**STATE OF MINNESOTA**
**IN COURT OF APPEALS**
**A10-2099**

In the Matter of the Appeal of
Rule 36 Limited Partnership of Duluth.

**Filed August 8, 2011**
**Affirmed**
**Johnson, Chief Judge**

Department of Human Services
File No. 7-1800-20742-2

Samuel D. Orbovich, Sten-Erik Hoidal, Fredrickson & Byron, P.A., Minneapolis, Minnesota (for relator Rule 36 Limited Partnership of Duluth)

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Considered and decided by Johnson, Chief Judge; Worke, Judge; and Muehlberg, Judge.*

**U N P U B L I S H E D  O P I N I O N**

**JOHNSON**, Chief Judge

The relator in this case is a private company named Rule 36 Limited Partnership of Duluth. Relator contracted with several counties to provide intensive residential treatment services to mentally ill adults at rates that are subject to the approval of the

*Retired judge of the district court, serving as judge of the Minnesota Court of Appeals by appointment pursuant to Minn. Const. art. VI, § 10.

state government. The Department of Human Services audited and reviewed relator's 2006 expenses and demanded the return of some of the payments relator had received from counties. An administrative law judge recommended setting aside the administrative action. The commissioner of human services adopted that recommendation in part, determining that DHS had used improper criteria when auditing relator's expenses. But the commissioner also rejected the administrative law judge's recommendation in part, determining that DHS was authorized to conduct a review to assess whether relator's expenditures exceeded the projected expenditures in its approved budget. We conclude that the department was authorized by statute to review and retroactively adjust relator's entitlement to payment from the counties and that the department did not improperly conduct its review pursuant to unpromulgated rulemaking. Therefore, we affirm.

## FACTS

Before reciting the facts of this case, which are essentially undisputed, we will summarize the legal framework of the heavily regulated, government-subsidized business in which relator operates.

### A. Intensive Rehabilitative Treatment Services

In 2003, the legislature amended the statute governing the administration of adult mental-health services by creating a program for intensive rehabilitative treatment services (IRTS). 2003 Minn. Laws 1st Spec. Sess. ch. 14, art. 3, § 19, at 1898 (codified

at Minn. Stat. § 256B.0622).[1] These services, which may be provided in a residential or non-residential setting, Minn. Stat. § 256B.0622, subd. 1 (2006), are intended to be "short-term, time-limited services . . . to recipients who are in need of more restrictive settings" with the goal of "develop[ing] and enhanc[ing] psychiatric stability, personal and emotional adjustment, self-sufficiency, and skills to live in a more independent setting." *Id.*, subd. 2 (2006). To be eligible for IRTS, a person must be an adult, "eligible for medical assistance," and "diagnosed with a mental illness." *See id.*, subd. 3 (2006). The person also must demonstrate unsuccessful treatment in other venues or an incapacity to live independently. *See id.*

Minnesota counties administer the delivery of IRTS under the supervision of the Department of Human Services (DHS). *See* Minn. Stat. §§ 245.466, subd. 1 (2006), 256B.05, subd. 1 (2006), 256B.0622, subd. 4(1) (2006). Counties enter into contracts with private IRTS providers, whose rates are established by a two-step process. First, the county recommends a rate to the commissioner of human services based on the county's consideration of six factors:

> (1) the cost for similar services in the local trade area;
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> (2) actual costs incurred by entities providing the services;
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> (3) the intensity and frequency of services to be provided to each recipient;
>
> (4) the degree to which recipients will receive services other than services under this section;

[1]Relator's business name refers to a rule within the Minnesota Code of Agency Rules that previously governed the provision of similar mental-health services. The former rule 36 now may be found at Minn. R. 9520.0500-9520.0690 (2009).

> (5) the costs of other services that will be separately reimbursed; and
>
> (6) input from the local planning process authorized by the adult mental health initiative under section 245.4661 [authorizing "pilot projects to provide alternatives to or enhance coordination of the delivery of mental health services"] regarding recipients' service needs.

Minn. Stat. § 256B.0622, subd. 8(c) (2006) (quoting Minn. Stat. § 245.4661, subd. 1 (2006)). Second, the commissioner approves or rejects the county's recommended rate for services "based on the commissioner's own analysis of the" six factors. *Id.*, subd. 8(g).

DHS began implementing the new IRTS statute upon its enactment in 2003. The department determined that it needed the authority to review contracts between counties and IRTS providers retroactively and to adjust a provider's rate upward or downward if the provider's actual expenditures were inconsistent with the projected expenditures in its approved budget. DHS did not promulgate a rule authorizing this retroactive review and rate adjustment. Instead, the department required counties to include a provision in their contracts with IRTS providers that allowed the department to review and retroactively adjust a provider's approved rates. DHS sent letters to counties explaining that contracts with IRTS providers "must contain" the following provision or its equivalent:

> The program rate is based upon the approved expenditures budget . . . . The vendor's actual expenditures are subject to review by the county and the State. If it is determined that the vendor did not incur expenses consistent with the approved budget, the program rate may be adjusted retroactively to reflect actual expenditures.

**B. Relator's 2006 Expenses**

Relator provides IRTS at six facilities. In 2006, relator had IRTS contracts with five counties and one consortium of 18 counties. Five of those six contracts contain language that is identical or very similar to the above-quoted language suggested by DHS. That language is absent from the sixth contract.

In February 2007, relator provided DHS with information about its actual expenditures in 2006 for the IRTS programs at each of its six facilities. DHS conducted an audit of relator's 2006 IRTS program expenditures. The audit concluded that relator had improperly allocated expenditures in its central office to its IRTS programs and had billed counties for "unallowable costs." The audit recommended the disallowance of approximately $700,000 that counties had paid to relator pursuant to its approved 2006 budget.

In April 2009, DHS informed relator that it must repay approximately $700,000 to the counties on the ground that expenditures of that amount had been disallowed and, thus, relator had received overpayments. Relator filed an administrative appeal of that determination and requested a contested-case proceeding. Relator moved for summary disposition in March 2010 on two grounds: first, that section 256B.0622 does not grant DHS the statutory authority to review and retroactively adjust its rates and, second, that DHS violated the Minnesota Administrative Procedure Act (MAPA) by not promulgating an administrative rule concerning retroactive rate adjustments but, instead, obtaining the right to review and adjust by way of contracts between counties and IRTS providers. DHS opposed relator's motion and filed its own motion for partial summary disposition,

arguing that DHS is authorized to establish retroactive rate adjustment in contracts with counties.

In June 2010, an ALJ recommended that relator's motion be granted and DHS's motion be denied. The ALJ concluded that section 256B.0622 did not permit DHS to retroactively adjust rates for IRTS providers in 2006 after those rates were approved. Furthermore, the ALJ concluded that the "the rate-setting guidelines DHS is attempting to enforce through the contracts between the counties and providers are unpromulgated rules [under MAPA] and are entitled to no deference." Thus, the ALJ reversed the disallowance of the approximately $700,000.

DHS asked the commissioner of human services to reject the ALJ's recommendation. In November 2010, the commissioner issued an order that adopted in part and rejected in part the ALJ's recommendation. The commissioner concluded that DHS had, in auditing relator's IRTS program expenditures, used audit criteria that were not set out in any applicable statute or rule. Thus, the commissioner adopted the ALJ's recommendation with respect to the amount of expenditures that were disallowed because of DHS's improper auditing criteria.

But the commissioner rejected the ALJ's recommendation that DHS was not statutorily authorized to conduct the review of relator's expenditures and to demand the return of overpaid funds. The commissioner reasoned that five of the six contracts executed by relator and the counties for 2006 contain a provision authorizing DHS to retroactively adjust relator's contract rates to ensure that relator's actual expenditures at its IRTS facilities were consistent with the projected expenditures in its approved budget.

The commissioner determined that DHS could not review or adjust relator's rates for the sixth contract, which did not contain a provision for retroactive rate review and adjustment. Accordingly, the commissioner concluded that relator is required to return some of the payments it received on five of its contracts. Relator estimates that the commissioner's order would require it to repay approximately $185,000. Relator appeals by way of a writ of certiorari.

**D E C I S I O N**

Relator argues that the commissioner erred by determining that DHS was authorized to review and retroactively adjust relator's contract rates in 2006 and to do so without promulgating a rule. This court may reverse or modify the commissioner's decision if a petitioner's substantial rights may have been prejudiced because the decision is

> (a) in violation of constitutional provisions; or
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> (b) in excess of the statutory authority or jurisdiction of the agency; or
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> (c) made upon unlawful procedure; or
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> (d) affected by other error of law; or
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> (e) unsupported by substantial evidence in view of the entire record as submitted; or
>
> (f) arbitrary or capricious.

Minn. Stat. § 14.69 (2010). The commissioner's decision enjoys a presumption of correctness. *In re Excess Surplus Status of Blue Cross & Blue Shield of Minn.*, 624 N.W.2d 264, 278 (Minn. 2001). This court will affirm if the commissioner engaged in

"reasoned decisionmaking," even if this court would have reached a different conclusion. *White v. Minnesota Dep't of Natural Res.*, 567 N.W.2d 724, 730 (Minn. App. 1997) (quotation omitted), *review denied* (Minn. Oct. 31, 1997). When reviewing questions of law, such as the meaning of words in a statute or regulation, appellate "courts are not bound by the decision of the agency and need not defer to agency expertise." *St. Otto's Home v. Minnesota Dep't of Human Servs.*, 437 N.W.2d 35, 39-40 (Minn. 1989). Relator has the burden to establish that the commissioner improperly reached its decision. *See City of Moorhead v. Minnesota Pub. Utils. Comm'n*, 343 N.W.2d 843, 849 (Minn. 1984).

Relator challenges the commissioner's decision on three grounds. First, relator argues that DHS exceeded its statutory authority when it reviewed and retroactively adjusted relator's contract rates. Second, relator argues that DHS violated MAPA by using contracts between counties and IRTS providers to guide its review of relator's expenditures instead of promulgating an administrative rule. Third, relator argues that the commissioner's order violates principles of separation of powers.

**I.**

Relator's first challenge questions DHS's authority to review and retroactively adjust relator's contract rates to ensure that they are consistent with relator's budgeted expenditures. "Administrative agencies are creatures of statute and they have only those powers given to them by the legislature." *In re Hubbard*, 778 N.W.2d 313, 318 (Minn. 2010) (quoting *Great N. Ry. Co. v. Public Serv. Comm'n*, 284 Minn. 217, 220, 169 N.W.2d 732, 735 (1969)). An agency's statutory authority may be either express or implied. *Id.* "In determining whether an administrative agency has express statutory

authority, we analyze whether the relevant statute unambiguously grants authority for an administrative agency to act in the manner at issue." *Id.* at 320. Whether an administrative agency has acted within its statutory authority is a question of law, to which we apply a *de novo* standard of review. *In re Qwest's Wholesale Serv. Quality Standards*, 702 N.W.2d 246, 259 (Minn. 2005).

DHS is tasked with the general duty to "[a]dminister and supervise all forms of public assistance provided for by state law and other welfare activities or services." Minn. Stat. § 256.01, subd. 2(a) (2006). In furtherance of this duty, the legislature has given DHS the authority to "monitor, on an ongoing basis, the performance of county agencies in the operation and administration of human services" and "accuracy of benefit determinations." *Id.*, subd. 2(a)(2), (3). In addition, all contracts with counties for mental-health services are required to name DHS as a third-party beneficiary, to include provisions requiring "financial controls and auditing procedures," and to condition payment on compliance by the service provider with sections 245.461 to 245.486 "and all other applicable laws, rules, and standards." Minn. Stat. § 245.466, subd. 3(1), (3), (4) (2006).

More specifically, DHS is authorized to approve and review expenditures of IRTS providers and to seek return of overpayments. Before approving a recommended contract rate of an IRTS provider, the commissioner is required to consider the "actual costs incurred by entities providing [intensive rehabilitative treatment] services." Minn. Stat. § 256B.0622, subd. 8(c)(2), (g). DHS may require counties "to identify overpayments, establish claims, and utilize all available and cost-beneficial methodologies to collect and

recover these overpayments." Minn. Stat. § 256.01, subd. 2(t) (2006). Furthermore, DHS may "require county agencies to make an adjustment to the public assistance benefits issued to any individual . . . and to issue or recover benefits as appropriate." Minn. Stat. § 256.01, subd. 2(a)(4). Moreover, DHS is authorized to recover funds from a vendor of medical care who was "improperly paid" due to "erroneous or false claims, duplicate claims, claims for services not medically necessary, or claims based on false statements," as well as "vendor or department error, regardless of whether the error was intentional." Minn. Stat. § 256B.064, subd. 1c (2006); *see also* Minn. Stat. § 256B.064, subd. 1b (2006) (citing additional grounds to recover funds).

Relator contends that DHS exceeded its statutory authority because section 256B.0622 is based on a "prospective rate-setting system," which, it contends, "contains no reference to interim, conditional, or settle-up rate-setting." Relator's argument does not fairly consider the statutes discussed above. A fair reading of the entire statutory scheme leads to the conclusion that DHS is expressly authorized to review the expenditures of IRTS providers and to retroactively adjust the providers' rates to ensure that they conform to the providers' budgeted expenditures. Our caselaw demonstrates that we may review several related statutory provisions to determine whether an agency has the express authority to take a particular action. *See, e.g.*, *Hubbard*, 778 N.W.2d at 320 (reviewing three sections of chapter 103F to determine whether DNR had statutory authority to approve local government variance decisions); *In re Administrative Order Issued to Wright Cnty.*, 784 N.W.2d 398, 402 (Minn. App. 2010) (reviewing several sections of chapter 326B to determine whether DOLI had statutory authority to issue

cease-and-desist order). We interpret the above-discussed provisions of section 256B.0622 to provide that in 2006, the year for which relator provided IRTS pursuant to the above-described contracts, DHS was statutorily authorized to retroactively review and adjust the contract rates of IRTS providers to ensure that each provider's "actual costs" comport with its projected budget. *See American Family Ins. Grp. v. Schroedl*, 616 N.W.2d 273, 277 (Minn. 2000) (stating that "statute should be interpreted, whenever possible, to give effect to all of its provisions"). [2]

Thus, the commissioner did not err by concluding that DHS was authorized by statute to review and to retroactively adjust relator's contract rates.

**II.**

Relator's second challenge questions whether DHS violated MAPA by utilizing contracts between counties and IRTS providers, rather than by promulgating an administrative rule, to define the criteria governing its review of relator's 2006 expenditures.

An administrative agency may formulate policy by promulgating rules or by case-by-case determinations. *Bunge Corp. v. Commissioner of Revenue*, 305 N.W.2d 779, 785 (Minn. 1981). A rule is an "agency statement of general applicability and future effect . . . adopted to implement or make specific the law enforced or administered by that agency or to govern its organization or procedure." Minn. Stat. § 14.02, subd. 4 (2010).

[2]In 2009, the legislature amended section 256B.0622 to provide that DHS may review and retroactively adjust an IRTS provider's contract rate "[a]fter each calendar year." 2009 Minn. Laws ch. 167, § 10, at 2252-53 (enacting Minn. Stat. § 256B.0622, subd. 8a (Supp. 2009)). The 2009 amendment "does not change contracts or agreements relating to services provided before January 1, 2010." *Id.* subd. 8a(f). Thus, the 2009 amendment does not apply to this case.

A policy that is equivalent to a rule must be promulgated in accordance with the MAPA. *Cable Communications Bd. v. Nor-West Cable Communications P'ship*, 356 N.W.2d 658, 667 (Minn. 1984). On the other hand, a case-by-case determination of policy is appropriate if a policy is determined based on specific facts as applied to specific parties. *Matter of Hibbing Taconite Co.*, 431 N.W.2d 885, 894 (Minn. App. 1988). An administrative agency's formulation of a policy on case-by-case determinations does not violate MAPA's provisions on rule-making. *Bunge Corp.*, 305 N.W.2d at 785. Agencies have discretion to decide whether to promulgate a rule or to make a case-by-case determination. *Id.*

Relator contends that DHS was not permitted to use contracts in lieu of a rule in this particular situation. The contracts at issue were between relator and five counties, and they applied only to those parties. DHS required counties to enter into such contracts with other providers as well. The limited applicability of the contracts is inconsistent with rules, which have "general applicability." Minn. Stat. § 14.02, subd. 4. In addition, the contracts were in effect for only one year. DHS chose to utilize short-term contracts because certain aspects of the IRTS statute had just been implemented, and DHS wished to gain experience with the statute before promulgating administrative rules. This approach is not a violation of MAPA. An agency need not promulgate administrative rules as soon as a new statute goes into effect. "Not every principle can or should be cast *immediately* into the mold of a rule because *some principles must be adjusted to meet particular situations*." *Matter of Investigation into Intra-LATA Equal Access & Presubscription*, 532 N.W.2d 583, 590 (Minn. App. 1995) (emphasis added), *review*

*denied* (Minn. Aug. 30, 1995). Thus, the contractual provision is not a "statement of general applicability and future effect" and does not meet the statutory definition of a "rule." *See* Minn. Stat. § 14.02, subd. 4.

Relator contends that DHS was not permitted to define its review pursuant to a contract because contracts are not included in the list of exemptions from the rule-making requirement. *See* Minn. Stat. § 14.03, subd. 3 (2010). But if a policy does not fall within the statutory definition of a rule, we need not determine whether it meets one of the enumerated exceptions to the rule-making requirement. *See Stony Ridge & Carlos View Terrace Ass'n Inc. v. Alexander*, 353 N.W.2d 700, 702 (Minn. App. 1984). Moreover, our caselaw recognizes that certain types of policies are not rules under MAPA even though they are not among the listed exemptions. *See, e.g.*, *In re Leisure Hills Health Care Ctr.*, 518 N.W.2d 71, 74-75 (Minn. App. 1994) (concluding that DOH procedures for inspecting nursing homes were not rules), *review denied* (Minn. Sept. 16, 1994); *Minnesota Chamber of Commerce v. Minnesota Pollution Control Agency*, 469 N.W.2d 100, 105 (Minn. App. 1991) (concluding that MPCA requirement for site-specific water quality criteria was not rule), *review denied* (Minn. July 24, 1991).

Relator also contends that its contracts with the counties are void because they are contrary to public policy. The power of courts to declare a contract void as against public policy is "a very delicate and undefined power, and, like the power to declare a statute unconstitutional, should be exercised only in cases free from doubt." *Hollister v. Ulvi*, 199 Minn. 269, 280, 271 N.W. 493, 498-99 (1937) (quotation omitted). A court should not invalidate a contract unless it violates public policy or the court can say with certainty

that enforcement thereof would be "hurtful to the public welfare." *Perkins v. Hegg*, 212 Minn. 377, 379, 3 N.W.2d 671, 672 (1942). There is no basis to conclude that the contract provision at issue in this case violates public policy or hurts the public welfare. To the contrary, the contractual provisions in relator's contracts give DHS a means of protecting the public's interest in ensuring that public resources are not wasted by IRTS providers. Thus, relator's contracts are not void as against public policy.

Relator further contends that the particular language of the contractual provision on retroactive rate adjustment is vague, unenforceable, and ambiguous. Relator did not present this argument to the ALJ or to the commissioner. Thus, relator has not preserved the argument for appeal. *See Thiele v. Stich*, 425 N.W.2d 580, 582 (Minn. 1988).

In sum, the commissioner did not err by concluding that DHS did not violate MAPA by utilizing contracts instead of promulgating rules to provide criteria governing its review and retroactive adjustment of IRTS providers' rates.

**III.**

Relator last challenges the commissioner's order on the ground that it violates the doctrine of separation of powers. *See* Minn. Const. art. III. More specifically, relator argues that the commissioner improperly "use[d] the contested case procedures of the [M]APA to usurp and encroach the authority of Article III[3] district courts."

Relator's argument is without merit for two reasons. First, relator elected to seek review of DHS's action before an ALJ and, later, to seek further review by the

[3]Article III of the United States Constitution created the judicial branch of the federal government. Article VI of the Minnesota Constitution created the judicial branch of the government of the State of Minnesota. Article III of the Minnesota Constitution is concerned with the doctrine of separation of powers.

commissioner. Relator did not commence an action in a district court. Second, "participation in an administrative process does not indicate a separation-of-powers violation when a decision rendered in the administrative process is subject to judicial review." *Riley v. Jankowski*, 713 N.W.2d 379, 394 (Minn. App. 2006), *review denied* (Minn. July 19, 2006). Relator ultimately exercised its right to judicial review by appealing to this court from the commissioner's order by way of a petition for a writ of certiorari. Thus, the doctrine of separation of powers has not been violated.

**Affirmed.**