Services*, 538 S.W.3d 298 (Ky. App. 2017), *review denied* (Feb. 7, 2018), we held that the Cabinet's method of calculation which incorporated the "parity adjustment" failed to comply with the provisions of KRS 205.560(2) requiring that "[p]ayment for hospital care . . . shall be on bases which

[2] Kentucky Administrative Regulations.

relate the amount of the payment to the cost of providing the services or supplies." *Id.* at 300. We concluded that the methodology utilized in that case was not based on a calculation specifically related to similar psychiatric hospitals and that it was, therefore, arbitrary. We remanded the matter for a calculation of the hospital's Medicaid reimbursement rate that did not include the disputed "parity adjustment."

In its brief on appeal, the Cabinet acknowledges that its application of the "parity adjustment" to reduce a provider's reimbursement rate "introduced into RiverValley's rates an element related to **hospitals of another class** (the so-called "DRG" [diagnosis related group] hospitals. . . ." (Emphasis added). This introduction of "an element related to hospitals of another class" into the formula used to calculate a provider's rate of reimbursement was the precise basis upon which we rejected the application of the "parity adjustment" in *Northern Kentucky Mental Health-Mental Retardation, supra*. In that case, we addressed that provisions of 907 KAR 10:815 with respect to "In-State Freestanding Psychiatric Hospital Care" as well as "Long-term Acute Care Hospitals" and "In-State Freestanding Rehabilitation Hospital Care." The disputed administrative provision required that the reimbursements for those facilities be calculated with reference to a "parity factor equivalent." 538 S.W.3d at 300.

We concluded that that method of calculation was invalid because there was no indication that the costs of providing acute care services by non-

psychiatric hospitals in any way related to the costs incurred by psychiatric facilities. "Yet, [we noted,] both are lumped together in determining the appropriate reimbursement factor." We observed that the psychiatric hospital challenging the reimbursement rates appeared to be an efficiently operated facility; that it was offering critically needed, innovative, and successful services; and that it had been penalized by the application of a rate-reducing methodology which used clinically dissimilar acute care hospitals to calculate reimbursement rates.

Similarly, RiverValley contends that the "parity adjustment" was applied to its rates without regard to its costs, economy, efficiency, high Medicaid utilization, or its unique characteristics as a child and adolescent psychiatric hospital. Based upon our decision in *Northern Kentucky Mental Health-Mental Retardation*, we agree and hold that this methodology fails to conform to the requirements of KRS 205.560(2). Consequently, the circuit court did not err by holding that the Cabinet's application of the "parity adjustment" to RiverValley's reimbursement rate was arbitrary.

We now address the Cabinet's application of its "capital cost adjustment" to RiverValley's rate of reimbursement. The regulation promulgated by the Cabinet, 907 KAR 1:815 (recodified as 907 KAR 10:815), directs that the allowance for the depreciation of a provider's buildings and fixtures will be reduced to 65% of the actual depreciation listed on the facility's cost report. We

addressed this regulation in *Cabinet for Health and Family Services v. Regional Healthcare, Inc.*, No. 2010-CA-001319-MR, 2013 WL 4508205 (Ky. App. Aug. 23, 2013), *review denied* (June 11, 2014).

In that case, Regional Healthcare contended that the Cabinet had improperly calculated the Medicaid reimbursement rate applicable to its Harlan psychiatric "distinct part unit" by failing to use a deprecation rate of 100%. Upon review, the Harlan Circuit Court concluded that the regulation allowing only 65% of actual depreciation costs in the Cabinet's calculations was arbitrary and that it violated the provisions of KRS 205.560(2); thus, it was invalid on its face. The court remanded the matter and directed the Cabinet to include 100% of the hospital's depreciation costs attributable to the provision of services and supplies to Medicaid beneficiaries in calculating the facility's reimbursement rate.

The Cabinet appealed and tendered an appellate brief that contained an argument challenging the circuit court's conclusion concerning the capital cost adjustment. However, before we undertook review, the Cabinet filed a motion to withdraw its appeal with respect to that issue. The Cabinet explained that it had recently discovered that "applying that portion of the administrative regulation . . . which reduced depreciation costs by [sic] sixty-five percent to distinct part units ("DPU") of a hospitals [sic] costs was contrary to the Cabinet's interpretation of the regulations." It assured the panel that DMS "does not as a matter of

interpretation of its own administrative regulation reduce depreciation costs to sixty-five percent (65%) on DPUs."

We made the following observations:

> The Cabinet's reasons underpinning its motion are puzzling. The Cabinet is prohibited from modifying or limiting any of its administrative regulations through "internal policy, memorandum, or other form of action." *See* KRS 13A.130(1)(a) and (b). And its statements to the effect that it either simply interprets "65%" to mean "100%," or that it simply chooses not to apply this regulation in a context where it plainly applies, seems to fly in the face of that rule. Nevertheless, it is not the prerogative of this Court to require the Cabinet to appeal the circuit court's order on this point if the Cabinet is unwilling to do so.

We granted the Cabinet's motion to dismiss that portion of its appeal. However, we noted that the Cabinet's failure to oppose the circuit court's conclusion that this section of its regulation is invalid was a failure on the part of the Cabinet to sustain its burden of proof to demonstrate the validity of the regulation. We also noted that it was a confession that the circuit court's holding that the regulation was invalid on its face was correct.

However, in this appeal, the Cabinet contends that this regulation as to depreciation is valid for the same reason that its regulation providing for a "parity adjustment" is valid. It argues that it has reasonably and correctly construed the provisions of KRS 205.560(2) requiring that providers' Medicaid reimbursement rates be computed "on bases which relate the amount of the payment to the cost of

providing the serves or supplies" especially in light of any ambiguity which may exist in the statute and associated administrative regulation.

We note that the Cabinet has admitted to this Court that it does not uniformly apply the challenged regulation – and that it failed to defend the regulation in *Regional Healthcare, supra*. Therefore, despite some measure of skepticism as to this issue, we cannot conclude that the circuit court erred. Because the Cabinet did not articulate any basis for the reduced depreciation allowance as part of its reimbursement calculation, we are persuaded that the circuit court did not err by concluding that the regulation is arbitrary. The Cabinet simply failed to sustain its burden of proof to establish the validity of its application of the regulation.

Next, the Cabinet argues that the circuit court misinterpreted the provisions of 907 KAR 10:815 section 7(2), which provide that the Cabinet shall update a hospital's *per diem* reimbursement rate by rebasing it "every four (4) years." The Cabinet contends that the regulation does not refer to calendar years but rather to "universal rate years." "Universal rate year" is defined by the provisions of 907 KAR 10:815 section 1(24) to mean the "the twelve (12) month period under the prospective payment system, beginning July of each year, for which a payment rate is established for a hospital regardless of the hospital's fiscal year end." It argues that under this definition, the Cabinet's DMS (Department for

Medicaid Services) was not premature in its re-setting of RiverValley's *per diem* reimbursement rate[3] for 2012 on July 1, 2011.

Again, we agree with the circuit court's conclusion. We hold that the word "year" as used in the regulation has its ordinary meaning and refers to a period of 365 days. The agency used the term "universal rate year" in its regulations when it meant to refer to that specifically defined period. However, the provision at issue does not use that specific term. Consequently, the circuit court did not err in its conclusion that the plain meaning of the regulation is that "year" (otherwise unmodified and undefined) refers to a calendar year of 365 days and does not refer to a "universal rate year." The Cabinet's July 2011 decision re-basing RiverValley's reimbursement rate was indeed premature by more than 100 days.

Finally, we address RiverValley's cross-appeal. RiverValley argues that the circuit court erred by failing to award pre-judgment and post-judgment interest on its Medicaid reimbursement once Judge Crittenden concluded that the reimbursement had indeed been calculated correctly. We disagree.

In the circuit court, RiverValley argued that the Cabinet breached the parties' Medicaid Provider Agreement by failing to reimburse RiverValley for Medicaid services at rates governed by state and federal statutes and regulations. It

[3] The previous date of re-basing this rate of reimbursement was October 15, 2007.

contended that the Cabinet's sovereign immunity was waived by the provisions of KRS 45A.245(1), which authorize (with certain limitations upon recovery) anyone with a lawfully authorized, written contract with the Commonwealth to bring an action against it for breach of the contract. Finally, it contended that damages resulting from the Cabinet's breach include interest.

The Cabinet argued that the Secretary has no authority to order the DMS to pay post-judgment interest to a provider and that an award of post-judgment interest was beyond the scope of the administrative proceedings. Additionally, the Cabinet noted that there had been no finding of a breach of contract throughout the proceedings. RiverValley had argued by analogy that the courts' decisions holding the Cabinet's rate-setting methodology invalid were tantamount to findings that the Cabinet breached provisions of the parties' agreement. The Cabinet noted that these assertions were made by RiverValley **only after** the proceedings had been finally reviewed by the courts.

The circuit court rejected RiverValley's contention that the Cabinet was liable for post-judgment interest. While it agreed that the Cabinet's sovereign immunity had been waived, it observed that no court had concluded that the Cabinet breached the parties' contract. The court held only that the challenged regulations were invalid because they did not comply with the provisions of KRS 205.560 and that the Secretary's original final order was arbitrary and that it

contained improper calculations of reimbursements. There was no issue before the court as to breach of contract.

In *Commonwealth of Kentucky v. Kentucky Retirement Systems*, 396 S.W.3d 833, 838 (Ky. 2013), the Supreme Court of Kentucky held that sovereign immunity does not apply to declaratory judgment actions "[w]hen the action involves an alleged contract with the state, or the constitutionality of a statute[.]" Based upon that holding, we specifically concluded in *Commonwealth v. Samaritan Alliance., LLC*, 439 S.W.3d 757 (Ky. App. 2014), that the Cabinet's sovereign immunity had been waived where a Medicaid service provider pursued a declaratory judgment action arising under its contract with the Cabinet for Medicaid reimbursement. However, we also held that in a declaratory judgment action, the service provider was entitled to seek only a declaration of its rights under its Medicaid Provider Service Agreement with the Cabinet. We observed that this action could ultimately result in the Cabinet's being required to comply with its contractual and statutory obligation -- but that a direct recovery of contract damages was outside the scope of the Declaratory Judgment Act.

Consequently, we hold that the circuit court did not err by failing to make an award of contract damages in the form of interest to RiverValley.

The opinion and order of the Franklin Circuit Court is AFFIRMED both as to the appeal and as to the cross-appeal.

ALL CONCUR.

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