ORIGINAL

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PROCEEDINGS BEFORE

THE SUPREME COURT
OF THE
UNITED STATES

CAPTION: OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, Petitioner V. GEORGETOWN UNIVERSITY HOSPITAL, ET AL.

CASE NO: 87-1097

PLACE: WASHINGTON, D.C.

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IN THE SUPREME COURT OF THE UNITED STATES

OTIS R. BOWEN, SECRETARY OF :
HEALTH AND HUMAN SERVICES :
Petitioner :
v. : No. 87-1097
GEORGETOWN UNIVERSITY HOSPITAL :
ET AL. :

Washington, D.C.

Tuesday, October 11, 1988

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 10:02 o'clock a.m.

APPEARANCES:

RICHARD J. LAZARUS, ESQ., Assistant to the Solicitor General, Department of Justice, Washington, D.C.; on behalf of the Petitioner.

RONALD N. SUTTER, ESQ., Powers, Pyles & Sutter, Washington, D.C.; on behalf of the Respondents.

C O N T E N T S

P R O C E E D I N G S

(10:02 a.m.)

CHIEF JUSTICE REHNQUIST: We will hear argument first this morning in No. 87-1097, Otis R. Bowen v. Georgetown University Hospital.

Mr. Lazarus, you may proceed whenever you are ready.

ORAL ARGUMENT OF RICHARD J. LAZARUS

ON BEHALF OF THE PETITIONER

MR. LAZARUS: Thank you, Mr. Chief Justice, and may it please the Court:

This case concerns the authority of a Federal agency to promulgate a retroactive rule. Our position can be simply stated. A retroactive rule is generally valid unless the agency's decision to impose the rule retroactively is arbitrary and capricious.

Unlike the D.C. Circuit, we do not believe that the Administrative Procedure Act bars virtually all retroactive rules regardless of their reasonableness, nor do we believe that the Medicare Act prohibits all retroactive cost limit rules in every circumstance.

Instead, in our view, retroactive cost limit rules are valid in two different ways under the Medicare Act, each sufficient by itself to support the rule struck down by the lower court.

QUESTION: Mr. Lazarus, I guess if we were to find that the Medicare Act itself prohibits retroactive rulemaking in this instance we wouldn't have to go on and reach the APA question, would we?

MR. LAZARUS: Technically the Court would not have to. We would urge the Court to address both questions.

The Administrative Procedure Act issue is by far the more important issue decided by the lower court. The D.C. Circuit is the most important circuit for administrative law questions, and it was decided by that court, and there's no reason why the Court logically has to address one rather than the other.

So the Court technically does not have to, but we would urge the Court to, and for the reasons in our brief, present, we don't absolutely think the Medicare Act itself does prohibit such rules.

The retroactive rule challenged in this case --

QUESTION: But still, the answer to Justice O'Connor's question is in the affirmative.

MR. LAZARUS: Yes. The Court does not have to, we would urge the Court.

The retroactive rule challenged in this case finds its genesis in the 1981 determination of the Secretary to make a wholly prospective change in the

Medicare Act cost limit rules.

At the time relevant to this litigation, the Medicare Act allowed for reimbursement of providers of health services for the reasonable costs of their services to Medicare beneficiaries.

To that end, the Act authorized the Secretary to promulgate cost limit rules based on the estimates of the costs necessary for the efficient delivery of health services.

In 1981, the Secretary determined that his then-existing rule regarding wage costs promulgated in 1979 required adjustment. The database upon which that rule was based did not accurately reflect differences in wage costs in different parts of the country.

As a result the rule unfairly disadvantaged certain providers in certain geographic areas. Those providers were receiving inadequate reimbursement under the Medicare Act while other providers were receiving excessive reimbursement.

Because the Secretary considered the modifications necessary in the database to be of a minor technical nature, he published the final revised rule without first providing for public notice and comment.

Respondents filed suit, and in 1983 a Federal district court invalidated the 1981 rule on procedural

grounds.

QUESTION: Mr. Lazarus, before you go further with the facts, I presume that the Secretary could have amended the rule in such a fashion as to eliminate the unfair disadvantage without eliminating what he regarded as the unfair advantage, in which case there would have been nobody to challenge the retroactive rule.

MR. LAZARUS: The Secretary could have approached it all kinds of different ways. The question is --

QUESTION: Well, I mean, you mentioned that it unfairly disadvantaged some people and unfairly advantaged others.

All we're really fighting about here are the people that you assert it unfairly advantaged, because you could have taken care of the people that it unfairly disadvantaged.

MR. LAZARUS: Well, not actually, I think, under the way that the respondents would see the case. They would suggest that any kind of retroactivity, and if the Secretary is without authority to make any kind of retroactive changes they would have been, in other words confined to the 1979 rule, the Secretary should have assigned recoupment from the others.

QUESTION: But the Secretary could have issued

the rule eliminating the unfair disadvantage, not the unfair advantage, and there would have been no one to challenge it.

MR. LAZARUS: No, it was the same rule.

QUESTION: I understand it. But the Secretary could have split it in two and said --

MR. LAZARUS: What, provided two different rules for two different -- the Secretary is certainly within his discretion to announce one rule applying to the entire --

QUESTION: My point is that we don't have to find for you, in order to enable the unfair disadvantaged to be eliminated. All we're fighting about here is the unfair advantage.

MR. LAZARUS: Well, I think we're actually fighting about, about both, particularly to the extent that we're dealing with the broader questions of the Secretary's authority in the future to promulgate retroactive rules.

If the Secretary in the future decides that he is incapable of promulgating a retroactive rule, then other providers in this case who relied justifiably on the 1979 rule would, I think, not have redress, and instead the Secretary would have had to seek recoupment against them.

QUESTION: The Secretary can do all sorts of things, so long as it doesn't hurt anybody.

MR. LAZARUS: Right. And the question still remains whether or not it's within the Secretary's discretion, I will grant you, to decide to treat them all alike, under one rule.

The District Court invalidated the rule concluding, the 1981 rule, that the APA required prior notice and comment. The District Court, however, specifically declined respondents' request that it order the Secretary to reimburse them pursuant to the 1979 prior rule. The court instead remanded the matter to the Secretary for further proceedings.

On remand, following a period of notice and comment, the Secretary promulgated a new rule in 1984 that was identical in substance to the 1981 rule.

QUESTION: But Mr. Lazarus, didn't they also reimburse them under the 1979 rule?

MR. LAZARUS: He did reimburse them under the 1979 rule as a matter of administrative grace. But in doing so he made it clear that that determination was subject to reopening, if he subsequently decided that the appropriate cost limit rule was one that excluded Federal wage data.

QUESTION: But did he reopen the -- did he

recoup the money that he paid pursuant to the 1979 rule?

MR. LAZARUS: I think he has. In fiscal intermediary's bid (inaudible), subsequently --

QUESTION: Oh, I thought it was for later years. I see. But all, in other words the result is just the same as if the original rule had been upheld?

MR. LAZARUS: A copy of the letter showing our qualification is included, appended to our reply brief, showing that we explicitly at the time they were reimbursed pursuant to the 1979 rule it was made explicit that if the Secretary subsequently determined --

QUESTION: And that particular reimbursement was then recouped?

MR. LAZARUS: That's right. That's my understanding.

QUESTION: Well, I wonder why they even reimbursed him.

MR. LAZARUS: I think it's a matter of administrative grace to get things going. But it was not --

QUESTION: As a matter of administrative grace, just lend them the money, in effect.

MR. LAZARUS: Well it wasn't, it was basically to keep the program moving.

On remand, the same rule, the 1984 rule, is identical in substance to the '81 rule. But it had an effective date when it came out in '84, more than 30 days after the date of promulgation, and it applies to cost reporting periods beginning in July 1981 and ending in October 1982, the time at which superseding statutory regulatory schemes became effective.

Respondents were among the few providers to receive less reimbursement under the retroactive rule, brought suit arguing that it was invalid because of its retroactivity.

The District Court agreed, narrowly concluding that the statutory interest served by retroactivity did not warrant the imposition of the burdens imposed on respondents by a retroactive rule.

The D.C. Circuit affirmed, but did not so narrowly grant its decision. That court instead concluded that the Administrative Procedure Act bars virtually all retroactive rules by defining them in terms of their future effect.

The court also concluded that retroactive cost limit rules were not within the Secretary's general rulemaking authority under the Medicare Act, nor the court found were such rules within the Secretary's authority under the retroactive corrective adjustment

provisions of that Act, known as Clause (ii).

We believe the decision of the Court of Appeals, its judgment, should be reversed for two independent reasons.

First, because the 1984 rule is a valid exercise of the Secretary's general rulemaking authority under the Medicare Act, and second, because it is valid exercise for the Secretary's authority under Clause (ii), which provides and authorizes the Secretary to promulgate regulations for the making of retroactive corrective adjustments.

The most important and the most sweeping aspect of the Court of Appeals decision is also that part which we believe is most clearly wrong. The Administrative Procedure Act does not bar all retroactive rules.

The language upon which the Court of Appeals relies which defines a rule in terms of its future effect does not speak to the retroactivity issue at all.

That language simply refers to when a rule applies, not to what transactions, whether past or present, applies. In other words, a rule is a statement of law that is not applied in the same proceeding in which it is announced. It applies in a future

proceeding, for example in an adjudication.

As said in our brief --

QUESTION: Mr. Lazarus, when the government quotes Section 551 in its brief it unfortunately makes something of an ellipsis. It just quotes the first portion of, of Section 551(4).

It leaves out the part which says, "and includes the approval or prescription, not in the future, but for the future, the approval or prescription for the future of rates, wages," and then it goes on to say, "costs or accounting or practices bearing on any of the foregoing," which seems to me exactly what we have here.

It uses the phrase there "for the future." You make a lot in your brief of the fact that it says, in the future, in the first part. It does indeed. But the second part of 551(4) says quite clearly, for the future, prescription for the future.

How does that affect your case?

MR. LAZARUS: I think it doesn't affect our case. That language in the second part, to the extent that it's anything different, was added pursuant to some testimony about ICC proceedings.

There was a question about whether certain ICC ratemaking proceedings would constitute a rule or not.

And because there was not unanimity on that question, that particular language was added.

And I think more importantly, if you look at the House report --

QUESTION: I don't understand the point of that comment. It only applies to ICC proceedings? Is that --

MR. LAZARUS: No. But let me get to the -- that was just basically the origin of that language, which was dealing with a discreet problem.

But apart from that, the most, I think, pertinent thing, if you look at the House report where they added the terms, future effect, the House report specifically states that it was, we think, not intended to bar the kind of rule at issue here.

And the words they use in describing future effect I think equate future effect in a way which both shows that it wasn't intended to bar retroactive rules and shows that the language "for the future" doesn't mean anything different.

In the House report, it's on footnote 1, I think it's cited in our brief. But let me just read you the pertinent language. It says, "the phrase 'future effect' does not preclude agency's from considering," and that's a separate question, "and so far as legally

authorized from dealing with past transactions in prescribing rules for the future."

QUESTION: But dealing with past transactions in prescribing rules for the future, that may mean from now on you will treat past transactions in this fashion. But up to now you have to have treated them the way they've been treated.

MR. LAZARUS: We think the better reading, though --

QUESTION: Well, I'm sure you do, but I don't --

MR. LAZARUS: And I think there are other factors in the legislative history.

The fact that Congress considered bills which would have explicitly barred retroactive rules and decided not to include that language, and we have the excerpt during the legislative hearings showing that being discussed, and showing a distinction being drawn between effectiveness and retroactivity and a notion that there was a problem with barring retroactive rules, particularly a problem because of the curative nature of the rules.

One could read these things, as obviously respondents do, differently. We think the better reading, and certainly a reasonable reading, is that,

and it's really unreasonable, we believe, to assume to the contrary.

Retroactive rules were a traditional aspect of administrative practice, rare, but appropriate in discreet circumstances, before the APA was enacted, and they have been ever since.

No court until the D.C. Circuit has ever suggested that the words "future effect" has --

QUESTION: Well, has any court ever suggested that "future effect" means what you say it means?

MR. LAZARUS: No court -- well, actually the District Court in the Southern District of Ohio. But I think there's no, it's not been litigated a lot.

There is some language, however, in Justice Harlan's opinion in Wyman-Gordon where he, I think, adopts precisely our view of it. Now, there was a dissenting opinion but it was not a matter which was being disputed with the majority at all. On that part of the case I think he was in virtual agreement.

He draws both the distinctions that we're drawing, both future effect referring to future effectiveness and a rule being something that is applied in a different proceeding in which --

QUESTION: Well, aren't the words completely redundant under your view? Won't every -- every rule

will have future effect, couldn't avoid it.

MR. LAZARUS: But that's the purpose of the definition provision in the APA. It wasn't designed to prohibit certain kinds of rules. It was designed to describe generally what rules are.

So there's nothing illogical or anomalous about the notion that most, that rules generally have future effect. The provision just wasn't intended to say, certain kinds of rules are fine, certain kinds of rules aren't fine.

It was designed to generally describe what a rule is, to codify and confirm what had been administrative practice. When the words, Justice Scalia, "future effect" were added in the House, when it was proposed over in the Senate, the Senate didn't consider it to have made any kind of significant substantive change.

QUESTION: If that's what future effect means, that is it has some effect in the future though it also has effect in the past, how do you distinguish a rule from an adjudication?

Doesn't an adjudication have a future effect? Isn't an agency under, under our decisions disabled from going back on prior adjudications unreasonably? Isn't that arbitrary or capricious action?

Doesn't in that sense an adjudication have a future effect? So, it has a future effect and it has a past effect. You tell us rules are the same. They have some future effect, but they also have past effect.

MR. LAZARUS: Well they only -- they have, they have an ongoing future effect in terms of effectiveness, while adjudication is different.

But I think it's more important to realize that there are many different ways, as this Court has realized, to distinguish rulemaking adjudication, each one has its exceptions. There is no real bright line rule.

But I think that the most significant one, and the one that is relevant for this case is the notion that a rule is not applied in the same proceeding which is then announced, while an adjudication is. And that's the handle which Justice Harlan also focused on in Wyman-Gordon.

As set out more fully in our brief, both the language, both the structure and legislative history support our view. There are two places in the legislative history that we believe discuss directly the retroactivity issue, both the House report and the Attorney General's Manual on Administrative Procedure, each of which we believe is consistent with our view.

The Attorney General's Manual on page 37.

QUESTION: Well, Mr. Lazarus, it seems that you're arguing that the APA allows retroactive rulemaking any time it isn't, in your view, arbitrary and capricious.

MR. LAZARUS: That's right. And it certainly --

QUESTION: Well, that just seems to make retroactive rulemaking totally available.

MR. LAZARUS: Well no, we don't think it will be totally available. In fact, as we've seen, no court has before held it was barred, and they are rare.

It's rarely done, because on fairness, which is typically associated with retroactive rules, makes the arbitrary and capricious standard a very significant hurdle for the Secretary to overcome.

And all we're asking in this case is an opportunity to show the Court of Appeals that this rule is not arbitrary and capricious.

QUESTION: Well, the facts of this case don't lend themselves readily to supporting the rule, even under your view. Do they?

MR. LAZARUS: Well, we think that --

QUESTION: I mean, to avoid the effect of failing to, to apply with the APA in the first

instance?

MR. LAZARUS: No, we think that this is a very good case for the arbitrary and capricious standard, because the respondents incurred all of their costs prior to the time at which the 1981 was first invalidated on procedural grounds.

Therefore, the rule that they had to rely on was the '81 rule. In fact, if the Secretary had not promulgated a retroactive rule, it would have had many of the same problems of unfairness, because all those other providers who relied on the 1981 rule, to their advantage --

QUESTION: Well, Congress could have done it. Congress could have pulled his coal out of the fire, if, if that was a problem.

And in that -- you make a lot in your brief about, well, it's so necessary, just as it's necessary for Congress to legislate retroactively now and then. But if Congress can't legislate retroactively there's no remedy.

There is a remedy here. If the Secretary can't issue a retroactive rule he can go to Congress and say, enact a retroactive statute, can't he?

MR. LAZARUS: That's true.

QUESTION: So the situation is quite different

from the legislative situation.

MR. LAZARUS: But we believe that Congress, when it delegates general rulemaking authority to an agency, it includes the authority in discreet circumstances to deal with, to impose retroactive rules, knowing that the kinds of concerns that one has with retroactivity can be addressed through the arbitrary and capricious review.

In the general rulemaking provision of the Medicare Act, Congress gave the Secretary full power to promulgate rules. We think that it's essentially full legislative power, which would include in certain very discreet circumstances retroactive rules.

We're not saying that all retroactive rules are valid. We're not saying that all retroactive cost limit rules are valid. All we're asking for is an opportunity to show that in this case the types of unfairness concerns are not really implicated, and that this rule is for that reason not arbitrary and capricious.

Respondents notably do not rely heavily on the Court of Appeals' construction of the Administrative Procedure Act, but instead rely principally on the argument that the Medicare Act, wholly apart from the Administrative Procedure Act, bars retroactive cost

limit rules.

The problem with their analysis is twofold. First, we don't believe that anything in the language of the statute states that cost limit rules must be prospective, and second, the legislative history upon which they rely does not speak to the type of retroactive rule at issue in this case, which is merely curative in nature.

The statutory language, which is in Section 1395x(v)(1)(A), reproduced on pages 2 and 3 of our brief, does not have any kind of a hint of a prospectivity requirement.

It states broadly that the Secretary may promulgate cost limit rules based on estimates of the costs necessary in the efficient delivery of health services. The language is straightforward, it's unambiguous, and there's no prospectivity requirement.

Respondents' only meaningful answer to the statutory language are statements in the legislative history that say that cost limit rules would operate prospectively.

In our view, those statements reflect Congress' understanding that cost limit rules generally in practice would operate prospectively, which is in fact what they do in practice.

But we think those statements fall far short of suggesting that Congress decided and considered the possibility of retroactive rules being appropriate in certain confined circumstances.

Indeed, the very reasons that Congress gives for generally favoring prospective rules we believe are the reasons it is most unlikely that Congress intended to bar all retroactive rules.

Congress was concerned about providers incurring costs before they knew the substance of the cost limit rule. In this case respondents incurred all of their costs before the 1981 rule was invalidated.

In fact, as I mentioned earlier, for this reason if the Secretary had not promulgated a retroactive rule, the very concerns expressed by Congress would have been realized, because other providers relied to their advantage on the substance of the 1981 rule in incurring their costs.

This is not a rule that the Secretary promulgated to, despite its unfairness. The retroactive rule was promulgated in order to avoid unfairness. More hospitals benefit from the retroactive rule than are burdened.

In over 234 areas the wage indices went up. In 67 areas the wage indices went down. The Federal

government may end up paying more money out under the retroactive rule than they would have under a prospective rule.

The government is not -- in other words, this is not a case where we're just trying to promulgate a retroactive rule to save the Federal face. It's a case where the retroactive rule is justified for two other compelling reasons.

One, to ensure adequate reimbursement for other providers who were receiving too little reimbursement under the Medicare Act, and second, to prevent a windfall by a few providers who were seeking to recover reimbursement for inefficient costs at the expense of other providers.

QUESTION: Mr. Lazarus, does the record tell us what you're telling us about the fact the rule actually caused the government to give more money away?

MR. LAZARUS: No. I said it's theoretically possible.

QUESTION: Oh, it's theoretically possible.

MR. LAZARUS: We don't, we don't, we don't have --

MR. LAZARUS: Kind of an unusual, somewhat inconsistent with the normal practice.

MR. LAZARUS: But it is in that it was 234

areas that wage indices went up. And if you look at the administrative record, I think six hospitals out of eight total commented in favor of excluding the Federal wage data in this, in this rule.

QUESTION: There's no question that under the, under the provision of, of the subject legislation, the Secretary could have recomputed for each of those individual hospitals the charges and found that the regulations didn't provide a fair return in this situation. There's no doubt he could have done that.

MR. LAZARUS: It's within the Secretary's discretion.

QUESTION: Both sides acknowledge that.

MR. LAZARUS: That's right. The question is whether, how much further the Secretary can go, whether the Secretary can approach these things in what we believe is an efficient manner, and that is in a systemic basis correcting the rule itself, rather than being forced to go through numerous and we believe duplicative and wasteful case by case review.

If there are no further questions --

QUESTION: Are you going to address the point of what regulation takes over, if the agency cannot issue a new one retroactively?

MR. LAZARUS: Our dispute with the Court of

Appeals on that, on that question is the following.

The Court of Appeals has stated that the invalidation of the 1981 rule necessarily had the effect of reinstating the 1979 rule, so as to preclude the Secretary from on remand promulgating a new rule.

We believe that as a general rule a court's authority to issue a remedy is confined to the nature of the agency's error.

Now that may have the result, Justice Scalia, that may have the result of leaving the only valid agency action remaining to be a prior agency rule. But that does not preclude the agency on remand from determining in the first instance what law should apply, perhaps by subsequently promulgating a retroactive rule, perhaps by immediately promulgating on an interim basis a rule.

QUESTION: Well, leaving aside your retroactive argument, which just gets us back into the main problem, I had always thought that a rule could only be amended by a rule. You can't change a rule by an adjudication.

And if you haven't amended the rule by another valid rule, it isn't a matter of reinstating the prior regulation. The prior regulation subsists*. Isn't that simply the state of the law?

MR. LAZARUS: But the question is whether it has the effect of them precluding the agency ultimately on remand from deciding what rule of law should apply.

And this court's decision, Burlington Northern, made quite clear that the court could not ultimately decide what law should apply as of the future.

But the court's decision may have the effect of leaving the only valid agency action remaining to be some prior agency decision. But it doesn't preclude the agency ultimately from deciding what the law should be.

And it's that aspect --

QUESTION: Although the agency can only decide one thing, it may be.

MR. LAZARUS: Well, that's where, of course, we disagree. We think the agency can decide --

QUESTION: Does this argument of yours hinge upon your retroactivity argument? If we reject your retroactivity argument then can we safely assume that the prior rule was the rule that had to be applied?

MR. LAZARUS: Again, it would depend on the nature -- in some instances, for instance, the court's decision would only suggest that the substance of the new rule was valid, and it might not, it might only question the agency's determination that a substance of

a new rule was valid itself.

It might not question the agency's determination that the old rule was invalid, in which case it wouldn't necessarily leave the prior agency action intact, and for that reason I think undermines why it's important that the agency should be able to decide on remand, because in the absence of that there would essentially be absence of power of retroactivity, there would be virtually no, no law to apply.

QUESTION: Mr. Lazarus, in your reply brief, you have as an appendix a letter dated January 31, 1984. Is that part of the record in this case?

MR. LAZARUS: It's my understanding that it is not formally part of the record.

If there are no further questions I would like to reserve my remaining time for rebuttal.

QUESTION: Very well. We will hear now from you, Mr. Sutter.

ORAL ARGUMENT OF RONALD N. SUTTER

ON BEHALF OF THE RESPONDENT

MR. SUTTER: Mr. Chief Justice, and may it please the court:

At issue is the validity of the Secretary's 1984 retroactive wage index rule. That rule is identical with the Secretary's 1981 wage index rule. We

successfully challenged the 1981 rule in the DCHA case. The Secretary did not appeal. The Secretary paid us in accordance with our claims, he paid us under the pre-existing rule.

But that did not end the matter. The Secretary proceeded to promulgate his retroactive rule. He applied that rule to take back the monies that he had previously paid as a result of DCHA. He stated in his re-opening notices that his retroactive rule had reversed DCHA.

The Secretary's 1984 rule is totally devoid of future effect. It was promulgated on November 26th, 1984, and applied in 1985, but applied only to the past. It applies exclusively to the period July 1, 1981 through September 30, 1982, a period that had long since been completed even when the Secretary issued his retroactive 1984 rule.

We contend that the Secretary's rule is invalid on four discreet grounds. First, the Medicare statute bars the Secretary from issuing a retroactive cost limit rule.

Second, the APA bars the Secretary from issuing a rule with primary retroactive effect. Third, this rule does not pass muster under the Chenery balancing test.

And finally, setting aside retroactivity altogether, this rule is arbitrary and capricious, even under the standards normally applied to the prospective rules.

QUESTION: Well what if, what if the Secretary had promulgated a rule applicable to this past period which, which was aimed at refunding to people who had paid on what the Secretary now thought was an improper basis?

MR. SUTTER: Well, I don't know --

QUESTION: Would that be --

MR. SUTTER: Justice White --

QUESTION: Now, what you're really saying is that this rule that he promulgated isn't a rule at all under the definition.

MR. SUTTER: It is not a rule.

QUESTION: And so, and so the rule that I just described would not be a rule.

MR. SUTTER: I think that's correct, Justice White, but I think, as Justice, Judge Oberdorfer stated in his case below, it is well established administrative law that an agency may always waive application of a rule when in individual circumstances he thinks justice so requires.

QUESTION: Well, that may be so. But --

MR. SUTTER: It would simply be a matter --

QUESTION: He couldn't do it by rule.

MR. SUTTER: Well, it would be a matter of waiving his past rule. That's right. It wouldn't be a rule. That's correct.

I, when I stated our four grounds I used the word "discreet," and in answer to your question, Justice O'Connor, we agree that if we are correct on the Medicare statute it does not require the Court to address the APA.

In our view it is absolutely clear that the Medicare statute precludes the Secretary from issuing a retroactive cost limit rule. The governing statutory provision, Section 223(b) of the 1972 amendment, uses words that import prospectivity, and I think that is specifically confirmed by the legislative history.

Both the House and Senate reports expressly state that the limits must be exercised on a prospective rather than retrospective basis.

The Secretary's regulations state that the limits will be imposed prospectively, and the prospectivity requirement is also confirmed by all of the Secretary's prior schedules and by his own administrative decision-making.

What the Secretary has done here marks a

radical departure from 12 years of consistent agency construction. We reminded the Secretary of this fact in our public comments, but the Secretary did not respond.

There is nothing in the record to reconcile what the Secretary has done here with the statutory language or the legislative history or the Secretary's own regulations or the statements in the prior schedules or the Secretary's own prior decision-making. There is simply no explanation to reconcile.

QUESTION: Mr. Sutter, let me come back to the problem of the Secretary revising the regulation in order to give more money to some people.

I suppose even if, even if it was an improper revision of the regulation retroactively, there'd be nobody to challenge it, so he could do it with impunity.

MR. SUTTER: I, I think --

QUESTION: But if he wanted to be technically correct, I suppose he could, what, present a, in an appropriations bill a little, a little line that says --

MR. SUTTER: That, that would certainly be a possibility, Justice Scalia.

QUESTION: What, what opposition would that likely confront in Congress, if the Secretary's in favor of it?

MR. SUTTER: I don't think it would incur any opposition.

QUESTION: It doesn't seem so to me either.

MR. SUTTER: Also, in response to the government's point about how, if the Secretary didn't act he would have to recoup from other hospitals, I think that's absolutely incorrect.

DCHA was not a class action suit. It involved only a limited number of hospitals. It did not require any action, either favorable or unfavorable against hospitals that were not participating.

And indeed the Secretary published his 1984 rule after settling virtually all cost reports in the country. He did not pay those other hospitals under the wage index which included Federal government hospital data. He continued to use the 1981 wage index rule for those other hospitals.

And in other circumstances he has clearly taken the position that he's not required to recoup in circumstances similar to these, we have cited that in the last paragraph of our footnote 36, which contains those references.

And Judge Oberdorfer in his decision in this case, at pages 38 and 39 of the petition appendix, explains, provides further reasons why there, why

recoupment would not be required from other hospitals.

So I think there's simply no merit at all to that, to the suggestion from the Secretary on that point.

The Secretary now relies on, although he did not rely on during the rulemaking, the retroactive corrective adjustment provision, which dates from the original 1965 legislation.

He argues that that provision confers on him the authority to issue retroactive rules, including retroactive cost limit rules.

QUESTION: Which section is this, Mr. Sutter?

MR. SUTTER: This is, Mr. Chief Justice, you will find this in our appendix at page 4, before you get to number 5, the public law, it's maybe, oh, about eight or nine pages down from the top there's a little two (inaudible), the language that begins, "provide with the making of suitable retroactive corrective adjustments." That is the language that the Secretary is now relying on.

QUESTION: And that's a part of Section 1861.

MR. SUTTER: That is part of 1861(v)(1)(A). That's correct.

We believe that the Secretary's reliance on that provision is clearly misplaced for several

reasons. First, it subverts Congressional intent. When Congress enacted Section 223(b) of the 1972 amendments, it made as clear as it possibly could that cost limits are to apply only on a prospective basis.

That clear expression of Congressional intent must prevail, however the retroactive provision is construed in other circumstances.

QUESTION: And then for that you rely on the phrase, to be recognized as reasonable, in another part of 1861?

MR. SUTTER: That is the statutory language. That's correct. And I rely on the specific words in both the House and Senate report, which state that the limits must be exercised on a prospective rather than retrospective basis.

Section 223(b) would trump the retroactive provision here. But, the second point that may be even more significant is, the interpretation which the Secretary is advancing here is post hoc interpretation conflicts with his own regulations.

His regulations have never construed the retroactive provision as conferring on him the authority to issue retroactive rules. His regulations have always construed that provision as a year-end accounting reconciliation process.

QUESTION: Did he use the retroactivity section to promulgate regulations on depreciation recapture at one time early in the act?

MR. SUTTER: He did not. Justice Kennedy, he did not.

I have recently reviewed both the proposed rule and the final rule in the preamble. He did not rely on the provision in promulgating those rules. And that was a rule involving secondary retroactivity, not primary retroactivity.

QUESTION: Did he cite the statutory authority for those recapture regulation -- or the recapture rules?

MR. SUTTER: Well at the end, I mean, he always has a little section which, which cites the authority.

I'm sure he included, I didn't specifically look at this. I'm sure he included Section 1861(v). But there's nothing in the preamble which would suggest that he thought he was acting pursuant to some kind of special delegation of retroactive rulemaking authority, as there was not in the preamble here.

And I might also note that the Secretary could not in good faith have done that in the 1984 preamble, because at the same time that he was publishing this

rule he was arguing in court that the retroactive provision means exactly what his regulations say it means.

And for evidence of that you can look at the 9th Circuit's decision in Regents of the University of California, which is reported as 771 F.2d. And if you read that opinion, 1985 decision, a year after this rule was promulgated, he stated there that this provision, the retroactive provision, means exactly what he says in his regulation, it's a year-end balancing process.

What the Secretary has done here, this post-hoc construction, which he cannot cite any authority for in his brief, marks a radical departure from 22 years of consistent agency construction. That's been the Secretary's interpretation in his regulation since 1966, and it's still there today.

Third, I think the Secretary's interpretation, his post hoc construction, is not a possible reading of that language anyway. The language refers to a process of retroactive adjustments where a provider's aggregate reimbursement for a period proves to be excessive. It focuses on actual evidence regarding the aggregate reimbursement of a provider.

And I can't imagine any language more foreign than this to the notion of issuing retroactive rules of

general application.

QUESTION: It would also be strange to say that the regulations shall provide for the issuance of regulations, that's rather a strange --

MR. SUTTER: That is correct, yes. That's correct.

I'd now like to consider the APA. There are two relevant statutory provisions, 5 USC Section 551(4) and 5 USC Section 553(d). Section 551(4) defines a rule as something having, among other things, future effect, and states it includes the prescription for the future of certain matters, matters that would be encompassed within this case.

I think Justice Scalia was entirely correct in pointing out that there's a big difference between in the future and for the future. It is certainly correct that if an agency publishes a rule in 1984, applies it in 1985, to recoup from 1981, the Secretary is acting in the future, at least from a 1984 vantage point. But he is not acting for the future.

QUESTION: Well, do you think the definition of rules set out in that definitional section of the APA is kind of the be-all and end-all, that it meant to just describe the full length and breadth of anything that a rule could do?

MR. SUTTER: I don't think it's the be-all and the end-all. But I think the significance is illustrated when you look at the legislative history and you also look at 5 USC Section 553(d), which generally prescribes a 30-day delayed effective date.

I think it's important to look at those two together. And I think the legislative history does confirm a plain meaning construction. The legislative history states, and this is in the legislative history volume at page 254, that rules formally prescribe a course of conduct for the future rather than pronounce past or existing rights or liabilities.

QUESTION: Well, Mr. Sutter, do you take the position today then that no retroactive rulemaking is allowed under the APA?

MR. SUTTER: No, Justice O'Connor, we do not. We --

QUESTION: Well, what defines the exceptions then, and how do you derive those from the plain language?

MR. SUTTER: Let me give you an example. Justice Frankfurter stated in the Addison case that law should avoid retroactivity as much as possible.

And I think the thing to focus on is whether it is possible to avoid retroactivity. I think there

may be some instances in which it will not be possible to avoid even primary retroactivity.

Suppose, for instance, that a statute requires that a certain benefit be in effect as of a certain date in accordance with regulations issued by the Secretary, the clear Congressional intent that the Secretary have regulations in place as of a certain date, and the Secretary simply doesn't do so.

In that case I concede that it would be possible to allow him to issue them retroactively. I see that as simply a case of the more specific prevailing over the general, the specific intent of Congress that these regulations be in place as of a certain date prevailing over the general rule in the APA.

I see it as a general rule in the APA. I believe that's also how the D.C. Circuit saw it.

QUESTION: Well, what if Congress provided that the Secretary of Energy shall by such and such a date issue regulations prohibiting anyone from charging more than 80 cents a gallon for gasoline, and the Secretary does not promulgate those regulations by that date, he promulgates them 20 days later, but he includes in that rule a statement that they shall be effective from the date that Congress said the regulation should

be in place, is that okay?

MR. SUTTER: Yes, it is. Because I see Congress' more specific intent controlling in that case.

QUESTION: Well, why, why should the rule be different if the Secretary, he doesn't fail to issue a regulation but he issues one that is invalid procedurally?

MR. SUTTER: I'm sorry. That is -- I didn't hear what you said. Procedurally --

QUESTION: Suppose he doesn't fail to issue a regulation but he issues a regulation that is invalid because of procedural omissions?

MR. SUTTER: Right.

QUESTION: So in, in, in short there is no regulation in place. Why can't he then issue a retroactive regulation?

MR. SUTTER: I think that if, if there was a clear Congressional mandate that the regulation be in effect as of a certain date, he could.

QUESTION: Well, there's certainly authority for him to have the regulation in effect.

MR. SUTTER: If there's just authority I'm not sure that he can. Let me take, let me take our situation here.

QUESTION: You, you must be sure that he cannot to win here, I suppose.

MR. SUTTER: Well, there are two reasons that he cannot here. One is, he had a pre-existing rule. If this rule is of no effect, it leaves in place what was there before. That's one reason.

The cost limits would not, I think, in any event allow the Secretary to act retroactively, not only because Congress said they had to be prospective, but also because Congress has never mandated that there be cost limits.

The Congress authorized the Secretary to issue cost limits. It did not require him to do so. And in the 16 years since Section 223(b) was enacted, for seven of those 16 years there have been no cost limits, and there haven't been any since 1983.

QUESTION: Mr. Sutter, depending on what the procedural deficiency is, there's also some room for courts of appeals to remand to the agency without setting aside the rule, isn't there?

I mean, frequently when what is lacking is a sufficiently precise statement of basis and purpose, the Court of Appeals will simply remand for a more precise statement.

MR. SUTTER: That is correct.

QUESTION: Considering the rulemaking as still being preceding and not yet, not yet terminated.

MR. SUTTER: Justice Scalia, that's absolutely correct.

QUESTION: That happens quite often, doesn't it?

MR. SUTTER: Yes -- well, I don't know if often, but it does happen.

And in DCHA, the Secretary did expressly ask that Judge Oberdorfer stay his decision so that the Secretary could take further action, and Judge Oberdorfer declined to do that.

But he did cite several of the sort of cases that you're referring to, and he distinguished those and said, no, that that remedy would clearly be inapplicable here.

One of the points I think is important is that if the Secretary disagreed with Judge Oberdorfer at that point in DCHA, he should have appealed. That was his appropriate remedy, because Judge Oberdorfer, I think, clearly indicated that these corrective procedures would not be appropriate here.

QUESTION: If you prevail in this case, what about those hospitals that have been benefited under the invalid rule? Is the Secretary entitled to recoup from

them now?

MR. SUTTER: No. He couldn't even recoup from them now, because the three-year re-opening period is over.

QUESTION: Well, let's assume there were no statute of limitations or re-opening period.

MR. SUTTER: I, I don't think so because DCHA was not a class action, involved only a few hospitals, and did not require him to do anything with respect to other hospitals, certainly did not require him to do anything with hospitals --

QUESTION: Well, if the, if the Court invalidates the rule, and forgetting the statute of limitations for a moment, isn't the Secretary entitled to go back and recoup the amounts that were paid in excess under the invalid rule?

MR. SUTTER: The Secretary has taken the position in other contexts that that would be unfair for him to do that, and he wouldn't do that. And we, we have citations in the last paragraph of our footnote 36 where he's taken that position elsewhere.

And again I think Judge Oberdorfer in his decision below at pages 38 through 39 offers several reasons why the Secretary would not be required to do so.

The cost limits, under the cost limits he's always had authorities to grant exceptions, and there's a big exceptions process, and his authority to grant exceptions will be found in the legislative history.

Also there's the general principle of administrative law that an agency may waive application of a rule where --

QUESTION: The Secretary doesn't want to waive it. So what if the Secretary, after Judge Oberdorfer's decision, had sued some of the hospitals who had benefited from the regulation saying, we now think, we have a court decision saying this is invalid, we want to get our money back from you.

Now, presumably the hospitals would have a right to litigate that question, because they're not bound by DCHA. But supposing that the other court agrees with Judge Oberdorfer, that this regulation was invalid, can't the Secretary then get the money back?

MR. SUTTER: Well, perhaps. I think you would have a balancing test involved there, and there would be questions of fairness.

QUESTION: Balancing --

MR. SUTTER: Well, the sort of balancing test that you would have under Chenery. What are the ill effects of the retroactivity?

QUESTION: Why, why, would that be so unfair, to get the money back?

MR. SUTTER: Well, it might --

QUESTION: They, they, they would not have relied on anything, the Secretary's ruling came after they had made their plans about how much they had to charge for medical services anyway, right? It didn't affect their primary conduct.

They were just given out of the blue money that they thought they weren't going to get.

MR. SUTTER: Well, the 1981 rule might have affected their conduct.

QUESTION: Might have affected their primary conduct?

MR. SUTTER: It was issued on June 30, 1981 to be effective the following day. So it's conceivable that it might have had some effect.

QUESTION: I thought you said it affected only past conduct.

MR. SUTTER: The 1984 rule affects only past conduct.

QUESTION: Yes.

MR. SUTTER: The 1984 rule was promulgated on November 26th, 1984, to go back to 1981 --

QUESTION: But that's what we're talking

about.

MR. SUTTER: Yes.

QUESTION: That's what we're talking about throwing away. That would not have affected --

MR. SUTTER: Oh, it would have no effect on, on other hospitals.

QUESTION: On, it would not have affected their primary conduct at all, they would have gotten a windfall, and the Secretary would be taking back their windfall.

MR. SUTTER: That's correct. The 1984 rule could not have affected --

QUESTION: I know it's hard for you to be hardhearted to hospitals, but it seems to have been a windfall.

MR. SUTTER: It is tough.

I would like to briefly discuss 5 USC Section 553(d), that establishes a 30-day delayed effective date. This rule here applies back to July 1, 1981, thus despite what the Secretary may say it has an effective date of July 1, 1981. And yet 553(d) precludes a retroactive effective date.

Section 553(d) is very similar to a statute which this Court addressed in the case of United States v. Baltimore & Ohio Railroad Company, which we've cited

in our brief.

That case involved a statute that precluded certain orders -- let me rephrase that. It established a 30-day delayed effective date for certain orders of the ICC.

And all members of this Court, including the dissent in that case, agreed on one thing, that is that the statute precluded the ICC from applying these rules retroactively. The language of that statute in 553(d) are very close, and I think merit very close review.

I would like to briefly address the Secretary's curative rulemaking argument. We believe that the, the Secretary's attempted curing* is something that cannot be done because of the very nature of the problem here.

The Secretary has missed a very important deadline established by Congress, one that reflects important values. From a procedural point of view he was certainly entitled to repeal his, or his 1979 rule and put in effect a new rule.

But to do that validly he had to publish a final rule by June 1, 1981 under Section 553(d), and he had to have completed the procedures mandated by the APA by that date.

He had to publish a proposed notice, solicit

comments, respond to the comments and publish a basis and purpose statement.

He didn't do that. In fact he didn't even start those procedures by June 1, 1981. And there's nothing that the Secretary can do in 1984 to complete those procedures by June 1, 1981. That's simply axiomatic.

Also, the Secretary at bottom is asking this Court to reward him for his illegal conduct. If the Secretary had acted legally on June 30, 1981, when he published the 1981 rule, he could not have given his new rule an effective date of July 1, 1981.

There's no reason why the Secretary should be in a better position today because he acted illegally rather than legally on that date. To allow that would truly be to trivialize and make a mockery of the APA.

As far as our third and fourth contentions go, we believe that we would be entitled to a judgment, to favorable judgment under any balancing test, as Judge Oberdorfer expressly found.

Judge Oberdorfer applied the balancing test, and the ill effects of the Secretary's rule have been very substantial. He has applied this rule to reverse a final court judgment. He has in effect substituted retroactive rulemaking for the normal appeals process.

He has applied this rule to recoup from already settled cost reports. In this case he applied it to recoup Medicare reimbursement for a, a, for costs incurred four years previously, but presumably under the Secretary's view it could have been six, seven, eight years previously. It would be very hard to draw the limit.

And as for the merits, well we have made our case in our brief at some length, and I think we have demonstrated that in issuing this rule the Secretary failed to consider relevant factors and drew conclusions contrary to the evidence.

And in his brief, the Secretary loosely throws around the windfalls, the word "windfalls," but you will note that he has made no response to our showing. He says, that should be remanded to the Court of Appeals. But you might want to look at his last briefs before the Court of Appeals because he essentially made no showing on the merits there.

If the Secretary had a case to make on the merits, he would make it. He has not made it. I can tell you as someone who has ready every page of the record at least four or five times, the Secretary cannot make a case on the merits. The rulemaking in this case was truly pro forma, as Judge Oberdorfer found in his

decision.

We respectfully submit that the decision of the Court of Appeals was correct and should be affirmed for any or all of the four reasons that we have discussed today. Thank you.

CHIEF JUSTICE REHNQUIST:* Thank you, Mr. Sutter. Mr. Lazarus, you have two minutes remaining.

REBUTTAL ARGUMENT OF RICHARD J. LAZARUS

ON BEHALF OF THE PETITIONER

MR. LAZARUS: Thank you, Mr. Chief Justice. I have just a few points in rebuttal.

First, the District Court did not order the Secretary to reimburse him pursuant to the 1979 rule. The court found only one error in the 1981 rule, the lack of notice and comment, and specifically declined to order the Secretary to reimburse him pursuant to the 1979 rule.

If you look at Oberdorfer's opinion, at page 62(a) in the appendix --

QUESTION: Only one error, that's all. He just didn't go through the rulemaking proceeding, is the only thing he did wrong.

MR. LAZARUS: It was an, it was an error which required -- the Secretary promulgated a new rule. But it was not one, which Judge Oberdorfer correctly

recognized, which mandated that he order reimbursement pursuant to the 1979 rule.

And in his opinion he explained why. He said, it is clear that to invalidate the 1981 wage index rule and enjoin* defendants, the Secretary, from retroactively applying any new schedule that excludes Federal wage data might well permit claims to recover a larger amount of Medicare reimbursement than they would under the present 1981 schedule. He recognized that for that reason it would be appropriate, and he didn't do so.

Second, the respondents concede, I believe, that the APA does not bar retroactive rules in all circumstances, that in narrow circumstances it is appropriate. It depends on whether they're necessary to serve Congressional intent.

QUESTION: But if the statute reads the way you say, why do you have to narrow it to circumstances? You're not reading the statute to say you can only do curative rulemaking. You're saying you can do, you can make rules retroactive generally.

MR. LAZARUS: But there --

QUESTION: I presume the rules would be the same as for retroactive adjudication. We've had some, some cases about when you can't change the law after the

fact too promptly, probably be the same for rulemaking, wouldn't it?

MR. LAZARUS: The same concerns, though, whether or not the retroactive rule is essentially necessary under Congressional intent is precisely the test that we suggest would be appropriate under arbitrary and capricious review.

And we believe here that the statutory interests being served are the need to ensure the providers are not reimbursed for costs they inefficiently incurred.

They can't have it both ways. Either it prohibits it or it doesn't. And we believe it doesn't, that the test about whether Congress, that needs require should be addressed during arbitrary and capricious.* Thank you.

CHIEF JUSTICE REHNQUIST: Thank you, Mr. Lazarus. The case is submitted.

(Whereupon, at 11:01 o'clock a.m., the case in the above entitled matter was submitted.)

CERTIFICATION

Alderson Reporting Company, Inc., hereby certifies that the attached pages represents an accurate transcription of electronic sound recording of the oral argument before the Supreme Court of The United States in the Matter of:

#87-1097 - OTIS R. BOWEN, SECRETARY OF HEALTH AND HUMAN SERVICES, Petitione
V. GEORGETOWN UNIVERSITY HOSPITAL, ET AL.

and that these attached pages constitutes the original transcript of the proceedings for the records of the court.

BY alan friedman

(REPORTER)