COMMITTEE BRIEFING

before

JOINT SELECT COMMITTEE ON MEDICAID REIMBURSEMENT

"Regarding the Federal government's position with respect to New Jersey's retroactive claim for disproportionate share payments for State and county psychiatric hospitals"

LOCATION: Room 260
Old Executive
Office Building
Washington, D.C.

DATE: December 22, 1992
2:25 p.m.

MEMBER OF COMMITTEE PRESENT:

Senator Dick LaRossa, Chairman

ALSO PRESENT:

Robbie Miller
New Jersey Office of Legislative Services
Aide, Joint Select Committee on
Medicaid Reimbursement

John P. Callahan
New Jersey Senate Majority Aide

Michael P. Torpey
New Jersey Assembly Majority Aide

Hearing Recorded and Transcribed by
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C O M M I T T E E   N O T I C E

TO: MEMBERS OF THE JOINT SELECT COMMITTEE ON MEDICAID REIMBURSEMENT

FROM: SENATOR DICK LaROSSA, CHAIRMAN

SUBJECT: **COMMITTEE BRIEFING - December 22, 1992**

The public may address comments and questions to Robbie Miller, Committee Aide, or make other inquiries to Sophia Love, secretary, at (609) 292-1646.

On **Tuesday, December 22, 1992 at 1:30 P.M. in Room 260 of the Old Executive Office Building, Washington, D.C.**, the Joint Select Committee on Medicaid Reimbursement will be briefed by Thomas A. Scully, Assistant Director of the federal Office of Management and Budget for Health, Labor, Veteran's and Education, and other appropriate officials from the Office of Management and Budget and the Health Care Financing Administration, regarding the federal government's position with respect to New Jersey's retroactive claim for disproportionate share payments for State and county psychiatric hospitals.

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SENATOR DICK LaROSSA (Chairman): (Opens briefing.)

THOMAS A. SCULLY: Well, I'll just say the reason HHS is not going to participate today is, and I think very correctly-- You know, we hope there's not litigation but there very well may be litigation and this is still pending in HHS. I guess we can start by saying, whatever I tell you, I'm just trying to be helpful for the process with what the Legislature's doing, trying to explain, you know, how the programs work and what's going on. My role has been more of an overview role. I don't intend, and I hope the comments aren't taken as representing HHS's position, because if they end up with some type of litigation between the State and the Federal government -- which we hope won't happen-- They didn't want to participate today because they didn't want to have anything that might affect that litigation. I certainly don't intend today's comments to do that, and certainly not to bind HHS.

You know, the Bush administration is ending in about two weeks, and before he left I thought it would be useful for you all to have some historical effect about what happened and why, and what our views are.

SENATOR LaROSSA: Which is really pretty much what we're hoping to try to achieve. It's very difficult to generate a report of any substance when all of the information that you have in terms of -- and I use it in quotes -- "testimony," only comes from one side of the presentation. And, again, realizing that -- and I'm sure that whatever the State is saying that's what their position is going to be is going to end up if, as HHS says, there is some litigation, it's going to be the same points that they're going to raise. But, nonetheless, that is what their point of view is and is part of what I think we need to have as part of the public record. It's not a matter of trying to--

MR. SCULLY: I don't think there's anything-- Believe it or not, when we get through this, I think you'll find it's not easily resolved, but the whole issue is there's not anything sinister going on. There's nothing particularly clear cut. The Governor probably did what most Governors in his siutation would do, and certainly an awful lot of other Governors beyond him would do, and that we've done what we should do. And there's an honest disagreement. The State wants a few hundred million bucks we don't think they're entitled to. I think they probably aren't entitled to it. They made a claim to see what would happen. And, you know, every other state in the country has virtually done the same thing. So, you know, I'm not trying to take any partisan political bent here, one way or the other. I think it's just a lot of miscommunication. Any time you're dealing with a situation between a Governor and the Legislature when somebody's got to find a big fiscal hole to fill, you're dealing with political dynamite.

We have exactly the same situation here with the roles reversed -- till now. (laughter) You know, we've got a Republican President sent up a budget and a Democratic Legislature that didn't like a lot of things we did, and it seems to me you have the roles reversed; the Governor sent up a budget with some things in it that were not too palatable to you and maybe weren't likely to happen. I mean, essentially, I assume the way your budget works is the Governor sends up what is essentially a request, just like the President's budget that goes to Congress: "Here's how I've planned to balance the budget, here's what I plan to do." You can take it or leave it. The Legislature has to enact it.

I can tell you, you can tell from reading the newspapers that President Bush certainly has been accused, not only correctly, of sending up some things like -- you probably don't know what this is -- the strategic petroleum reserve where you assume a couple billion dollars from selling it off. Well, Congress is never going to do it. That doesn't mean we're not going to ask for it. And Congress comes back and says, "Well, that's terrible. We're not going to do that policy-wise, even though you like it." Congress doesn't like the policy so we're going to have to go do something else to raise the money. It seems to me what happened here, and I don't think it's illegitmate from, as I said, there's lots of states, including New York, who have done the same thing. Governor Florio thought he had a claim. I think it's an extremely skimpy one, and obviously HHS has not totally turned it down yet, but we've had pretty clear discussions with the State about it.

I'll go through and explain the whole program to you -- that the Governor made a claim of $412, I think it was, million in back payments due from Medicaid, and he put that in his budget as a plug. We're going to get $412 million from the Federal government. He obviously could get, I think, an honest opinion from probably his own lawyers, and probably lawyers here, that he might have a claim to that. But we don't think he has a claim and I think at best you could say it was, you know, maybe a longshot. You can't blame him for trying to claim it and get the money, and he's certainly not the only Governor in the country that's done it. There's probably 15 or 20 that have done very similar things; Republicans and Democrats. Nevertheless, he made a plug claim for $412 million of which the vast majority, basically, we believe, clearly under the law the State was not entitled to, and when he turned around and said it wasn't there, that left a big hole for the Legislature to fill.

So, it's obviously a huge political problem, and fiscal problem for the Legislature. Maybe I'm missing something, but it seems to me that's exactly what happened. Now, is there anything -- you know, not that I'm trying to be any friend of Governor Florio's -- anything horrible or criminal he did? No. He basically threw a big ball in your court -- the big fiscal problem that, you know, he assumed in his budget he was going to get $412 million, and it's not going to come. I mean, he may get 300 and something, but it's not like the same thing doesn't happen in Washington every day. We have the same-- I could wring out five or six other state legislatures that have exactly the same problems you guys do. Some of them aren't quite so big, but we have the same problem in Arizona, a little bit of the same problem in New York. So, it's not unprecedented. I think the timing of it and the central focus of the debate in the State that it seems to have taken -- although I haven't read your newspapers too much -- it seems to have taken on a life of its own.

SENATOR LaROSSA: Right.

MR. SCULLY: You know, have made it a little more controversial.

Medicaid is an incredibly confusing subject. This particular program that's going on now, which it might help if I explain that, to start in the background of what's going on nationwide has only exploded in the last couple of years and there's very few people that understand it. And there's very few states-- You know, most people talk about Medicaid and their eyes glaze over. New Jersey seems to be the only State where its actually become a fairly intense political debate. In most of the states it's not because the money is not there, it's because nobody understands what they're talking about.

Maybe I should give you a historical context first on how this program came about, so you know that you're not the only ones that have this problem.

Do you want to jump in here, Steve? If you want me, for the record to tell you-- You know who Steve Cole is? Okay, well just so you know. Well, just so you know, since I'm a political appointee I'll be leaving -- probably for the good of the world. I'll be leaving in about two weeks.

Steve Cole is a career civil servant here. He's worked on this all along so he has no loyalties -- Republican or Democrat -- and that's the way most of OMB is. So, he has done the vast majority of the substantive work on this, and he will be here so you can continue to come down and pummel him for the next couple of years, if you'd like. (laughter)

SENATOR LaROSSA: For information only.

MR. SCULLY: But, Steve has been very involved with a number of states on this issue.

Essentially, what happened is that the Medicaid Program which is basically a state/federal matching program-- I don't know what New Jersey's match is.

STEVEN COLE: New Jersey's match is 50 percent.

MR. SCULLY: Fifty/fifty. It varies by states. The poorer states like Mississippi may have an 82. The Federal government pays 82 percent of the cost of the program and the state government pays 18, which is the one extreme. There are other states like New Jersey, New York, California -- mainly the bigger states -- that pay 50/50 match. So, the way the Medicaid Program is set up is that somebody pays a hospital bill. Medicaid pays the hospital bill. The program in New Jersey pays the hospital bill. We pay 50 cents to the dollar and you pay 50 cents to the dollar.

In the late 80s a couple of southern states started figuring out-- The concept was that in a number of states Medicaid reimbursed at a much lower rate than what Blue Cross/Blue Shield and private providers would reimburse at, which I'm sure you're familiar with. Most states do. The concept was that in some states -- and it started out really in West Virginia, Kentucky, Tennessee, Alabama -- that Congress passed what's called the Disproportionate Share Hospital Program. The concept was for hospitals in the state that had a disproportionately high share of Medicaid patients, it was tough for them to be able to transfer those costs. Say the hospital has 50 percent Medicaid patients. If the state's paying a very low Medicaid rate, it's very difficult to transfer the low state reimbursement for Medicaid off on the other 50 percent of your patients if most of the other hospitals in the state have 10 percent Medicaid and a 90 percent base to transfer to.

So, the concept was -- when Congress passed this provision back in the early '80s -- that if the state wanted to go out and have a program where they set up a special pool and they designated, say, 5 or 10 percent of their hospitals as high Medicaid hospitals, they could set up, basically, a subsidy pool, and we'd match it 50/50 to make extra payments to them to subsidize the fact that they had a lot of Medicaid patients and not much of a base to transfer it to. But, because of the way the program was structured, nobody thought of it when it was passed -- it was very open-ended. A bunch of these southern states figured out that, essentially, it was an open-ended pool for getting free money from the Federal government. So, what happened, it started out in West Viriginia and Tennessee because they basically started saying, "Hey, look. We'll just call up all the hospitals and tell them, 'Look, we're setting up the disproportionate share pool.'" The concept was the state would put its general revenues in, and the Federal government would match it with its general revenues. What some smart state Medicaid directors figured out was, "Why don't we go to the hospitals and tell them, 'Hey, why don't you give us some money for 60 days. Kick it in and we'll put it in the pool and we'll call it state funds. We'll go to the Federal government and get them to match it and we'll pay you back.'" You know, basically a Ponzi scheme, totally legal, allowable in the law, but that's what started happening. And it was only -- in '87 and '88 -- a couple of hundred million bucks a year. The Medicaid budget at that time was probably, you know, $50 billion a year, so it was a relatively small problem.

In the late 80s, this thing took off. A lot of the states expected the Federal government would shut it down. We basically never did, because Congress kept putting in one year-- HHS continually put out regulations to shut it down in '87, '88, and '89, and every year Congress would pass a one-year moratorium. The states were pretty timid about moving forward with it during those years because they always assumed it was going to get cut off.

In the budget agreement of 1990 they put in-- By that time it had grown to about 15 or 20 states. In the 1990 budget agreement, in the middle of the night -- something I probably should have caught -- about 4:00 in the morning, the last night, somebody slipped in a little provision that basically opened the barn door very wide. Nobody realized it until after it was over with, but there was a further one-year extension that told us -- that basically Congress told HHS they couldn't put any regulations. It also tied HHS's hands even more than had been in the past.

MR. TORPEY: This is OBRA 90.

MR. SCULLY: This is OBRA '90. And what quickly happened was we went out and said to everybody we're going to shut this down next January 1, please don't do anything. But all the state Medicaid Directors obviously have conferences and they know what's going on, and they all ran around and told each other, "Hey, create a disportionate share fund." And then in those 12 intervening months -- actually about 10 intervening months -- we went from about 15 states to, I think, about 49 or 50 states. And the bottom line is that between 1988 it was probably about $400 million a year, and in 1991 it went to about $9.5 billion -- 1992 it was $16.5 billion. So, this program, basically, was very small in '87 and '88. In '87 and '88 it went from $400 million a year to what it is now -- $16.5 billion in '92 and will be $16.5 billion in '93.

And basically, every state did it differently. Essentially, what they did was either by taxes or donations, or some mechanism -- and it was usually the hospitals that figured it out and they came into the state and said, "Hey, it's no skin off the state's back. Why don't you get us all to throw in money for 60 days or 90 days, collect it, call it state money, and send it off to the Federal government." You know, the purest example is Pennsylvania where the nursing homes got together, borrowed $400 million from a bank for 60 days, I think it was--

MR. COLE: Just the hospitals.

MR. SCULLY: The hospitals and nursing homes together?

MR. COLE: Just the hospitals.

MR. SCULLY: Just the hospitals. The hospitals got together, borrowed $400 million from a bank, gave it to the state on a loan for 60 days. The state sent it in to the Federal government. We had to give them $400 million back. So now they get $800 million. They pay the bank off, but they got $400 million of free Federal money.

SENATOR LaROSSA: But you had to provide it because it was statutorily required.

MR. SCULLY: That's the way the statute was. That's right. We didn't have any choice. So, we had a big fight all during 1991, all last year -- in fact, I almost got fired a few times -- with all the governors. And you can't blame them. For all the governors it was a way, you know, for them to balance their state budgets with, basically, backdoor revenue share, and it was going on in almost every state. New Jersey was probably in the middle of the-- I would say on-- If you want to look at abusers of it, and it's totally legal, and any governor you explain it to, they'd all say, "Hey, I know it sounds pretty crazy. It's probably not good policy, but it makes my life easier because I don't have to raise taxes." So, any governor that was probably smart, or had a Medicaid Director who was smart, did it.

MR. TORPEY: What about New Jersey?

MR. SCULLY: New Jersey was in the mid-range of states doing it.

MR. TORPEY: But we provide for our disproportionate share payments through our uncompensated care system which until recently was paid for by--

MR. SCULLY: By all state money.

MR. TORPEY: By state money and through, essentially, a tax on hospital bills.

MR. COLE: Hospitals--

MR. TORPEY: Bills. Yes. Every hospital bill had a 19 percent tax and these moneys were--

MR. SCULLY: Sure. And yours is--

MR. TORPEY: -- from the Uncompensated Care Trust Fund which were then used to pay. And in the case of state and county psych hospitals, it was all State money.

MR. SCULLY: It was all State money until '88 or '89, and the State woke up and said, "Hey, this-- Guess what? We can send it in and get it matched, and double our money from the Federal government."

MR. TORPEY: As opposed though-- I'm just making a distinction between doing that, and Pennsylvania which was a state which essentially set up a scheme -- from what you're telling me -- with private hospitals that took out a private loan, lent the money to the state--

MR. SCULLY: No, no. I'm not comparing New Jersey. In fact, your program is now allowable. Pennsylvania has one that's now allowable. New Jersey's situation is more like Louisiana's. Louisiana had been providing charity care through a system of mainly Catholic charity care hospitals for years and years and years with 100 percent Louisiana state money, and they're mainly poor people. They realized a couple of years ago that they could, you know-- "Why should we do it with all the Louisiana money? We could get Federal money, too." So they turned them all public and they just took what had been

100 percent Louisiana money and made it-- I think their match is about 60/40 -- sixty percent Federal and 40 percent. So, what you guys basically did is, you said, "We've been providing indigent care with all New Jersey money, why don't we turn in the Medicaid money and do it?" That's allowable, and it's far more legitimate than what some of the other states have done.

Nevertheless, I'm just telling you the in the context of the Federal government, we have this explosion of programmatic money that was never there before. Massachusetts, you know, just to show you they did the same thing. If you remember, Governor Weld came out last year and magically announced that his $400 million budget deficit had been resolved and that they had miraculously found this, you know, this Medicaid and also got a $10,000 bonus for doing it, for the same thing. They had an Indigent Care Pool that had been for years funded 100 percent Massachusetts money, and one of their people figured out, "Hey, we can send it in to the Federal government for a match. We can double our money." Boom, they solved their budget deficit. A lot of states do this; they just didn't realize it.

MR. TORPEY: You're saying it's legitimate, but clearly--

MR. SCULLY: The different ways of doing it are legitimate and we can get off-- We should get onto New Jersey, at some point, but I was trying to give you the context. When we negotiated the agreement with the National Governors Association and then got it through to pass -- we had to pass it through both Houses, the Senate and the House unanimously at the end of last year, which was not easy. It was incredibly controversial.

SENATOR LaROSSA: That's one of the points that I really wanted to get some detail on, was the NGA agreement. If you want a chronology, or just get into that a little bit even now. Whichever you think is--

MR. SCULLY: Well, I'll just give a chronology. I'll tell you what happened in 1991, and Steve may have done a lot of things since-- I can't remember all of it. Steve, jump in here. Correct me.

Basically, when we negotiated the OBRA '90 budget agreement, we quickly realized, just by watching what was happening in the states, that there was a huge loophole in there that we didn't know. As I said, it happened in October of 1990. During the course of January, February and March of 1991, Gail Walenski who was then the head of HCFA and subsequently came over here to the White House, who's a very good friend of mine -- we're kind of a tag team -- we went around and met with the NGA and met with all the states and said, "Look, you know, we know all you are expanding these programs very quickly, but the moratorium goes off on January 1 of next year and we are going to put out a very tough regulation to shut all this down." We may actually have spread the virus more quickly by explaining this program to people. Some states didn't even understand what was going on. We did not want any states to be shocked when the Federal government came out the next January 1 with a moratorium cutting all these off. So we went out and said, "Don't go too far. We're going to cut you off January 1."

MR. TORPEY: But they--

MR. SCULLY: Well, instead of slowing people down, what happened is, it was free money for one year. Every state went out and did it and that just built enormous pressure, because every state was relying on it -- as you got towards the end of the year -- to continue it. Because you've now gotten to the point where almost every state in the country was relying on this, essentially, revenue sharing to finance the state budget. Rather than having the success of slowing it down, some would argue -- including my staff -- that by Gail and I going out and trying to explain to people that this wasn't going to go on forever, we actually spread it even more quickly. Is that fair to say?

MR. COLE: You educated them.

MR. SCULLY: We educated people on how it worked, which was probably too bad. I mean, basically at that point we had 15 or 20 states that knew what they were doing, and by going out and telling everyone else, please don't get into this -- because we knew others would -- we basically ended up educating all 49 that are doing it now on how to do it.

MR. TORPEY: But the reimbursement sought during that year, there is nothing in--

MR. SCULLY: It was open-ended. There was nothing we could do. You could do anything you wanted. You want to borrow $40 million from a bank and send it in during 1991, we were prohibited by law from doing anything until January 1, 1992. But, we were going to cut everybody off for 1992 which would have caused a huge problem for a lot of states. I mean, California was in it for $1 billion, New York, $2.5 billion, Tennessee, $700 million, Alabama $500 million or $600 million, Louisiana for $1 billion. A lot of states have a much bigger stake in this than, say, New Jersey. And they basically said we can't afford to be cut off. So, they came in and we had an enormous fight with the governors of all the states. Republicans-- I mean it was a very bipartisan fight. Let me tell you. There were lots of Republicans-- Some of the biggest states are Republicans, so it wasn't Republican/Democrat; it was how much each state had gotten into it across the board.

Basically, what we said to them was: Medicaid is going to melt down if you do this. In theory, you could have financed your entire state budget through it -- your roadbuilding programs and everything else. You could have sent it in and got it matched by Medicaid and paid for the whole thing. What we basically said to the governors was we either got to get this thing under control or the Medicaid Program is going to melt down and all your other state matching programs are going to melt down. You can't just have a position where every time you send in a (indiscernible) to the Federal government we got to match it with the state match. You can refinance your whole budget through it.

Even though lots of people wanted -- everybody wanted to get in the till and get as much as they could, the NGA, I think, much to their credit-- And it was a big problem because there's some states that were really into this and some that weren't in it at all, so there's a massive inequity going on even now between the states, which we've tried to phase out over a number of years.

We basicallly said, "Look, we're never going to get the money back." We're out at that point $12 billion that the states were getting. You know, we weren't able to go back and tell Illinois that they're going to create a $650 million hole in their budget, or New Jersey. What is it, 250 a year in New Jersey?

MR. COLE: New Jersey is 160. That's what it would be.

MR. SCULLY: What it is now?

MR. COLE: Right now it's in dispute.

MR. SCULLY: I mean, it's retroactive in the dispute. Prospectively--

MR. COLE: We haven't approved it prospectively.

MR. SCULLY: Prospectively. We'll say New Jersey's plan is okay. It's $140 million, but I mean New Jersey would have a $140 million hole. Some states are still doing nothing, but most states are between 100 million and say, 300 million. There are a few that are like a billion -- a billion-and-a half, just depending how far they went.

So we basically said to the states, and we negotiated this when Congressman Waxman-- The first thing that happened was in the fall of 1991, Congressman Waxman, pretty overwhelmingly -- probably in September -- passed a bill in the House that said the Administration cannot put out any regs to limit this in any way, shape, or form, basically another one year moratorium that said we cannot come out with regs to stop this on January 1, 1992.

We basically went to the NGA and we lost by probably 200 votes on the House floor. Waxman creamed us. We said, "Look, if you guys want to put another moratorium in there, fine, but the Medicaid Program is going to melt down. You can forget about it." And we also said, health care reform is coming down the road. If you guys want to take, you know, 15, 20, $30 billion dollars a year from the Federal government for your own health care problems and want to get used to it, when health care reform comes we're going to take all of it back to pay for it and you guys are going to have a big hole in your budget. So, why don't we deal with it rationally? And, fortunately, the Governors did deal with it rationally.

The problem was there were huge differences in what states were getting, so instead of trying to go through and level everybody out at once, what we said was we would freeze everybody where they were on November 26, 1991 at whatever they were at -- some states were at zero and some states were at $1 billion. At that time we went through a polling of all 50 states and we added up all the dollars they were expecting to get then, which was $12 billion, roughly. And the total cost of the Medicaid Program in 1992 is expected to be at that point $100 billion, so we made the rough calculation that, regardless of what happens, we were going to put a cap on overall disproportionate share hospital spending, nationwide, at 12 percent of the total Medicaid Program. So for '92 it was supposed to be $12 billion out of $100 billion. If the next year Medicaid grew to 110, then it could have been 12 percent of that; if it was 140, it was 12 percent of that. See what I'm saying?

So we just said, look, no matter what happens, 12 percent of the Medicaid Program can go through these disproportionate share payments, and that's it. Now if you add up that 12 percent cumlatively, some states had 40 percent of the progams of disproportionate share and some had zero. And there was no way to straighten that out, so what we said was that the states that were above 12 percent would be frozen permanently -- say, here at California which was 19 percent, I think, at the time. California would not get 19 percent. They'd get their set amount of money which at the time was about $1.4 billion or $1.2 billion. And they would get $1.2 billion with no inflationary increase for a long time until that percentage shrank from 19 percent to 12.

In a state like, I think Alaska that had nothing, would start at zero, but whatever growth there was-- In other words, California would keep at 1.4 percent (sic), which might be 19 percent this year, but it might be 17 the next, and 15 the next. The growth would be shared by the states below 12 percent, so eventually, hopefully, every six or seven years Alaska would be at 12 percent by growing, California would be at 12 percent by staying straight. New Jersey was at about 6 percent, so New Jersey would share in the growth until it got to 12. I think New Jersey is at 6 or 7 percent. A state like Ohio is at 9 percent so they would have grown more slowly as well. A state like Louisiana that was at 30 percent had to come down slowly. But the point was, since there was this huge inequity over, you know, five, six, seven years, we're intending to get everybody to 12 percent of their state Medicaid payments (indiscernible) and that was it.

Essentially, that was the best we could do. I think the program was terrible public policy, but the states had gotten to rely on it and we couldn't get the money back. So that was basically what happened. What happened was Waxman passed this prohibition in September, and the states were very happy about it, and we basically went in and said, look, the whole program is going to melt down. We spent two months very intensely, every day-- Very, very-- Would you say it was very intense, Steve?

MR. COLE: Until late at night.

MR. SCULLY: Very late at night, very intensely, negotiating with the NGA staff, and we came to an agreement. I mean, this thing came down to the last day of Congress. I think it was December 12, or something?

MR. COLE: Yes.

MR. SCULLY: We came to a tentative agreement about the 26th of November, which is why we set that date. Then we had to go out and sell it to all the governors because it had a massive impact on different states, and the governors. And because it was so late in the session of Congress, the only way you could pass it was to pass it unanimously through both Houses of Congress, basically. It was obviously incredibly controversial. So, Waxman, as I told you had already beaten us by 200 votes the first time around, so we had to go out and convince everybody in every state that this was going to save the Medicaid Program from melting down. It wasn't fair, but it was the best we could do. And I was very surprised as was most people, that over the course of two weeks of talking to 50 different governors, a lot of different state legislators, and a lot of other people, fortunately we convinced the leadership of Congress, the NGA, and a lot of other people, this was the best we could do, and this thing passed December 12, or something. It was the last thing done by Congress in 1991.

MR. TORPEY: Just to be clear, this is P.L. 102-234?

MR. COLE: Yes.

MR. SCULLY: The last thing passed by Congress was passed by unanimous consent, I think, in the Senate, but usually that means it wasn't controversial. I can tell you I probably talked personally with 70 Senators. I don't know, maybe not 70, maybe 50, but there was no state that wasn't concerned about it and everybody--

MR. COLE: Any single Senator could have objected to it.

MR. SCULLY: Any single Senator could have objected, and there were lots of states coming in at the last minute trying to make sure they were taken care of, because it was very confusing. A lot of states didn't know what the impact was going to be on them.

So, anyway, it passed on December 12, and one of the deals was -- in that bill -- that anybody that wanted to make it-- Basically, 1991 had basically been open season. And as a transition period, what we said was anybody that had a state plan amendment by November 26, 1991 -- and that was because that was the date we first reached the agreement with the NGA instead of going out and talking to people-- And we didn't want everybody sending their deals, but rumors had gotten out anyway. A lot of states came in with last minute changes because they heard this was going on. We had been negotiating for two months. A lot of states knew what was going on during September and October. They knew we were trying to set some kind of deadline and say anybody who doesn't change their plan by "X" date is not going to get in the door.

And so New Jersey, like many other states, cooked up a whole bunch of state plan amendments and sent them in. They got theirs on what? November 22.

MR. TORPEY: Right.

MR. COLE: And their's was a revision of a prior--

MR. SCULLY: Yes, I can get into that, a revision of a prior thing. But they sent in a couple of changes, trying to get this new program going, which is one of the issues. So, they sent a whole bunch of changes on November 22.

MR. TORPEY: But wasn't the deadline the 26th?

MR. SCULLY: The deadline was the 26th, but there are a couple-- We should go through these. First of all, what New Jersey did in 1988-- New Jersey sent in, I think, on July 1, 1988, a very minor plan amendment to pay some state psych hospitals disproportionate share payments, but it was a really small amount. I'm not sure what the amount was. It was tiny. It was, you know, a very minor thing. They were going to make small payments. And the plan in 1988-- The plan was never approved by HHS. It sat around for two-and-a-half years. While all these negotiations were going on in the fall, New Jersey pulled that plan out of the file, which is a minor plan, and slapped on this enormous expansion of the State Disproportionate Share Plan and basically claimed that this was an amendment to that '88 plan. I mean, you know, that's like-- It was a massive change; pretty hard to argue that it was an amendment. This is some of the argument that HHS is now having with the State, but basically, you know, it's like taking a plan that's worth three bucks and amending it with one that's worth, you know, 200 million.

MR. TORPEY: The issue isn't the amount, though. It's whether or not it's even permissible.

MR. SCULLY: No, the issue is, one: they sent in the state plan-- They sent the original plan in '88. As these negotiations were going on and people were hearing that they better get any changes they want in their plans for disproportionate share before this law might pass, a lot of states sent them in at the last minute. New Jersey got in November 22. Number one, New Jersey sent it in on the 22nd and HHS would argue that it was not an amendment to the '88 plan because it was so massively different in character. I mean, the '88 plan was a minor little amendment. These guys pulled it out and slapped on, you know, huge changes. That's number one. Number two: HCFA requires, and always has required, public notice in the state before a state plan amendment is considered to be valid. When New Jersey sent their state plan amendment in on November 22, they hadn't gone out for public notice. After they sent it in HHS said, "I'm sorry. This isn't valid. You didn't go out for public notice." Then, they came back in again on December 28 or 29, after having gotten public notice, and HHS said all right. They still had questions about it, but at least you fulfilled that. They basically agreed with some caveats that from December 29, 1991 on, they would pay for New Jersey's Disproportionate Share Program. Maybe not all of it, and I don't know the details of that.

MR. COLE: Right now it's January 1.

MR. SCULLY: January 1. The point is it came out on December 29. So that's one. That's never really been in that much dispute, the fact that New Jersey sent in a plan, that it's okay as of January 1, 1992 or December 29, 1991, or whatever. From there forward, that's really not in dispute. There's some minor technical disputes about how much you're going to get paid and when it starts, but the major dispute -- the vast bulk of the money -- is that New Jersey wanted to get paid all the way back for services until 1988.

MR. TORPEY: Now one of the plans that's being made--

MR. SCULLY: Basically, the $400 million-- What the Governor requested was: "Here's our plan. We're submitting it on November 22, 1991 or December 29, 1991. By the way, we want to get paid retoractively back to the whole year 1988." Well, HHS's appropriation language flat out -- and I don't think there's any debate about this, because I've been through this-- HHS's Medicaid Program is not allowed to pay any expenses for anything that's not incurred in that quarter or prospective quarters. They can't pay anything retroactively.

MR. TORPEY: I'm just curious as to just a site for that. Does anyone--?

MR. COLE: That's the appropriation--

MR. SCULLY: It's the annual appropriation language--

MR. COLE: What it specifically says is that states may not be reimbursed for any costs related to a state plan amendment earlier than the quarter in which the state plan amendment was submitted, because HCFA had interpreted the November 22 submission as a fundamentally different state plan amendment than the actual state plan amendment that was submitted in July, 1988, the absolute earliest they could pay back to was October 1, 1991. However, because of the public notice problem, they felt that they could not pay in the first quarter of Fiscal Year 1992 in any case because there was no public notice.

MR. SCULLY: So the real dispute here is not so much, you know-- I just explained the history of the Program for you in context so you understand what a big fiscal problem this is for the Federal government. Okay? But even though we don't like it necessarily, lots of states are doing it and most -- many states now prospectively, under this 12 percent cap-- It all operates under this cap, now, which is the deal we cut. These programs are still going on, there's just an absolute dollar cap that we'll pay. Under this cap, most states now have these programs, and New Jersey's program in some form will probably be approved and the issue-- There may be some minor technical issues, but from January 1, 1992 on, there's really not too much doubt that you can have a program.

The issue is, the state tried to claim back payments back to 1988 which, from the very beginning -- it's no great secret. I think I've told everybody who called me on the phone, reporters, you guys, anybody, that that was not only unprecedented, but we didn't think it was even remotely legal under the appropriations language. And there are other states that tried to do it, too, and we've consistently said no. We can't blame them for trying, but we've consistently said no. And if we let every state go back and try to claim 1987 or 1988, that they need to get back payments under this program-- Their argument basically is, "Hey, Kentucky was doing it. West Virginia was doing it. Tennessee was doing it. The only reason we're not getting the money is because we didn't know about it." That's unfortunately true. Some of the other states were getting it. There's still some states that aren't getting anything, though, or getting very little. The problem was that some states found out about this early on, and the virus kind of spread; but I don't think New Jersey's ever had a good argument for getting-- I don't know what their argument is, in fact, for getting retrospective payments.

MR. TORPEY: Well, let me just address that because that's something that I guess needs to be talked about for a second.

MR. SCULLY: That's where most of the money is. That's where all the money is -- the retroactive--

MR. TORPEY: There's no question about that. The question is retroactive payments and the issue of public notice, and from what point forward New Jersey receives its funding. The claim being--

MR. SCULLY: Before you go on, even if the public notice issue as far as -- from what I could tell-- Again, I don't want to make the-- This is not intended to have any effect on HCFA's legal arguments, because even if you had gotten your plan in November 22 instead of December 29, it doesn't seem it would change anything except you hadn't paid for the time between November 22 and December 29.

MR. COLE: Potentially, it might have been paid back as early as October 1, 1991.

MR. SCULLY: You could go back, maybe, to October.

MR. CALLAHAN: You're saying the Appropriations Act precluded us from getting anything prior to October 1.

MR. SCULLY: The appropriations language precludes you from getting anything prior to when your plan is approved, so the debate may really, to me, comes down to when your plan is submitted. Did you submit your plan accurately to HCFA December 29, November 22? I didn't know there was some early date, but retroactively-- We've been through this many times on other issues that have nothing to do with Medicaid. The Appropriations Act only allows you to pay for services incurred in that quarter or services that are projected to be incurred in future quarters that can be tracked. You can't go back and pay retroactively for services that were not allowable in the law.

MR. TORPEY: One of the things that the State's claiming is that OBRA '90 clarified OBRA '87 with regard to disproportionate share payments, and that the methodology that was submitted on November 22, '91 was a reflection of that clarification and that OBRA '90 did permit disproportionate share payments back to the effective date of OBRA '87 which was July 1, 1988 which is, of course, exactly what is in question.

MR. SCULLY: Well, I can't tell you what-- I mean, maybe they can subpoena me for the trial. (laughter) I mean, it always kills me when people say what was written and they try to read legislative history. I was there all night long in OBRA '90 and I think I negotiated just about all the entitlement changes in the budget act, now called tax and budget sum of 1990. (laughter) It's so popular.

That certainly was never discussed. I mean the whole concept was intended to happen in 1990. Some language was added, and you know, whether it's an accident or not can be debated, but nobody really understood the impact of it that turned this small program into a massive explosion. That was certainly never intended. If you look at the minor changes that were intended to be made to the Disproportionate Share Program in 1990, they were scored -- just to give you an intact of how minor we expected them to be -- they were scored by both OMB and CBO at a total of about $200 million over five years. It's going to now cost about $95 billion to $100 billion over five years. So the projection when we did it in 1990 was we were making small technical changes that might cost a couple hundred million bucks over five years, and it's going to cost almost $100 billion because of what's happened.

So, the point is if you're looking at trying to-- My point is that if somebody's saying that we intended to make retroactive payments under DS back to 1987, nobody remotely discussed that. Now somebody may be able to read the language there, but anybody that was involved in those negotiations-- It never came up. It was a small minor change.

MR. TORPEY: I don't think they're talking about intent. I appreciate your point about the intent may, in fact, have been not to expand the program, but the question is what ultimately occurred and how it reads. And I guess that's what I'm getting down to, what does the law actually say, which is the intent.

MR. SCULLY: I understand. But since the law doesn't say anything clear -- it sounds like you're a lawyer, I am, too -- but the law's not very clear. Congressional intent does have some impact. And I can tell you that this was a-- If you want to go back, I'd probably have more evidence of Congressional intent than anybody in the country. If you had pulled out my old notes on the budget summit, or everybody elses, this thing was hardly even discussed. It was a minor technical change to Medicaid. Unfortunately, one of the minor technical changes that was made-- There's some pretty smart lawyers and state Medicaid Directors out there that created an explosion in this program, but nobody ever consciously was trying to say, hey, we want to take what was intended to be a small program -- the DS Progam -- which intended to do exactly the kind of thing that I guess you guys were doing, making modest supplemental payments to the hospitals that had a high level of indigent care, to turn into what's happened is an enormous state revenue-sharing program.

So, but anyway, that's somewhat irrelevant to what you're talking about, but the point is that if you check the

Appropriations language you'll see what HCFA's argument is, and so they don't have the ability to pay retroactively. What you're saying is that it was your state plan-- It was just an amendment to what you filed in '88.

MR. TORPEY: It had already been filed, and so therefore we had already staked the claim, so to speak.

MR. SCULLY: Well, but that's-- What you're saying is you already changed your state plan, but if you look-- My understanding is, if you look at your state plan in 1988 -- which was a state plan that encompassed minor payments to a fairly small number of pysch hospitals -- and you look at what you're trying to get retroactively reimbursed from -- 1988 through 1991 -- it is a totally different program and it covers totally different payments to completely different hospitals. I think if you look at the Appropriations language you would see that there were never services rendered between 1988 and 1991 that any rational person could envision us having paid for.

MR. TORPEY: Reason may have been tossed out the window in this entire process. That may be true. I guess I'm still trying to--

MR. SCULLY: Well, I guess my point is it's for HCFA to argue the legality of it. I'm not going to try to do that. I'm just trying to tell you the history of what happened and, why, when New Jersey came in and made this claim they may -- and obviously it sounds like still do -- think they have a claim-- I think HCFA-- I can tell you their general counsel, Darryl Grinstead, who was very involved in all the negotiations for settling this thing in 1991-- I mean, it was basically Gail Walensky and he and I that -- and Steve was there -- negotiated the whole thing. He's a very good lawyer, a very solid guy, career civil servant. Probably the best Medicare/Medicaid person I've run across in town. I mean he doesn't think -- and there's many times he has sided, inconveniently, on his legal opinions where it cost us a lot of money. He doesn't think this is a close call, and I'll let HHS argue that in court, but I've looked at enough to see that--

If I were Governor Florio, I probably would have done-- I can't say exactly what he did, but I can't blame him for doing what they did, which is trying to make the claim which might have been reaching retroactively to get the payment. Probably made it easier to balance the budget he submitted. It probably did a lot of things. He's not the only governor in the country that did it. I don't know the total number but I bet it was well over 20 that did roughly the same thing in different, varying amounts. Basically, he said, "I think I can get $412 million," of which he's probably going to get a small slice, what's prospective and not the amount that's retroactive. He basically made a claim for that. He's probably not going to get it. You may win. I assume the state, if it doesn't come out right, will appeal and they can keep appealing.

I don't think that they're going to get that retroactive chunk. You know, he probably thought they had some legitimate claim. I'm sure some of the lawyers did, but there are many states that did roughly the same thing -- some with much more money; some with much less. Basically, the problem is when he didn't get the money it created a big budget problem for the State Legislature.

SENATOR LaROSSA: The point I still want to get back to, and going into the negotiations with the NGA in terms of trying to get them to agree because of the potential meltdown, you know, of that system. You also mentioned that all 50 governors had to agree or there were negotiations going on. Was it literally, when you say all 50 governors, or was it NGA doing the negotiation and then being their representative? You know, were--

MR. SCULLY: All of the governors should have known about it. The NGA, since they represent them-- I did not-- Obviously, we did not negotiate directly with the governors.

SENATOR LaROSSA: Right.

MR. SCULLY: And, in fact, the NCSL came in shortly thereafter and complained that we negotiated with the governors and not as much with the state legislatures, which is legitmate. But given the time and the way it was -- the way the situation was to try to get it through, we didn't have much choice. We did talk to some state legislators. We talked mainly to governors and we let the NGA do that primarily.

Now some states have much bigger problems than others. I went out to the National Governors Association in Seattle in August, and spent two days getting pummeled trying to explain it to the governors, and I went out to the Midwest Governors Association meeting. Anyplace I was invited I tried to explain this problem because it was a huge problem for the governors. The governors that had a very heavy investment in this, like Governor Edgar in Illinois or Governor Wilson or Governor Richards in Texas--

MR. COLE: Ashcroft.

MR. SCULLY: Ashcroft-- Well, their's wasn't that big. Governor Ashcroft was the head of NGA at that time, and he got very involved. But, a lot of the big states had a very major stake in this. Governor Chiles, in Florida--

The only difference in intensity I would say is that the governors that have a lot of it are very interested in it and the governors that weren't doing it at all were furious that they hadn't figured it out yet.

MR. CALLAHAN: But, to our knowledge there was no document that all 50 governors signed.

MR. SCULLY: There was correspondence back and forth, I'm certain, because the NGA could not sign off on it untill we had the unanimous agreement of the governors.

MR. CALLAHAN: Of all 50 governors?

MR. SCULLY: That's my understanding from the NGA; that they had all 50 governors sign off. Now some governors were far more intensely interested than others. They had a lot of correspondence back and forth with all their governors -- whether the governors' staff signed off on it, whether the governors signed off on it, I don't know. But I can tell you that they had some states weren't that involved in it, other states not only was the governor intensely involved, but, you know, this thing was on the floor of the Senate off and on for a couple of days, and I can tell you in some states both Senators spent hours talking to me about how they were going to fix their problems if they had any, making sure they understood what the deal was, so it varied greatly by which state-- And I can tell you, to get if off the floor of the U. S. Senate, if one Senator had objected it would have been gone. And I can tell you that West Virginia where Senators Rockefeller and Byrd were extremely involved, Kentucky where Senators Ford and McConnell were involved, California, Louisiana, I mean there were probably a couple of dozen states where there were members that were intensely involved and specifically how it was going to affect their state programs. So, it was not a lightly taken bill even though it passed by unanimous consent. It was very controversial and--

MR. CALLAHAN: But you have no specific knowledge of New Jersey's involvement in those discussions with NGA. Is that correct?

MR. COLE: During the negotiations, the NGA negotiators routinely met with the Washington representatives of as many states as wanted to attend.

MR. SCULLY: New Jersey was involved in it, I know, because at one point we were concerned after Mr. Waxman's bill passed the House prohibiting us from putting in another regulation, we were pretty sure, likewise, because we had Senator Dole and other people in the Senate helping us, that we could keep it from getting to the Senate. I mean, we weren't going to let another bill pass prohibiting us from slowing this down, but we also didn't look too good in October for passing, you know, accompaniments. A number of states were very worried about it -- probably two dozen states -- we actually began to start talking to them about trying to work out-- Because the states were worried about what they were going to do for the next year and it was a very uncertain time. So, a number of states, Ohio, I remember specifically, five or six other states wanted to come in and kind of negotiate something we could live with because they knew we were going to put out a regulation in January and they wanted to work out something they could live with.

I had a lot of discussions with Brenda Bacon who works for Governor Florio about that. So I know that-- And I have--

MR. CALLAHAN: About this specific point?

MR. SCULLY: No, not about this specific point because nobody knew it until the legislation passed, but about trying to develop a different program, assuming we couldn't pass legislation -- nothing about this specific point. But my point is, they were very aware of what was going on, and she was involved in it. I'm not trying to say positively or negatively. I think she's a good staff person and she was pretty much on top of it, so I'd be surprised if the Governor wasn't aware of the negotiations. I never talked to him personally, but I talked to Brenda off and on during that period and they were aware of what was going on with the NGA. They were very aware of what was going on. I wouldn't say one of the more active, you know, states as far as negotiating at the end, but they where aware of what was going on.

As far as this specific idea of when they sent in the state plan, what the retroactive claim was, I never discussed that with her at all. I wasn't even really familiar with it until this year when it came up that the state was trying to claim $414 million of which a large chunk was retroactive.

The whole problem has been the retroactive payment, and I think nobody asked me at the time, but I think I would have told them right then if they asked, that we didn't think that was legitimate. Obviously they put it in their budget, and I'm sure you could find a number of very respectable Medicaid lawyers, like you two, that think they might have a claim, but we don't think it's very strong.

SENATOR LaROSSA: But the involvement with regard to staff out of the Governor's Office really would have been as it related to the closure of the loophole and stopping the system from melting down, not as related to negotiating a specific point--

MR. SCULLY: They were never involved with negotiating a specific point. Brenda Bacon, who I think was the Health Advisor, or whatever, that I dealt with here in a bunch of issues. She came down to talk to me about AFDC waivers, Medicaid waivers, and a number of other things. When this thing looked like it wasn't going to be solved-- I mean, basically what you had was an enormous war going on between basically me and most of the states because the states-- You know my job was to try to slow this thing down, and Gail Walensky's, and we were threatening to put out a regulation on January 1 that was going to basically cause a lot of states to go find $10 billion in revenue someplace else. You can imagine they weren't too happy about that. But we were trying to keep this program from exploding, so we had a little game of chicken going on at the time where we were saying either negotiate with us and try to find a rational solution -- which we did in the end -- to put a cap on this or we're going to basically blow this thing up on January 1. So, a lot of states that were afraid or worried about what was going to happen, started to come in quietly and say, "Look, we need to continue our program at some level. It doesn't look like you're going to find a way to work this out with the Congress. Can we work out, like, side deals on our own?" And five or six states started to do that. Brenda had gotten to the beginnings of that, probably in October, and we had a couple of discussions about when the negotiations started getting better with the Congress and the NGA -- we spent a lot of time in negotiations with the NGA -- she was not real heavily involved in that, so--

SENATOR LaROSSA: I just want to clarify one point in my mind. As it relates then to NGA -- people from New Jersey negotiating whatever they were involved with -- with regard to conversations -- it really was very narrowly focused with regard to the explosion of the program and trying to bring it back under control and the fact that it was going to be, you know, shut down or squeezed down to get a level playing field as opposed to any negotiations that would have taken place with regard to any points of a specific claim, i.e, retroactivity.

MR. SCULLY: Oh, there were a lot of discussions about that because a whole bunch of states wanted to come up with new plans at the end and we basically said anybody that's in before a certain date, we'll let you continue your program for one more year if its been ongoing, but we're not letting any new programs come in at all. Because, not only do we not want to pay retroactively, we didn't want to pay prospectively for new programs that violated the law. So we had very clear discussions about that. Not only did we say that we wouldn't pay retroactive, we said if you're not in by a date certain, we're not going to accept any new programs. So, one of the debates would be-- You could make an argument, I'm surprised HCFA hasn't made -- that if you did not have an approved program in by November 26, 1991, that you weren't going to get any money for that program. Now what's happened, apparently, is that HCFA's agreed that even though you may not have had public notice, that submitting your plan on November 22, at least met that deadline. If you had not submitted your plan at all before November 26, you wouldn't have gotten a dime even prospectively. Is that right?

MR. TORPEY: Right.

MR. SCULLY: So HCFA has at least agreed that since you technically got your plan submitted by November 22, even though it didn't have public notice, that at least counted for submission and you got it in before the deadline so they pay you prospectively. Had you not gotten it in at all until November 27, you not only wouldn't have gotten it retroactively, you wouldn't have gotten it prospectively either. So, I think it's pretty clear that we were trying to shut-- We not only were trying to slow it down, but nobody even envisioned that we'd be paying retroactively. It was all a matter of would we paid prospectively. See what I'm saying?

SENATOR LaROSSA: Uh-huh.

MR. SCULLY: It never even occurred to me that somebody would try to come in and get a back payment from a program before November 26. I just didn't, and I mean, I was--

MR. TORPEY: I know--

MR. SCULLY: I mean if anybody else that negotiated it-- Because basically Gail Walensky and me and Steve did a lot of staff work and I'd say that I was the major public enemy number one at the time. I had to deal with--

MR. TORPEY: There just seems to be some disagreement between what we view as when our plan is effective because New Jersey believes that it did have a plan or it staked it's claim, so to speak, back in September of '88 which had the effective date of July 1, '88 and that the change that we made on November 22, 1991 was simply an amendment to the submitted amendment.

MR. SCULLY: No, I understand your argument. I totally understand your argument. I would argue that what the original plan of $4 million or $5 million a year is even less than that. In disproportionate share payments that was a technical-- The one on November 22, 1988 which happened to be thrown in the middle of the negotiations at the last deadline to expand the program to $140 million a year that-- I know you're going to make the argument you should do it in court-- (laughter)

MR. TORPEY: No, that's fine. And I guess that that actually gets me though to-- I think, quite frankly--

MR. SCULLY: I mean, I will say that as a matter of public policy, because I've, in the last four years, you know, basically received about $700 billion in the budget-- This is the biggest disgrace in-- I mean, it's not just New Jersey -- nationwide, the fact this happened, it's so complicated the average taxpayer doesn't understand it, but the fact that it happened is an absolute disgrace. It's horrifying to have $130 billion -- well, it's going to be in this one program about $100 billion over the next five years -- go out the door because of a technicality that nobody knows about. And I'm not saying it's not doing wonderful things for hospitals in lots of states. It's just happening without any real public discussion or oversight.

MR. TORPEY: The final point that I had an interest in had to do with the California DAB decision which seems to be -- the Human Services Departmental Appeals Board decision regarding California's disproportionate share payments -- it seems to be there's some points that seem to be onpoint with New Jersey's case. Are either of you familiar with that or able to discuss that?

MR. COLE: Nope.

MR. SCULLY: Nope. I'd be happy to be educated, but I don't know anything about it.

MR. TORPEY: Well, quite frankly if there--

MR. SCULLY: No, I'm not familiar with it at all. The point is I don't think--

MR. TORPEY: I read the decisions. It seems to me that there's some very--

MR. SCULLY: The reason HHS didn't come today is obviously because they think there's going to be some litigation. I don't think it has anything to do with this because I wouldn't have been able to mention it. But they just don't think-- I mean, if there's going to be further litigation, which we hope there won't be, I don't think it's appropriate to discuss it. I was just trying to give you all-- I mean I had a lot of telephone conversations. I was trying to give you all some context about how this happened and how the time--

MR. TORPEY: That's fine. There's just some points, just for the record, there's some points in the DAB decision which deal with no public notice--

MR. SCULLY: The HHS appeals?

MR. TORPEY: Yes, the HHS Appeals Board which deal with public notice, which deal with what constitutes significant change, and arguably, New Jersey is positive-- New Jersey's case is positively affected by the points made in that decision.

MR. SCULLY: For $300 million you should take the case on a contingency. (laughter) I mean, I'm not going-- I mean, obviously you're going to make those arguments. I think-- I mean, I've looked at the appropriations language and I'm familiar with what's happened in the past in these types of retroactive payments to some degree. You know, you may win. It will be setting a new precedent if you do. I'd be surprised.

MR. CALLAHAN: You had indicated that--

MR. SCULLY: And I think basically in a public policy argument -- just looking at this historically -- that if, in fact, you did win there would be a pretty damned good chance somebody would go back and legislatively would prohibit the payment. Just because it would set an unbelievable precedent for all the other states to go back and make the same claim. It would be an enormous cost to the Federal government. I think it's pretty clear that New Jersey had no real governmental structural scheme to make this kind of payment anywhere between 1988 and 1991. They just found out they could do this at the last minute and they submitted a plan to do it. Nobody was out there expecting -- between 1988 and 1991 -- envisioning this money was going to come through the system.

SENATOR LaROSSA: Can I ask, at a point in time only because in terms of trying to dig through it and only because you would be perhaps more familiar with it, some section you say in the budget language or the appropriations language as to where retroactivity would have been specifically excluded--

MR. SCULLY: It's in the 1990, probably the 1980 through-- Every year-- It's called the Labor HHS Appropriations Bill. I don't know what the number is this year, but every year there is a stock provision in there that says every year that you can only pay for-- Only reimburse for expenses.

MR. COLE: You can find the language as well in any budget -- any Federal budget.

MR. SCULLY: Yes. Nobody ever read any of them. Just pick one out and crack open the pages. (laughter)

SENATOR LaROSSA: We'd like some light reading instead of our newspapers.

MR. SCULLY: Yes, it's very light reading. I'll miss writing those things. (laughter)

MR. CALLAHAN: You had indicated before that New Jersey would be entitled to the money from January 1, 1992 to present.

MR. SCULLY: Prospectively.

MR. CALLAHAN: Wouldn't it really go back to 11/22/91?

MR. SCULLY: That's something that's still subject to negotiation with HHS. I don't think they have approved your plan at all, and I probably shouldn't count on it. My understanding, unofficially, is that there are minor technical differences left, and that there is not too much debate about the reimbursability of New Jersey's plan from January 1, 1992 forward. The issue is back. I guess the issue of how far forward they pay you has to do with when the plan is considered submitted, and that may be January 1, December 29. They argue that you have to have public notice, which you obviously didn't accomplish with -- public notice with the plan submitted until December 28.

MR. CALLAHAN: Or it may go back to 11/22.

MR. SCULLY: It could go back to 11/22, or maybe some other date of submission. But their argument is the date of submission of that plan was, you know-- It was the ant that was submitted in 1988, not the elephant that sat on it in 1991. (laughter)

MR. CALLAHAN: But no dollars have been authorized to date.

MR. SCULLY: Pardon me?

MR. CALLAHAN: No dollars have been authorized to date.

MR. SCULLY: I don't think so. Is that right?

MR. TORPEY: We keep hearing conflicting information on that.

MR. COLE: What is the latest thing you have heard?

MR. TORPEY: Actually the latest, I'm not sure. The latest might be that we are not getting it, but it has gone back and forth two or three times.

MR. CALLAHAN: What is the Federal government's position on this?

MR. SCULLY: Well, my position is that it's, you know-- Basically our involvement in this-- These are the kinds of day-to-day transactions that happen with HCFA on state Medicaid plans all the time. I usually get involved in them when they have massive complications and explode, like they did in the case of this legislation. As a result of my heavy involvement for a year-and-a-half in trying to fix this program legislatively, I have gotten a little more involved because most of the states that had problems generally remembered me, and came back to find me. So I have gotten involved in the details of this program more than I normally would, but the decision about -- you know, the technical decision about when it was submitted and when they would reimburse you is generally, you know, a HCFA issue, and a HCFA decision.

I have gotten involved in the retroactivity issue a little bit because obviously Governor Florio and his staff, and you and other people, have called up and made the arguments, you know, pretty strongly, and $300 million or $400 million is not a small sum of money. So it has gotten to another level where we kind of got involved in it.

MR. CALLAHAN: If we could clarify one point--

MR. SCULLY: At least in looking at it to make sure that the merits were looked at.

MR. CALLAHAN: If we could clarify one point: There seems to be some discussion from the Federal side that the first time New Jersey involved the State and county psychiatric hospitals was August of 1991 when they requested-- There have been letters back and forth, 9/30/88; the Federal government wrote back 11/18/88; New Jersey 9/29/89; Federal government back on 1/8/90; and then on 10/5/90, all of those letters stated the State and county psychiatric hospitals were included in the correspondence. So that they were, right from the beginning, involved with State and county psychiatric hospitals, and not just acute care. I want to ensure that we clarify that point.

MR. SCULLY: Well, I mean, I think that gets back to the issue--

MR. COLE: Are you asking whether we are aware that this involves the psychiatric hospitals that the State and county--

MR. CALLAHAN: Right.

MR. COLE: Yes, we are aware that this disproportionate share in the State plan amendment is exclusive to the State and county psychiatric hospitals; that there is a separate plan for acute care hospitals, which operates essentially the same way.

MR. CALLAHAN: Right.

MR. COLE: But it is just a different State plan amendment, and that is not under dispute here.

MR. CALLAHAN: But the State and county psychiatric hospitals went back to the 9/30/88. They were first stated in that correspondence. You were constantly--

MR. SCULLY: Well, it was originally in '88 a very small program to help subsidize--

MR. COLE: Right.

MR. SCULLY: But I mean the way that the notice was filed in '88-- It was a fairly small, limited program that affected some State psychiatric hospitals. I don't know what the payment level was, but it was relatively minimal.

MR. TORPEY: It was $15 million for the year.

MR. COLE: The fact is, when a state submits-- You probably know this, but when a state submits a state plan amendment, HCFA has 90 days to approve it. If it doesn't take action on an act they approved otherwise, it must either say, "It is not approvable," and seek additional information within those 90 days, or otherwise it is approved. The letter I assume of September 30, 1988 was a letter which inquired about information that was necessary for HCFA to approve it. That is really a level of detail we don't get into.

But, you know, as I understand it, there was a substantial amount of dialogue that occurred over the years between the first submission and the November 22, 1991 submission. It is also our understanding that the November 22, 1991 submission was, in essence, a substantial departure, given all the conversations that had taken place. This was a different beast.

MR. CALLAHAN: Isn't it true substantial from the point of view of the dollars, but not substantial insofar as the State and county psychiatric hospitals were always included going back to 9/30/88?

MR. SCULLY: I am not sure that this is an area-- If there is subsequent litigation -- which I hope there is not -- I'm sure it will be exact on these points. I am pretty confident from looking at it that HCFA-- Let's put it this way -- now that I am leaving I can say these things -- HCFA has not been known for its strong backbone in these cases, so they feel pretty strongly about this one. They generally don't make these kinds of arguments unless they are pretty clear on the legal end and the merits of it. It is possible that it could turn out the other way, but I think this type of issue is probably what will be the source of some future legal controversy. I am not sure if we-- This is not the kind of work that we get into. We have not gone through it with the State or anyone else; reviewed the files. These are files that we don't have. I think I was just trying to clarify for you timing-wise and politically and historically what's happened.

You know, I guess the point I made at the beginning, which is, you know, because this has obviously become a fairly major political issue up there-- It is that I don't think the interplay here -- what happened -- is much different than what happens in most other states here in Washington. The Governor had a nice big amount of money that he thought he had some claim to, and he probably wasn't totally without merit in thinking that, although I think, you know, if you could get 10 or 20 lawyers together you might not find too many out of that group to think that. But he thought he had some legitimate claim to the money, so he sent it in and, you know, it made it easier to make the budget numbers meet. He may very well still get it, but he probably won't. The fact that he didn't get it, and won't likely in the future, creates a problem for you all. This is not the first time it has ever happened, I don't think.

SENATOR LaROSSA: We are really trying to get an historic perspective, as you said, in terms of -- as well as--

MR. SCULLY: I'm just not sure it helps us to get into--

SENATOR LaROSSA: I agree.

MR. SCULLY: Future litigators might have to do it someday.

SENATOR LaROSSA: You made a comment earlier; I have heard it repeatedly. We had it in our last piece of testimony. They keep referencing a loophole in the law. You used it before. Even New Jersey's own Human Services people and our OMB people, they keep referring to a "loophole." I am assuming you mean the same thing.

MR. SCULLY: Well, a loophole in the law is maybe not-- It may have been intentional. I can't ever find anybody that will tell you that. I am just telling you that what happened in 1990 was that we had a very long, miserable five- or six-month negotiation over the budget agreement. The most contentious stuff at the end -- surprise, surprise -- as you see now, is taxes. The second most contentious--

SENATOR LaROSSA: That's on the Federal level, not the State level.

MR. SCULLY: Yes, on the Federal level. You know, basically it was Darmin (phonetic spelling), the Deputy Director OMB, and the three associates, of which I am one, who negotiated this. I did most of the entitlement stuff with the help of Steve and some staff people. You know, even in my area -- I wasn't doing any taxes -- Medicare is by far the most contentious issue. Medicaid was somewhat of an afterthought. At the end, it turned out to be the single last issue holding up the budget agreement the last night, and we stayed up all night long and argued about Medicare and Medicaid. We got through it at 4:00 in the morning. They argued about--

Basically the argument at that time-- There used to be a program called-- We thought we were shutting the thing down. The original program set out donations in the '80s, where the hospitals would get together and donate money to the states. The state would call up their own to get the match -- some states. We were trying to shut that down. The states had argued at the time-- You have to understand, our understanding of this whole thing then was probably pretty elementary. It wasn't very good. It still isn't. It is a very complicated program. But, some states had argued that it was -- you know, they could understand if we were trying to keep Pennsylvania from getting donations from the hospitals and using them for a state match to get Federal money. But if the state had a legitimate tax, you should allow legitimate taxes.

The argument made at the time was that-- At the time, Florida had a state hospital tax, not too unlike New Jersey's, only Florida's was, like, a 1 percent hospital tax. The argument said, if Florida wants to go out and tax its hospitals 1 percent to put together a disproportionate share pool and then spread that money back to the hospitals, why do you care if they do it through a legitimate tax? The example given then was Florida. Florida happened to be taxing all of the hospitals at 1 percent. As a matter of public policy, it didn't look too bad because mainly the money was going back to poor hospitals. So the wealthiest suburban hospitals were not getting much money back. They might have been getting taxed at 1 percent, but they might get 20 percent back of what they paid in, and the poor urban hospitals that needed the money were getting kind of a transfer payment. That seemed to be legitimate public policy, and we didn't seem to mind that.

So what we did was, we changed the law to say that donations weren't allowed, but taxes were. Okay? The problem is, we weren't smart enough then to realize that some of the staff people-- It is debatable whether the staff people knew what they were doing or not -- the Federal staff people on the Hill. That was kind of a loophole. You have to realize that at this point this was an issue that came up at 4:00 in the morning for maybe 20 minutes, and I sat there listening to HCFA people--

MR. COLE: What you have to understand is, once an agreement is reached, then the staff goes back and drafts language to implement the--

MR. SCULLY: And they drafted the language a little differently than what the agreement was, too -- much tougher. I'm sure you have been through that.

SENATOR LaROSSA: I totally rely on--

MR. SCULLY: That's right. That's why you have good staff there. But somehow, the staff people who-- Some of them argued with me and wanted to expand the Medicaid Program, and saw this as a loophole, as a way to do it. But, number one, I don't think we really understood what we were doing. We said, "Okay, we'll get rid of the donations." We thought most of the programs then -- the Kentucky program, the Tennessee program, and all those programs -- were donations programs, where the hospitals voluntarily donated to the state; the state took the money, sent it off, and got a payment back from the Federal government.

We were trying to prohibit those and we thought we were shutting the thing down. Mr. Waxman and others said, "Well, look, taxes. If the state wants to set a legitimate tax and they want to just go out and tax all the hospitals, you should do that." So, instead of qualifying that, we just said donations are out, but basically the language says the Federal government cannot prohibit the tax programs. Well, it didn't take long for the states to all turn around and figure out what to do, and we didn't catch on to that. What they basically did was tell us they wouldn't tax all the hospitals, they would just tax some of the hospitals.

So essentially what happened was, a lot of states went out and said, if you have 100 hospitals in the state and 50 of them are, you know, relatively poor hospitals, we won't tax the low Medicaid hospitals; we'll tax the high Medicaid hospitals, and we'll tax them maybe on 10 percent of their revenues, collect them, send them en masse to the Federal government, get back the money, and pay them all back twice what they put in. What happened pretty quick was, the states were saying, "Oh-- You know, the hospitals would say-- They would say, "A 10 percent tax? Please, tax us 20 percent, tax us 30 percent," because they were getting double their money back in 30 days.

What we envisioned was-- And that's why the new rule that came out of the subsequent legislation was a broad-based, redistributive tax; the concept being that if you want to go out and tax every hospital in the state, which New Jersey was doing with its 19.6 percent tax--

SENATOR LaROSSA: Right, right.

MR. SCULLY: As a public policy matter, if a state decides to tax every hospital in the state, rich hospitals pay in "X" and get back one-tenth "X"; poor hospitals pay in "X" and get back two "X." You know, it is hard to argue that as a public policy matter. It is redistributive. There is a natural barrier beyond which was the argument in Florida. Florida used to have a 1 percent hospital tax. They tried to raise it to 2 1/2 percent, and some of the richer suburban hospitals went wild, because they weren't getting the money back they paid in, and they could beat the tax.

The argument all along was, if you have a natural-- As long as there is a natural barrier where there are winners and losers and the losers will scream, then you are going to have the normal political tensions you have. But what has happened in these tax schemes in the states is, they only tax the ones that are going to win. They tax the money, collect it, send it off, get the money back and pay the winner. So, you know, as long as everybody is winning and keep doubling their money every two months, there is nobody to be too unhappy.

SENATOR LaROSSA: It sounds like it would have an impact to be contrary to that loan position, doesn't it?

MR. TORPEY: I think so.

MR. SCULLY: When you talk about the loophole in the law, the loophole in the law in 1990 was, number one, instead of just saying, "We are getting rid of the whole program," we agreed to get rid of donations but allow taxes. When the language was written, it basically didn't say, "We'll allow taxes." It said, "The Federal government cannot prohibit any taxes of any kind." That is what opened up the floodgates.

SENATOR LaROSSA: Okay.

MR. SCULLY: Do you follow?

SENATOR LaROSSA: Yes, I do. I only have one other question.

MR. SCULLY: You haven't said a word yet, Steve.

MR. COLE: I'm listening.

MR. TORPEY: You handle it very well.

SENATOR LaROSSA: I really only have one more point, which is the second half of-- I apologize for going back, but I just want to understand one other role in this entire negotiation as it relates to trying to stop that meltdown. I think I have a pretty good idea in terms of the NGA, the negotiations, Brenda Bacon, and people of that nature.

MR. SCULLY: Well, Brenda wasn't-- The guy who negotiated-- Two people when we talked to them were Ray Shapock (phonetic spelling), who is the head of the NGA, who I think did a great job. He didn't want too much. It is very hard to be the head of the NGA and have 50 states with this much on the line. I don't know whether Ray is a Democrat or a

Republican, but they were both mad at him. And, Alicia Pelrine, who was from the Medicaid staff. They did most of the negotiations.

SENATOR LaROSSA: What was the last name?

MR. SCULLY: Alicia Pelrine.

SENATOR LaROSSA: But the other part-- You mentioned Congress and the U.S. Senate in terms of their involvement, their notification, their acquiescence of buying into the entire scheme in terms of stopping the meltdown. How were they brought into the process? You started mentioning about how you met with almost a whole bunch of them.

MR. SCULLY: Well, the states were, you know-- I mean, as it would probably be in your Legislature. There are 435 House members and 100 Senators, but there are only about six staff that really understand this, which is the way it usually works, I'm sure, in your Legislature, too.

MR. COLE: That's an overstatement.

MR. SCULLY: Pardon me?

MR. COLE: That's an overstatement.

MR. SCULLY: Yeah, maybe five. And the original view of the staff, when we started talking in the spring of '91 about trying to find a legislative fix, was, "You may be right, but good luck. You are going to have 50 governors who, you know, want the money, who are into this. It is never going to happen, and you are going to get creamed."

So the staff were kind of sympathetic to working something out. They were just sure that we could never pull it off. Congressman Waxman was violently against anything, because he looked at the-- He has generally supported expansions in the Medicaid Program for years, and I think, well, you could argue whether his staff that did the drafting in 1990 did it intentionally or unintentionally. They argued that they didn't know at the time what exactly the impact was. Once it happened, I don't think they were unhappy to find that this was an enormous new source of basically unfinanced -- it didn't have to be financed -- Federal spending on the Medicaid Program. It was basically a deficit-financed $12 billion a year injection of money into the Medicaid Program. I don't think he was unhappy about it. In fact, they were probably happy to see it keep going, which is why he fought us for a long time.

As it went on -- and I think we explained to some of the governors, and to some of the governors' credit-- Governor Ashcroft, who had a state that was somewhat into this; even Governor Romer. There were a couple of governors who basically understood that this was going to cause the Medicaid Program to explode. They knew also, once they understood how it worked, were somewhat upset about the public policy. I would say, to be fair, that their view was, "This is terrible and outrageous public policy, and we probably should slow it down, but we sure can't afford to give back the money we got."

So, I think what basically happened was, a lot of governors realized once you explained it to them, and it wasn't easy to explain how this thing worked and what was going on, you know, most of them, their Medicaid Director walked in and said, "Guess what? I got a Christmas present. Here is $100 million, or $400 million," or whatever. And they all said, "Great. This enormously solved our budget problem." I can't blame any governor for doing that.

SENATOR LaROSSA: But the big difference is that the governors have a Medicaid person who supposedly deals with this and who is, if you will, an expert. When you get into Congress and you get into the U.S. Senate, they don't necessarily have staff people who are as intimately familiar with the specifics of the--

MR. SCULLY: Of each state.

SENATOR LaROSSA: Well, not only each state, but obviously the Federal regulations at all. I mean, you know, quite frankly--

MR. SCULLY: Well, you can see that by the difference in the states--

SENATOR LaROSSA: Then we have had a reasonable--

MR. COLE: No, I think that is probably not reasonable. I think there are two experts who are on the congressional staff.

MR. SCULLY: There are experts.

SENATOR LaROSSA: No, no, on congressional staffs.

MR. SCULLY: Yes, committee staffs. Yes, Congressman Waxman's people are experts, and Senator Bentsen's people are pretty good, too.

MR. COLE: They have people who pay attention full-time to Medicaid.

MR. SCULLY: They have people who do nothing but Medicaid on those staffs. Congressman Waxman probably has four or five; Senator Bentsen probably has two.

SENATOR LaROSSA: So, in addition to what OMB may have, or HHS might have, a staff who would understand these, the congressional staff who may be expert in that area would be another resource, if you will, on a parallel basis to other staff members or other members of the--

MR. SCULLY: Yes, but there weren't too many people who knew what was going on simultaneously in all 50 states. Every state had a different tax scheme; every state was doing it a different way. Some states didn't figure it out for awhile. You can see the difference from New York's 2.7 billion and you all at 140 million, and Alaska is at zero, or whatever, and a bunch of other states are at zero. Some states figured it out earlier; some got a bigger hit out of it. But I think it is fair to say that most governors, when it came in there basically was a new source of revenue, and really nobody understood or cared very much. I mean, Governor Sununu got deeply involved when he was Chief of Staff. He understood it a little bit because he remembered the State Medicaid Director coming in and saying, "Here's a great revenue-sharing thing."

And, actually, as far as working this out, he was unbelievably helpful because he had seen it going on in New Hampshire, and then when he came down and he became a Governor, when all the other governors came in upset about, you know, the Federal government trying to restrict their new source of revenue, he understood it. He was also friendly with a lot of them and he kind of helped to slow them down and get them to take a second look and then understand it. Governor Sununu spent many, many, many hours on the phone with me with governors. That's probably the only reason I'm still alive today. (laughter) He got very involved with it. But I think a lot of the governors, especially Governor Ashcroft and Governor Romer, when they looked into it, they basically said, this is crazy. It doesn't make any sense. We've got to do something to slow this down. But, on the other hand, you know, I can't afford to give up 100 million, 50 million, 400 million out of my budget. So, while we think it's bad news and we should try to fix the problem, we're sure not willing to give the money back because we don't have anyplace else to get it. So that is essentially what the compromise worked out to be in the end.

The problem was, some states came back in and said, "Hey, we missed out, and for the last four years, we would like to collect on that, too," which essentially is the situation New Jersey is in.

SENATOR LaROSSA: Jack, do you have anything?

MR. CALLAHAN: Just one. You indicated there was some correspondence when we talked about the NTA. You thought there was some correspondence available.

MR. SCULLY: All right. I don't--

MR. CALLAHAN: If any correspondence is available, we would appreciate it.

MR. COLE: That is just speculation.

MR. SCULLY: That is just speculation. I remember that when I was-- I mean, I was the other side of the negotiation. You know, who knows, it may be one of these car dealer things where they say, we've got to go check with our boss, and run into the back room. They never did anything. They smoked cigars.

SENATOR LaROSSA: How many car dealers were there?

MR. SCULLY: But they always said to me, you know-- They always said, "Well, we can't agree with that yet. We've got to go back and call all 50 governors and send them faxes." I saw a few of them, so I know there was some correspondence. But in theory, as we were going through these negotiations every day, they had to go back for a couple of hours and check with the governors and send faxes back and forth.

MR. COLE: Maybe it was just a clever negotiating ploy.

MR. SCULLY: It could have been a clever negotiating ploy. You never know.

SENATOR LaROSSA: The vote in the Senate-- Was it 100 to zip, where there was no dissenting vote?

MR. COLE: It was unanimous consent.

MR. SCULLY: Unanimous consent.

MR. CALLAHAN: It had to be.

MR. SCULLY: It had to be. It could not have gone through.

MR. COLE: They had to suspend the rules in order to--

MR. SCULLY: It was the last day of Congress, and anybody who wanted to filibuster could have, so it had to be unanimous consent or it would not have gone through. It was not easy. In fact, to be honest with you, one of the things that got through at the end was, we were originally planning to have-- The original cutoff date for no new plans was October 1; and Connecticut had sent one in on November something.

Anyway, the only reason you arguably get that November 22 would count, is because a couple of the states -- and I don't think New Jersey came up in the discussion at that point--

MR. COLE: No.

MR. SCULLY: But a couple of states had sent in plans already in late October, early November, and would have missed the October 1 cutoff date we had in the original draft. So we moved it back to November 26. So it was almost by accident that your November 22 filing would have made it in. I mean, that was something that was done at the last day to keep a couple of Senators from killing us, you know.

SENATOR LaROSSA: I think we have exhausted matters.

MR. SCULLY: You have exhausted my knowledge, I know that; at least my memory.

SENATOR LaROSSA: We've exhausted my capacity for--

MR. COLE: I am just exhausted.

MR. SCULLY: Well, I know it is a big fight up there, and I understand. If I were in your situation, I would be outraged that you just had this $350 million, or whatever it is, hole in your budget thrown in your lap to finance. On the other hand, if I were in Governor Florio's shoes, I can't tell you that I wouldn't have done the same thing, having done similar things in our budget.

SENATOR LaROSSA: I think the fact of the matter is -- and I think your comment is probably going to be the most accurate one -- that whatever the intent-- I guess when you get into what the letter of the law is versus the spirit of the law versus what the question is, and you have two sides on an issue, it probably is going to end up being resolved in litigation.

MR. SCULLY: It probably will end up being resolved in litigation. If I were you all and I had $300 million at stake, I would probably litigate it, too. You know, the lawyers can't cost you that much.

SENATOR LaROSSA: He's on staff. This is the guy who does it at 3:00 in the morning.

MR. SCULLY: So you go out and, you know--

SENATOR LaROSSA: You have to understand, he is the one who puts it in at 3:00 in the morning. It is Robbie's (Committee Aide) responsibility to find it at 5.00 and correct it.

MR. SCULLY: Well, I have done that for 13 years. I would be a rotten private lawyer. I would have preferred to stay here in the government, but let's not mention it.

SENATOR LaROSSA: (Concludes briefing.)

(BRIEFING CONCLUDED)