SUPREME COURT OF THE UNITED STATES

No. 93–120

THOMAS JEFFERSON UNIVERSITY, DBA THOMAS JEFFERSON UNIVERSITY HOSPITAL, PETITIONER *v.* DONNA E. SHALALA, SECRETARY OF HEALTH AND HUMAN SERVICES

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

[June 24, 1994]

JUSTICE THOMAS, with whom JUSTICE STEVENS, JUSTICE O'CONNOR, and JUSTICE GINSBURG join, dissenting.

The Court's opinion reads as if this were a case of model agency action. As the Court views matters, 42 CFR §413.85(c) (1993) is "unambiguous," *ante*, at 9, and respondent Secretary of Health and Human Services (Secretary) has always been "faithful to the regulation's plain language." *Ante*, at 11. That plain language, according to the Court, required the Secretary to disallow the reimbursement petitioner sought. The Court's account is hardly an accurate portrayal of this case. When the case is properly viewed, I cannot avoid the conclusion that the Secretary's construction of §413.85(c) runs afoul of the plain meaning of the regulation and therefore is contrary to law, in violation of the Administrative Procedure Act, 5 U. S. C. §706(2)(A). I therefore respectfully dissent.

The Court holds that §413.85(c) has substantive content, reasoning that "the language in question speaks not in vague generalities but in precise terms about the

conditions under which reimbursement is, and is not, available." *Ante*, at 13. In my view, however, §413.85(c) is cast in vague aspirational terms, and it strains credulity to read the regulation as imposing any restriction on the reimbursability of the costs of graduate medical education (GME) or other approved educational expenses. On the contrary, subsection (c) appears to be nothing more than a precatory statement of purpose that imposes no substantive restrictions.

Subsection (c), in stark contrast to the remainder of §413.85, reads more like a preamble than a law. See *ante*, at 2–3, n. 1 (quoting §413.85(c)).[1] In the community support portion of §413.85(c), the Secretary praises the benefits of approved educational programs and expresses a belief that communities "should" pay for such programs. The subsection then announces the Secretary's intention to support such activities "appropriately," limited only by the vague suggestion that at some point in the future a restructuring of fiscal priorities at the "community" level may obviate the need for federal support. The anti-redistribution principle is no less precatory than the community support principle. It states two "intent[ions]": first, to pay for the "customar[y] and traditiona[l]" educational activities of Medicare providers, and, second, to avoid reimbursing expenses that should be borne by educational institutions affiliated with teaching hospitals. I would not permit the Secretary to transform by "interpretation" what self-evidently are mere generalized expressions of intent into substantive rules of reimbursability. Cf. *Stinson* v. *United States*, 508 U. S. ___, ___ (1993) (slip op., at 8–9) (an

[1]Like the Court, *ante*, at 3, I refer to the last sentence of 42 CFR §413.85(c) as the "anti-redistribution principle," and to the remainder of the subsection as the "community support principle."

agency's interpretation of its own regulation cannot be sustained if "`plainly erroneous or inconsistent with the regulation'") (quoting *Bowles* v. *Seminole Rock & Sand Co.*, 325 U. S. 410, 414 (1945)). See also *Udall* v. *Tallman*, 380 U. S. 1, 16–17 (1965).

We rejected a similar attempted transformation of precatory language in *Pennhurst State School and Hosp.* v. *Halderman*, 451 U. S. 1 (1981). There, we addressed a claim that the "bill of rights" of the Developmentally Disabled Assistance and Bill of Rights Act of 1975, 42 U. S. C. §6010 (1976 ed. and Supp. III), created substantive rights in favor of the mentally retarded. The bill of rights provided, in part, that such persons "have a right to appropriate treatment, services, and habilitation" and that State governments "have an obligation to assure that public funds are not provided to any [noncomplying] institutio[n]." §6010(1), (3). We held that the bill of rights did not have substantive effect: "§6010, when read in the context of other more specific provisions of the Act, does no more than express a congressional preference for certain kinds of treatment. It is simply a general statement of `findings' and, as such, is too thin a reed to support the rights and obligations read into it by the court below." 451 U. S., at 19. Even though *Pennhurst* did not involve an agency regulation, its textual analysis suggests that it is unreasonable to give substantive effect to precatory, aspirational language—as would the Secretary's construction of 42 CFR §413.85(c) (1993). Cf. *EEOC* v. *Arabian American Oil Co.*, 499 U. S. 244, 260 (1991) (SCALIA, J., concurring in part and concurring in judgment) (explaining that "deference is not abdication, and it requires us to accept only those agency interpretations that are reasonable in light of the principles of construction courts normally employ").

Interestingly enough, for the first two decades of the Medicare program's operation, the Secretary's fiscal intermediaries, with her acquiescence (if not

approval), gave §413.85(c) precisely the same substantive effect as I would—none. During that entire period, the Secretary *never* invoked the subsection to deny reimbursement for previously unreimbursed costs, and providers were actually reimbursed for such costs despite §413.85(c). Indeed, contrary to the Court's baffling assertion that "petitioner fails to present persuasive evidence that the Secretary has interpreted the anti-redistribution principle in an inconsistent manner," *ante*, at 11, one need look no further than petitioner's brief, see Brief for Petitioner 21–24, to find evidence of such interpretive inconsistency as to both the anti-redistribution and community support principles.

Petitioner received no Medicare reimbursement for any GME costs from 1966 to 1973. Even though the anti-redistribution and community support principles were in effect for that entire period, see *ante*, at 3, n. 1, petitioner was awarded reimbursement *for the first time* in 1974, for salary-related GME costs. Because those GME costs were not paid for by the Hospital prior to 1974, even the Secretary's opinion below finds, as a matter of fact, that they were borne, to a large extent, by the Medical School during that period. Cf. App. to Pet. for Cert. 32a (identifying public educational grants to the Medical School and Medical School tuition as sources for funding the Hospital's pre-1974 GME activities). Also, the funding for those costs that came from sources other than the Medical School (namely, hospital fees from charges to non-Medicare beneficiaries, see *ibid.*) did not come from Medicare and therefore constituted "community support." See App. to Pet. for Cert. 18a (the Secretary "views community support as any source of funding other than the Medicare program").

Yet under the Secretary's present interpretation of §413.85(c), petitioner should never have received *any* GME cost reimbursement because it had not obtained such reimbursement from the beginning of the

Medicare program. To the extent the Hospital's GME costs were previously borne by the Medical School, providing petitioner reimbursement for those costs violated the anti-redistribution principle, as presently construed. See *ante*, at 9 ("The Secretary interprets the regulation . . . to deny reimbursement for costs previously incurred and paid by a medical school") (editorial revisions omitted). Indeed, the Provider Reimbursement Review Board (PRRB) explicitly recognized this fact, finding that, on the fiscal intermediary's interpretation of "redistribution" (adopted by the Secretary below), "[i]n 1974, the [Hospital] commenced shifting costs . . . to the Medicare program" and that "[a]dditional cost shifting occurred in 1984 when certain clerical costs of the Medical School were included in the [Hospital's] cost report." App. to Pet. for Cert. 50a.[2] Similarly, reimbursing petitioner for GME costs violated the community support principle, to the extent funding for such costs had been available previously from non-Medicare sources. See *ante*, at 6 (where community support has been received, §413.85(c) "prohibits Medicare reimbursement"). Thus, the Court's statement that there is no "evidence that the Secretary has interpreted the anti-redistribution provision in an inconsistent manner," *ante*, at 11, appears to be wishful thinking: petitioner has been routinely granted reimbursement which it should have been denied under §413.85(c), if the Secretary's current interpretation is correct.

I think it reasonable to conclude that in reimbursing petitioner since 1974 for GME costs not reimbursed from the inception of the Medicare program, the

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[2]Because the Secretary, through the HCFA, only modified rather than reversed the PRRB's decision, see App. to Pet. for Cert. 37a, the PRRB's opinion remains in force to the extent consistent with the opinion of the HCFA. Cf. 42 U. S. C. §1395*oo*(f)(1).

Secretary acted on the basis of an interpretation of §413.85(c) that attached no significance to a Medicare provider's failure in prior years to be reimbursed for, or to carry on its books, eligible educational costs. This conclusion has significant support in the Secretary's roughly contemporaneous pronouncements. Cf. *Lyng* v. *Payne*, 476 U. S. 926, 939 (1986); *M. Kraus & Bros., Inc.* v. *United States*, 327 U. S. 614, 622 (1946) (opinion of Murphy, J.). In 1978, for example, the Secretary advised fiscal intermediaries that reasonable GME costs incurred by a related medical school are "allowable hospital costs," Intermediary Letter No. 78–7 (Feb. 1978), without even mentioning either the community support or the anti-redistribution principle as potential limitations on its construction. App. to Pet. for Cert. 64a. The letter's explicit statement that the Secretary therein addressed the "appropriateness" of "allocating [educational costs] to the hospital [in question]," *ibid.*, demonstrates the inaccuracy of the Court's suggestion that the letter addressed topics entirely unrelated to the anti-redistribution principle, *ante*, at 11–12; the "appropriateness" of allocating costs from a medical school to its affiliated hospital is precisely what the anti-redistribution principle governs, to the extent it has substantive effect at all. See 42 CFR §413.85(c).

Moreover, in 1982, the Secretary answered a query from a fiscal intermediary concerning the relationship between the anti-redistribution principle and Intermediary Letter 78–7 with the statement that "allocation of costs to a hospital from a related medical school is governed by Intermediary Letter 78–7." App. 25. The Court makes much of the fact that the 1982 memorandum did not explicitly mention the anti-redistribution principle. *Ante*, at 13, n. 4. In so doing, however, the Court overlooks the fact that the fiscal intermediary's inquiry presented the Secretary with a specific binary choice: are

approved educational activities previously paid for by an affiliated educational unit either allowable (*i. e.*, reimbursable) hospital costs (as Intermediary Letter No. 78–2 advised) or a prohibited redistribution of costs under §413.85(c)? By answering the fiscal intermediary's pointed query with the statement that Intermediary Letter No. 78–2 is controlling on the reimbursability of the costs associated with such activities, see App. 25, the Secretary quite clearly (albeit implicitly) afforded the anti-redistribution principle no substantive effect whatsoever.

To be sure, in 1985 the Secretary issued a memorandum stating, without elaboration, that "[t]he fact that [the anti-redistribution principle] is not mentioned in the [1982] memorandum does not change the basic policy as espoused in [§413.85(c)]." *Id.*, at 27. The 1985 memorandum's bare reference to the "policy" of §413.85(c), however, neither disavowed the Secretary's past interpretation of the regulation nor set forth any alternative interpretation. The Court thus considerably overstates matters in its suggestion that the 1985 memorandum specifically confirmed the continued vitality of the anti-redistribution principle. *Ante*, at 13, n. 4.[3]

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[3]Even less satisfactory is the Secretary's suggestion that her failure to apply §413.85(c) in prior fiscal years is of no relevance. See Brief for Respondent 37. The prior inconsistent conduct of the agency is quite relevant—not because her inconsistency "estop[s]" her from changing her view, *ante*, at 12 (internal quotation marks omitted))—but rather because agency conduct, no less than express statements, can effect a construction of statutes or regulations. Cf., *e. g.*, *Motor Vehicle Mfrs. Assn.* v. *State Farm Mut. Auto. Ins. Co.*, 463 U. S. 29, 41–42 (1983) (holding that "[a] `settled course of behavior embodies the agency's informed judgment that, by pursuing that course, it will carry out the policies [of applicable

Based on a reading of the undeniably precatory language used in §413.85(c), confirmed by two decades of consistent agency practice, I would hold that subsection (c) imposes no limit on the reimbursability of approved educational activities. Cf. *M. Kraus & Bros.*, *supra*, at 622 ("Not even the Administrator's interpretations of his own regulations can . . . add certainty and definiteness to otherwise vague language"). Instead, the subsection seems intended merely to explain the remainder of the regulation, which addresses the reimbursability of approved educational costs in clear, unmistakably mandatory terms. Cf. *Pennhurst*, 451 U. S., at 19, n. 14.

By giving substantive effect to such a hopelessly vague regulation, the Court disserves the very purpose behind the delegation of lawmaking power to administrative agencies, which is to "resol[ve] . . . ambiguity in a statutory text." *Pauley* v. *BethEnergy*

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statutes or regulations]'") (quoting *Atchison, T. & S. F. R. Co.* v. *Wichita Bd. of Trade*, 412 U. S. 800, 807–808 (1973)). Two decades of providing reimbursement in contravention of what is now claimed to be the community support and anti-redistribution principles certainly constitutes a "settled course of behavior," and I find it difficult to believe the Secretary would permit such a persistent—and costly—error in the application of her reimbursement rules. Cf. 1991 Medicare Explained (CCH) ¶ 706, p. 178 ("When Medicare pays for noncovered services or it pays too much for covered services, the program will ordinarily attempt to recover the amount of the overpayment"). A settled interpretation that persists over time is presumptively to be preferred, see *Motor Vehicle Mfrs. Assn.*, *supra*, at 41–42, and therefore judges are properly suspect of sharp departures from past practice that are as unexplained as the Secretary's in this case. *Id.*, at 42. See also *Wichita Bd. of Trade*, *supra*, at 807–808.

Mines, Inc., 501 U. S. 680, 696 (1991). See generally *Chevron U. S. A., Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U. S. 837, 865–866 (1984). Here, far from resolving ambiguity in the Medicare program statutes, the Secretary has merely replaced statutory ambiguity with regulatory ambiguity. It is perfectly understandable, of course, for an agency to issue vague regulations, because to do so maximizes agency power and allows the agency greater latitude to make law through adjudication rather than through the more cumbersome rulemaking process. Nonetheless, agency rules should be clear and definite so that affected parties will have adequate notice concerning the agency's understanding of the law. Cf. *FTC* v. *Atlantic Richfield Co.*, 567 F. 2d 96, 103 (CADC 1977) (Wilkey, J.). Cf. generally K. Davis & R. Pierce, 2 Administrative Law §11.5, p. 204 (3d ed. 1994) ("An agency whose powers are not limited either by meaningful statutory standards or . . . legislative rules poses a serious threat to liberty and to democracy"). The aspirational terms of §413.85(c) are woefully inadequate to impart such notice.[4]

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[4]As a result of the Court's ruling today, petitioner and other Medicare providers who, in the past, received reimbursement for GME costs in violation of the Secretary's present interpretation of §413.85(c) are suddenly faced with the possibility of being sued for recoupment of the millions of dollars of "overpayments" they received from Medicare. The Social Security Act, we have noted, "permits . . . retroactive action" within three years by the Secretary to make "`corrective adjustments . . . where, for a provider of services for any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be . . . excessive.'" *Bowen* v. *Georgetown Univ. Hospital*, 488 U. S. 204, 209 (1988) (quoting 42 U. S. C. §1395x(v)(1)(A)). Thus, although the Secretary

In view of its unbelabored conclusion that §413.85(c) imposes substantive limits on the reimbursability of approved educational costs, the Court's discussion focuses primarily on what substantive import §413.85(c)'s anti-redistribution principle should be read to have. The Court finds the anti-redistribution principle "straightforward" in its meaning—any costs that, at some previous point in time, were carried on the books of an affiliated educational institution cannot subsequently be reimbursed by Medicare. *Ante*, at 8. For the reasons previously discussed, I would hold that §413.85(c) cannot reasonably be construed to impose substantive restrictions on the reimbursability of approved educational costs. Nevertheless, if I had to give the principle substantive effect, I could not agree with the Court's sweeping construction of the principle. In my view, the Court's reading is premised on a distortion of the text of the regulation enunciating the anti-redistribution principle, and it is the text, of course, which must be given controlling effect. See *Bowles*, 325 U. S., at 414 (holding that an agency's interpretation of its own regulation must comport with "the plain words of the

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permitted petitioner to recover reimbursement for "those medical education costs which it has traditionally claimed and been allowed prior to 1984," App. to Pet. for Cert. 37a, that act of administrative grace appears to be subject to revision at the whim of the Secretary. Cf. *Heckler* v. *Community Health Services of Crawford County, Inc.*, 467 U. S. 51 (1984) (Secretary not estopped from recouping overpayment to Medicare provider whose prior reimbursement claims were made in reliance on erroneous advice of its designated fiscal intermediary).

regulation").

Under the relevant portion of §413.85(c), it is the *type* of educational activity engaged in that determines whether or not reimbursement is proper: "[T]he intent of the [Medicare] program is to share in the support of educational activities customarily or traditionally carried on by providers in conjunction with their [patient care] operations." 42 CFR §413.85(c) (1993). The proper question under the anti-redistribution principle, therefore, is not, as the Secretary puts it, whether "[a particular provider] has traditionally claimed and been allowed" reimbursement for a particular category of reimbursable costs. App. to Pet. for Cert. 37a. Instead, the relevant question is whether the educational activities for which reimbursement is sought are of a type "customarily or traditionally" engaged in by providers. If, in a particular case, that question is answered in the negative, then it would be a forbidden "redistribution" of costs to award Medicare reimbursement for the costs associated with the activities in question. Conversely, if the costs for which a provider seeks reimbursement result from educational activities that are traditionally engaged in by Medicare providers, no redistribution of costs occurs when those costs are reimbursed.

A prohibition against shifting the costs of educational units (for example, medical or nursing schools) to patient care units was necessary because of the Medicare program's related-organization rule, which provides that "costs applicable to services, facilities, and supplies furnished to the provider by organizations related to the provider by common ownership or control are includable in the allowable cost of the provider." 42 CFR §413.17(a) (1993). In light of the related-organization rule, §413.85(a)'s recognition of educational costs as reimbursable costs created the distinct possibility that many, if not most, of the costs arising from educational unit

activities could be shifted to affiliated Medicare providers (and therefore to the Medicare program) because, by definition, such units engage in educational activities. Cf. 57 Fed. Reg. 43659, 43668 (1992) (expressing the Secretary's concern that "Medicare payment for medical education costs should not result in a redistribution of costs from the educational institution to the provider"). Since Medicare is primarily intended to fund health care for the elderly and disabled, not to subsidize the education of health care professionals, cf. 42 U. S. C. §1395c, the Secretary avoided such an inadvertent "expan[sion] [in] the range of items and services for which a provider could claim payment" by barring the redistribution of costs from educational to patient care units. 57 Fed. Reg., at 43668.

The Court therefore errs in reading the term "redistribution" wholly divorced from the context in which it appears. See *ante*, at 8–9 (suggesting the first clause of the anti-redistribution principle is not even "relevant" to an understanding of the second phrase). In my view, "redistribution" can only be properly understood in light of the remainder of the sentence in which it appears and in light of the related-organization rule, because interpreting a statute or regulation "is a holistic endeavor." *United Savings Assn. of Texas* v. *Timbers of Inwood Forest Associates, Ltd.*, 484 U. S. 365, 371 (1988). Viewed in the proper textual context, §413.85(c)'s anti-redistribution principle simultaneously expresses an intent to fund educational activities customarily conducted by teaching hospitals and disallows reimbursement for costs incurred by their affiliated educational units in conducting educational programs not customarily or traditionally engaged in by such hospitals. The Secretary's contrary interpretation, in my view, is unworthy of deference. Cf., *e. g.*, *Bowles*, 325 U. S., at 414.

There can be no question that the GME activities for

which petitioner seeks reimbursement are customarily or traditionally engaged in by teaching hospitals. As the District Court cogently explained in *Ohio State Univ.* v. *Secretary, U.S. Dept. of Health and Human Services*, 777 F. Supp. 582 (SD Ohio 1991), aff'd, 996 F. 2d 122 (CA6 1993), cert. pending, No. 93–696:

> "In the case of graduate medical education, it would be customary and traditional for a teaching hospital to employ qualified physicians in various medical specialties to select and supervise the interns and residents enrolled in the educational program. These physicians would need clerical and administrative staff, office space and supplies to carry out their function[s]. Their salaries, the salaries of their clerical and administrative staffs, and the cost of their office space and supplies would all be part of the cost of the educational activity which ultimately contributes to the quality of patient care in the hospital." 777 F. Supp., at 587.

As a result, the anti-redistribution principle provides no basis for denying petitioner Medicare reimbursement for the full level of its GME costs, less tuition revenues. See §§413.85(a), (g).

I therefore wholeheartedly agree with the PRRB that "[t]he fact that [the Hospital] did not fully identify all of the costs associated with its GME programs in prior years does not prohibit the correction of this [cost accounting] error in the cost reporting period in contention." App. to Pet. for Cert. 58a-59a. In ruling to the contrary, the Court arbitrarily subjects similarly situated Medicare providers, with identical levels of reimbursable GME costs, to disparate reimbursement, simply because one provider may have forgone reimbursement to which it was plainly entitled as a consequence of its cost accounting procedure's failure to identify all of the provider's reimbursable costs. Although "[m]en must turn square corners when they deal with the Government," *Rock Island,*

A. & L. R. Co. v. *United States*, 254 U. S. 141, 143 (1920) (Holmes, J.), the manifest injustice of the Court's result should be apparent.

Because, unlike the Court, I do not believe the anti-redistribution principle may reasonably be read to bar petitioner's claim for reimbursement for non-salary-related GME costs, I must also address petitioner's challenge to the Secretary's construction of the community support principle. Petitioner argues that interpreting the term "community support" to include all non-Medicare sources of funding for GME costs is inconsistent with the text of §413.85(c). I agree. Not only is the community support principle merely an aspirational statement of policy, see *supra*, at 2–6, but, in my view, the other provisions of 42 CFR §413.85 (1993) plainly leave no role for the principle in the cost reimbursement calculus for approved educational activities.

Section 413.85(a) authorizes a provider to "include its net cost of approved educational activities" in its allowable Medicare costs and provides that the "net cost" of such activities is to be "calculated under paragraph (g) of this section." §413.85(a). Section 413.85(g), in turn, defines "[n]et cost of approved educational activities" as the provider's "total costs of these activities," less "revenues it receives from tuition." §413.85(g). Section 413.85(g) therefore clearly establishes the level of reimbursement a provider may expect for approved educational costs, and the only source of funding that is to be offset against such costs is tuition revenues. No other potential sources of funding for GME activities are included in the offset required by §413.85(g). Thus, the Secretary's interpretation of the community support principle as requiring, in effect, all non-Medicare sources of funding to be offset against total educational cost, is flatly inconsistent with

§§413.85(a) and (g).

The plain implication of §413.85(g) is confirmed by its regulatory history. Cf. *Payne*, 476 U. S., at 941. In 1984, the Secretary amended the subsection's predecessor to eliminate the requirement that "grants" and "specific donations" be offset against educational costs actually incurred. See 49 Fed. Reg. 234, 296, 313 (1984) (amending 42 CFR §405.421(g) (1983)). See also 48 Fed. Reg. 39752, 39797, 39811 (1983) (withdrawing 42 CFR §405.423 (1982) relating to offsets for certain grants and gifts). The Secretary's construction of the community-support principle essentially reintroduces grants and specific donations into the reimbursement calculus. The Secretary has thus rendered the 1984 amendment to the regulation entirely superfluous, a disfavored result that should be avoided where possible. See *Kungys* v. *United States*, 485 U. S. 759, 778 (1988). Cf. also *Connecticut Nat. Bank* v. *Germain*, 503 U. S. ___, ___ (1992) (slip op., at 4).

Consequently, the Secretary's construction of the community-support principle to impose a substantive restriction on the reimbursability of approved educational expenses is inconsistent with the regulation. As such, the construction is unworthy of deference. See, *e. g.*, *Stinson*, 508 U. S., at ___ (slip op., at 8–9).

For the foregoing reasons, the Secretary acted contrary to law, within the meaning of 5 U. S. C. §706(2)(A), in construing 42 CFR §413.85(c) (1993) as denying Medicare providers the right to receive reimbursement for otherwise eligible educational costs simply because the costs had not previously been reimbursed by Medicare. I would therefore reverse the judgment of the Court of Appeals. I respectfully dissent.