IN THE COURT OF APPEALS OF MARYLAND

No. 94

September Term, 1995

DEPARTMENT OF HEALTH AND MENTAL HYGIENE

v.

CHIMES, INC.

Murphy, C.J.
Eldridge
Rodowsky
Chasanow
Karwacki
Bell
Raker,
JJ.

Opinion by Murphy, C.J.
Bell, J. dissents.

Filed: August 27, 1996

The issue in this case is whether the Developmental Disabilities Administration in the Department of Health and Mental Hygiene violated the Maryland Administrative Procedure Act by instituting a cost containment measure without following "notice and comment" or emergency rulemaking procedures.

I

In 1952, the Commission on Administrative Organization of the State, appointed by Governor McKeldin, recommended adoption of the 1946 Model State Administrative Procedure Act (MSAPA) "to the end that administrative agencies may be subjected to essential controls but not unduly hampered in the performance of their functions." Seventh Report of the Commission on Administrative Organization of the State 70 (1952). That statute was designed to ensure that "certain basic principles of common sense, justice and fairness," including notice to interested parties, are applied in administrative procedures, Id., "without unduly restricting the agencies in the performance of their various tasks." Id. at 8; see also Maryland Code (1995 Repl. Vol., 1995 Supp.) § 10-201 of the State Government Article (declaration of policy); Commission to Revise the Administrative Procedure Act, Initial Report on Subtitles 2 and 4 of the APA 2 (1992). The Maryland Administrative Procedure Act (APA), adopted by Ch. 94 of the Acts of 1957 and based on the MSAPA, therefore, sought to balance the State's interest in efficient administration against the individuals' interest in fairness. Cf. Bonfield, State Administrative Rule

Making § 1.2.2 (1986 & Supp. 1993) (discussing the 1981 MSAPA); Woodland Private Study Group v. State, 109 N.J. 62, 533 A.2d 387, 393 (1987) (in determining whether the intra-agency statements exception from the New Jersey APA applies, the court focuses upon "whether the agency's interest in streamlined procedure is outweighed by the importance of the interests that are affected."); see also Emma Ah Ho v. Cobb, 62 Haw. 546, 617 P.2d 1208, 1213 (1980) (discussing the federal APA contracts exception).

The APA requires State agencies to submit proposed regulations[1] to the Attorney General for approval as to legality,

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[1] Section 10-101(g) (formerly paragraph e) of the APA defines "Regulation" as follows:

(1) "Regulation" means a statement or an amendment or repeal of a statement that:
- (i) has general application;
- (ii) has future effect;
- (iii) is adopted by a unit to:
  - 1. detail or carry out a law that the unit administers;
  - 2. govern organization of the unit;
  - 3. govern the procedure of the unit; or
  - 4. govern practice before the unit; and
- (iv) is in any form, including:
  - 1. a guideline;
  - 2. a rule;
  - 3. a standard;
  - 4. a statement of interpretation; or
  - 4. a statement of policy.

(2) "Regulation" does not include:
- (i) a statement that:
  - 1. concerns only internal management of the unit; and
  - 2. does not affect directly the rights of the public or the procedures available to the public;
- (ii) a response of the unit to a petition for adoption of a regulation under § 10-123 of this subtitle; or

§ 10-107(b) of the State Government Article, and also to the Joint Committee on Administrative, Executive, and Legislative Review (AELR Committee) for preliminary review 15 days prior to publication. § 10-110(b). The agency must publish the proposed regulation in the Maryland Register and may adopt the regulation 45 days later. § 10-111(a)(1). For 30 out of the 45 days, the agency must accept public comment on the proposed regulation. § 10-111(a)(3). The AELR Committee may delay adoption of the regulation to allow more time for review. § 10-111(a)(2)(i). The AELR Committee considers whether the regulation is in conformity with the statutory authority of the agency and the legislative intent of the statute under which the regulation is promulgated. § 10-111.1(b). If the AELR Committee votes to oppose adoption of the regulation, the agency may withdraw or modify the regulation, or submit it to the Governor for approval. § 10-111.1(c)(2). The Governor may then order the agency to withdraw, modify, or adopt the regulation. § 10-111.1(c)(3). Notice of the adoption of the regulation must be printed in the Maryland Register. § 10-114. This process is commonly known as "notice and comment" rulemaking.

The APA also provides for "Emergency Adoption" of regulations. If an agency deems it necessary, § 10-111(b)(1) allows immediate

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(iii) a declaratory ruling of the unit as to a regulation, order, or statute, under Subtitle 3 of this title.

(3) "Regulation", as used in §§ 10-110 and 10-111.1, means all or any portion of a regulation.

adoption of regulations by submitting the regulation and a fiscal impact statement to the AELR Committee. A majority of the AELR Committee or the chair or co-chair may approve the regulation. § 10-111(b)(2)(i). A public hearing must be held at the request of any member of the AELR Committee. § 10-111(b)(2)(ii). The circuit courts must declare invalid any regulation adopted in violation of these procedures. § 10-125(d).

II

The Developmental Disabilities Administration (DDA) in the Department of Health and Mental Hygiene is charged with developing a State plan to provide services to persons with developmental disabilities through "consultation, cooperation, contract, or direct operation" of facilities. Maryland Code (1994 Repl.Vol., 1995 Supp.) § 7-303 - 305 of the Health-Gen. Article. DDA may provide for community-based residential programs such as public or private group homes or alternative living units. § 7-601. The Chimes, Inc. is one of 93 private entities with which DDA contracts to provide such services.

In 1987, DDA established by regulation the "Prospective Payment System" (PPS) for reimbursement of private providers. Code of Maryland Administrative Regulations (COMAR) 10.22.17. The regulation incorporates by reference the "Prospective Payment System for Community Services to the Mentally Retarded and Developmentally Disabled Clients Procedures Manual (First Edition)" (Manual). COMAR 10.22.17.02.A. The Manual explains that the PPS

is "a system based on a fixed price per day per client." Manual at 800-3. It is intended to give providers the incentive to provide quality care efficiently and the flexibility to develop innovative programs, as well as to give accountability to providers and DDA. Id.

To be included in the PPS, a provider must operate under a grant contract for two years, giving DDA the opportunity to review the provider's costs. When a provider is accepted into the PPS, it is exempted from the State's competitive bidding requirements. Maryland Code (1995 Repl.Vol., 1995 Supp.) § 11-101(n)(2)(iii) of the State Fin. & Proc. Article.

Under the PPS, payments to providers are based on two categories of costs or "cost centers." COMAR 10.22.17.10.A. The first is the Client Assessment Sub-System, or "the costs of providing routine services to clients," COMAR 10.22.17.01.B.(25), and is not at issue in this case. The second set of cost centers is the Provider Component which includes administration, general, capital, special, and transportation costs. COMAR 10.22.17.01.B.(51). DDA bases reimbursement rates upon reports submitted by the providers. COMAR 10.22.17.06. DDA eliminates costs that are not reimbursable, such as advertising and lobbying expenses, COMAR 10.22.17.13, and adjusts the reimbursement rate for inflation and attendance rates. Manual at 800-9.

Sections 7-205 and 7-234(a) of the State Finance & Procurement Article prohibit State agencies from spending money in excess of

budget appropriations. The DDA regulation, accordingly, establishes that the PPS "is subject to the budget appropriations approved by the Legislature." COMAR 10.22.17.02.E. The regulation further provides:

> The Department may take cost containment measures to control total expenditures on the prospective payment system. These cost containment measures may include, but are not limited to:
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> (1) Sharing in any surplus on prospective payments less actual cost;
>
> (2) Establishing limits on the percentage of the prospective payment rate for any cost center.

COMAR 10.22.17.08.A. In addition, the Manual provides that "[o]ther cost containment measures for budgetary control may also be necessary." Manual at 800-8. The regulation and the Manual were incorporated into the "Provider Agreement" between DDA and Chimes in paragraph IA in which Chimes agreed to comply with the applicable statutes and regulations, as well as "transmittals and guidelines issued by the Department."

To stay within budget appropriations, DDA has instituted numerous cost containment measures over the years. In fiscal year (FY) 1990, DDA set a ceiling for certain cost centers at one standard deviation above the average cost for all providers. DDA cut the annual inflation rate from 6% to 2.5% in FY 1991 and again to 0% in FY 1993. In FY 1992, DDA froze the hourly rates in the Client Assessment Subsystem. In FY 1993, the ceiling rate was calculated using a weighted average and was cut to .75 standard deviations above the mean. Beginning in FY 1993, DDA cut $37 per

client per month from each provider's rate for 21 consecutive months. Providers were notified of these cost containment measures by memoranda from DDA. Although the agency did not follow APA "notice and comment" or emergency rulemaking procedures in instituting these cost containments, no provider challenged any of these actions prior to this case.

In August 1993, DDA met with members of the Maryland Association of Community Services to discuss reimbursement rates for FY 1994. DDA subsequently notified providers in individually-addressed memoranda that it was taking several steps to control costs. At issue here is DDA's limitation on the growth in the administration, general, capital, and transportation cost centers to 7% for providers whose costs were below the mean and 4% for providers whose costs were above the mean. In FY 1994, DDA applied the "growth cap," calculating averages for each cost center separately. In FY 1995, DDA again imposed the "growth cap," using an aggregate of four cost centers to determine whether providers were above or below the mean. As a result of this action, Chimes' reimbursement rate was cut.[2]

Chimes initially appealed imposition of the "growth cap" to the PPS Appeal Board, which is empowered to hold evidentiary or oral hearings on the calculation of the reimbursement rate, the

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[2] Beginning in FY 1996, DDA voluntarily followed APA procedures in imposing the "growth cap." See Notice of Emergency Action, 22 Md. Reg. 1654 (1995).

final reimbursement amount, and other disputes between providers and DDA. Manual at 700-3, 7. The PPS Appeal Board delegated its authority to the Office of Administrative Hearings (OAH). The parties filed cross motions for summary decision. The Administrative Law Judge (ALJ), ruled in favor of DDA. OAH, the ALJ held, "may rule on whether a statute or regulation was appropriately applied by the agency, but has no authorization to determine the validity of the regulation itself," and was, thus, without jurisdiction in this case.

Chimes then filed a Complaint for Declaratory Judgment in the Circuit Court for Baltimore County claiming that DDA's adoption of the 4%/7% "growth cap" violated the rulemaking procedures required under the Maryland APA. Both parties filed motions for summary judgment. Following a hearing, the circuit court held, on January 25, 1995, that the "growth cap" was a regulation under the APA and was not within the "internal management" exception of § 10-101(g)(2)(i) of the APA. The court also rejected DDA's contention that the existing regulation (COMAR 10.22.17.08.A) grants DDA the authority to implement cost containment measures without following APA rulemaking procedures. It declared the "growth cap" invalid and later granted supplemental relief in the amount of $941,788 for FY 1994 and a similar amount for FY 1995, to be determined at the end of the fiscal year. DDA appealed to the Court of Special Appeals. Before arguments in that court, we granted a Writ of Certiorari.

III

DDA argues that "[j]ust as an agency must have the discretion to decide whether to proceed by rulemaking or case-by-case adjudication, it must also possess the flexibility in applying existing regulations to respond to the myriad situations that it routinely confronts in the pursuit of its regulatory mission." Specifically, it says that the question presented is whether it must undergo "the rigorous and time-consuming requirements of the rulemaking process each time it seeks to implement existing regulations that authorize the State to take cost containment measures to stay within its budgetary appropriation in administering a government program through private contractors." It further says that the State's right to limit the amount that contractors may be reimbursed for their overhead costs does not constitute a quasi-legislative judgment giving rise to a new rule, but rather amounts to no more than the specific application of the core authority that underlies the entire PPS. In this regard, DDA explains that its action effected no change in existing law but merely applied a regulation that notified all participants in the PPS that the State has the right to impose the same cost containment measure that was implemented in this case. According to DDA, requiring that it amend its regulation each time it must account for unpredictable contingencies constitutes an unnecessary and costly burden on the State at the expense of proper efficient and effective government. Thus, DDA maintains that it was

authorized to impose cost containment measures without following APA rulemaking procedures.

In Consumer Protection v. Consumer Pub., 304 Md. 731, 501 A.2d 48 (1985), the Maryland Attorney General proceeded by adjudication against a company which sold diet pills through the mail, alleging that its advertising was false and misleading in violation of the Maryland Consumer Protection Act. Id. at 737. The company claimed that since the same advertising practices were used industry wide, the rule would apply to many companies, and the Attorney General should have proceeded by rulemaking as required by the APA. Id. at 753. We held that the Attorney General was not required to proceed by rulemaking because he "did not change existing law or even formulate rules of widespread application." Id. at 756.

We again declined to require formal rulemaking procedures in Balto. Gas & Elec. v. Public Serv. Comm'n, 305 Md. 145, 501 A.2d 1307 (1986). The Public Service Commission, when determining whether a utility is entitled to a fuel rate adjustment, is authorized by statute to consider whether the utility's plants operate at a "reasonable level." Id. at 152. The Commission partially denied BG&E's requests for fuel rate adjustments to recover the costs of purchasing supplemental power during forced outages at BG&E's plants. The Commission determined that the outages were partially due to "managerial imprudence" and, thus, the plants were not operating at a "reasonable level." Id. at 153-55. We held that the Commission was not required to proceed by

rulemaking because the Commission had not applied "materially modified or new standards ... retroactively to the detriment of a company that had relied upon the Commission's past pronouncements." Id. at 169.

The only time we have mandated that an agency proceed by rulemaking was in CBS v. Comptroller, 319 Md. 687, 692-93, 575 A.2d 324 (1990). In that case, the Comptroller used a new method of calculating Maryland's share of CBS's advertising receipts. Id. at 690. We held:

> The effect of the Comptroller's audit was to announce a substantially new generally applicable policy with respect to apportionment of the network advertising income of national broadcasting corporations. That change, for practical purposes, amounted to a change in a generally applicable rule. Unlike the agency action in Consumer Protection, it *was* an effective "change [in] existing law" and *did* "formulate rules of widespread application." Unlike the agency action in Baltimore Gas & Elec. it *was* "a case ... in which materially modified or new standards were applied retroactively to the detriment of a company that had relied upon the [agency's] past pronouncements.

Id. at 699.

IV

In this case, DDA did not formulate new rules of widespread application, change existing law, or apply new standards retroactively to the detriment of an entity that had relied upon the agency's past pronouncements. The "growth cap" at issue here applied only to a limited number of providers in their capacity as contractors with a state agency pursuant to contracts between the

parties subject to termination by either side. Furthermore, the "growth cap" applied only in a particular program, in a particular year, and in response to a particular budget crisis. Thus, the "growth cap" was not a rule of widespread application.

The "growth cap" did not, as we said, change existing law. Both the statute and regulation limited DDA's expenditures to budget appropriations and the regulation and Manual provided for cost containment. The regulation specifically contemplated the need for "establishing limits on the percentage of the prospective payment rate for any cost center." COMAR 10.22.17.08.A. The "growth cap" merely effectuated these policies, but did not change the law. Cf. Radiological Soc. v. New Jersey State Dept., 208 N.J.Super 548, 506 A.2d 755, 760 (1986) (policy statement need not be promulgated as regulation where it "was simply a re-affirmation of the certificate of need requirements already enunciated in existing regulations... and does not constitute a material and significant change from a clear, past agency position."); Bendix Forest Etc. v. Div. of Occup. S. & H., 158 Cal.Rptr. 882, 600 P.2d 1339, 1344 (1979) (state agency did not engage in rulemaking when it required an employer to provide gloves for employees, but merely implemented a regulation that provided "[h]and protection may be required for employees....").

Finally, the "growth cap" did not apply new standards retroactively to the detriment of an entity that relied on prior agency pronouncements. The "growth cap" did not apply

retroactively, but was instituted to control costs in the current fiscal year. The regulation and the Manual notified the providers that reimbursement was limited by budget appropriations and DDA had instituted numerous cost containment measures previously. In addition, DDA notified the providers that it needed to implement additional measures in FY 1994 and afforded them the opportunity to discuss various options for controlling costs.

Chimes' interest in fairness was substantially honored, despite the lack of APA procedures. On the other hand, DDA had a strong interest in adopting a cost containment policy as quickly as possible. DDA's FY 1996 adoption of the "growth cap" as a regulation through emergency adoption procedures took months to complete. Such a time lag is a huge burden on an agency administering a complex program such as the Prospective Payment System. As Judge Eldridge said for the Court in Judy v. Schaefer, "flexibility is needed in the administration of the budget in order for the State to run efficiently and to avoid deficits." 331 Md. 239, 261, 627 A.2d 1039 (1993) (upholding statute authorizing Governor to reduce budget appropriations by up to 25%).

We hold, therefore, that following the standards enunciated in CBS, Balto. Gas & Elec., and Consumer Protection, the "growth cap" was not a "regulation" in the sense contemplated by the APA and need not have been promulgated according to APA rulemaking procedures. See also Dep't v. Lions Manor Nursing Home, 281 Md. 425, 430 (1977) (nursing home vendor payment schedule was valid as

a contract amendment regardless of its status under the APA).

JUDGMENT REVERSED; COSTS

TO BE PAID BY APPELLEE