1982 WL 189182 (S.C.A.G.)

Office of the Attorney General

State of South Carolina
February 22, 1982

***1** Honorable Hugh K. Leatherman, Sr.
Chairman
Subcommittee on Reimbursement Review
Health Care Planning and Oversight Committee
Suite 107 Blatt Building
Columbia, South Carolina 29201

Dear Senator Leatherman:
You have requested an opinion concerning several issues which relate to the South Carolina Medicaid program; in particular, matters concerning the reimbursement of nursing homes.

It appears that some facilities or nursing homes are owner operated, while others are under lease; there is a difference in the applicable rate of reimbursement paid by the Department of Social Services. If the nursing home is owner-operated, there is one rate specified and determined under the provisions of the contract; on the other hand, if the nursing home is lessee operated, the specified rate is a higher rate than those of the owner-operated facilities. You indicate that the only reason for the increased rate in the lessee-operator situation is that the cost of the lease (rent) is included as an operating expense when determining the reimbursement rate.

Your first question is whether or not the State 'has any obligation under the lease agreement [between the owner and the lessee] even though it is not a party thereto. We conclude that no such obligation exists.

Your second question is whether or not the Department of Social Services can obligate the State under contract for a period more than one year 'according to the State Appropriation[s] Bill'? We conclude that the Department of Social Services may not by contract obligate state funds beyond the period of appropriation, which is normally the fiscal year.

Your third question is that if the State now changes its reimbursement policy by excluding lease costs (rent) as a basis for future reimbursement rates only upon 'historical costs' does the State have any continuing responsibility because of the lease agreements which have been entered into? We conclude that no such continuing obligation exists.

The enclosed Memorandum will more fully explain the legal analysis upon which these conclusions are based. If we can be of further assistance, please do not hesitate to contact us. With kindest regards,
Very truly yours,

Raymond G. Halford
Deputy Attorney General
Robert D. Cook
Assistant Attorney General

ATTACHMENT

MEMORANDUM

RE: Opinion Request of January 19, 1982, from the Honorable Hugh K. Leatherman, Sr., Chairman Subcommittee on Reimbursement Review Health Care Planning and Oversight Committee Suite 107 Blatt Building Columbia, South Carolina 29201

DATE: February 22, 1982

(1) Your first problem concerns the present method of funding the nursing home operations under Medicaid by virtue of a specified rate under contract with the Department of Social Services. It appears that some facilities or nursing homes are owner operated, while others are under lease; there is a difference in the applicable rate paid by the Department of Social Services. If the nursing home is owner-operated, there is one rate specified and determined under the provisions of the contract; on the other hand, if the nursing home is lessee operated, the specified rate is a higher rate than those of the owner-operated facilities. Your letter indicates that the only reason for the increased rate in the lessee-operator situation is that the cost of the lease (rent) is included as an operating expense when determining the reimbursement rate. Your letter indicates that the nursing home lease agreements run for various periods of from three, five or ten years and the lessee-operator 'expects medicaid to pay the lease cost (rent) for that period of time.'

***2** Based upon the foregoing summary, the question which your raise is whether or not the State has any obligation under the lease agreements even though it is not a party thereto? In the opinion of this office, the State has absolutely no obligation under the lease either to the owner (lessor) or to the operator (lessee) as the lease is a separate and distinct contract from the contract by the Department of Social Services for reimbursement for the care of patients.

The federal Medicaid Act, Title 19 of the Social Security Act, has traditionally afforded each state considerable latitude in dispensing its available funds to nursing home providers. No minimum payments to such providers are required by federal law and reimbursements are usually governed by a contractual agreement between the state medicaid agency (DSS) and the nursing home providers, subject only to federal regulations and guidelines. In view of this wide latitude, the questions which you pose will be viewed primarily in terms of state contract law. See, Briarcliff Haven Inc., v. Dept. of Human Resources of the State of Georgia, 403 F.Supp. 1355 (N.D. Ga. 1975).

It is well recognized that 'the rules of law pertaining to the contracts of a governmental body or agency are not different from those pertaining to any other contract.' 72 C.J.S. Supp.; Public Contracts, § 2 (emphasis added). A basic tenant of contract law is that one who is not a party to a contract simply is not bound by the terms thereof. The 'obligation of contracts is limited to the parties making them' and parties to a contract cannot 'impose any liability on one who, under its terms, is a stranger to the contract.' 17 Am.Jur.2d, Contracts, § 294.

Moreover, in the present situation any assurances to an owner or lessee operator that there would be a continuation of the medicaid program and continued payment of the operation of the nursing home facilities could not serve to bind the state. It is fundamental in the operation of government that there can be no guarantee to a private party that there will be a continuation of a governmental program beyond the legislative branch's authorization of and funding for that program. See, State ex rel. Edwards v. Osborne, 193 S.C. 158, 173, 7 S.E.2d 526 ('it may be conceded that the legislature has plenary power . . . to change its mind from year to year as to the purposes to which in each year it will apply the proceeds of particular sources of revenue. . . .'). The contract between the Department of Social Services and the nursing home can be entered into only for the life of the legislative appropriation, which is usually made on the basis of the State's fiscal year, from July 1 to June 30 of the following year. This legal limitation upon the State agency's power and authority to contract will be discussed in considerable detail, infra. See e.g., Code of Laws of South Carolina, §§ 11-9-20 and 11-1-40 (1976).

Thus, assurances by state officials of continuation of the program beyond the life of the appropriation for that program, even if made, would not be binding upon the State. It is well recognized that,

***3** persons dealing with public officers or agents are required to act with reference to the authority, limitations and restrictions imposed on their power to contract and are bound to ascertain at their peril the extent of the power of the officers and agents making the contract, and are therefore chargeable with knowledge of not only the law of the state affecting the officers and agents but that the validity of their acts are subject to those laws.

72 C.J.S., Public Contracts, § 4. As the South Carolina Supreme Court has observed,
A public officer derives his authority from statutory enactment, and all persons are in law held to have notice of the extent of his powers; and therefore, as to matters not really in the scope of his authority, they deal with the officer at their peril. . . .

The doctrine of equitable estoppel has no application to a sovereign State . . . The State can only act under its constitution and through its legislative enactments pursuant thereto, and can only ratify in the manner in which it could originally authorize; and if it could be estopped to assert the truth, the effect might be to fix upon the State responsibilities in conflict with its constitution and laws. All men are bound to take notice of the special authority of the State's officers, and when dealing with them outside their authority, they assume the peril with their eyes open, and cannot be heard to say they placed reliance upon the State.

Carolina Nat. Bank v. State of South Carolina, 60 S.C. 465.

Therefore, it cannot be claimed under any set of foreseeable circumstances that the parties to the lease could derive benefits from or attach obligations to the State, which is not a party to the lease. Nor may the parties to the lease look to the State either by contract or principles of equity to acquire greater rights than those which could lawfully be given by the contract between DSS and the owner-operator. It is elementary that the assignee of the rights of the assignor possesses no higher claim to benefits or rights under a contract than does the original owner. See, 6 Am.Jur.2d, Assignments, § 102.

(2) Another question which your committee has raised is whether or not the Department of Social Services can obligate the State under contract for a period more than one year 'according to the State Appropriation Bill'? The answer to this question has been partially answered in (1) supra. While no provision of State law or expression of authority explicitly addresses or forbids this situation, various related provisions when taken together, indicate that no such obligation may be made.

Pursuant to Art. 10, § 10 South Carolina Constitution (1895), the fiscal year is set as commencing on the first day of July of each year. More definitively, § 11-9-80, restates inter alia this constitutional provision. This section further provides that all acts to be performed shall be within the fiscal year and that all officers are required to keep their accounts and records in conformity with the fiscal year.

***4** More specifically, Art. 10, § 9 of the Constitution states that 'money shall be drawn from the Treasury only in pursuance of appropriations made by law.' This provision governs contracts made by public officers or officials. Beacham v. Greenville County, 218 S.C. 181, 185, 62 S.E.2d 92. It was intended to 'prohibit expenditures of the public funds at the mere will and caprice of those having funds in custody without legislative sanction therefor.' (emphasis added). Grimball v. Beattie, 174 S.C. 422, 431, 177 S.E. 668. Contracts made by officers without a 'regular appropriation' of the monies expended by the contract contravene Art. 10, § 9. State of South Carolina v. Corbin and Stone, 16 S.C. 533, 538.

Significantly, § 11-1-40 further provides as follows:
It shall be unlawful for any public officer, state or county, authorized to so contract, to enter into a contract for any purpose whatsoever in a sum in excess of the tax levied or the amount appropriated for the accomplishment of such purpose or to divert or appropriate the funds arising from any tax levied and collected for any one fiscal year to the payment of any indebtedness contracted or incurred for any previous year.

The South Carolina Supreme Court has declared that the 'manifest intention' of this provision is

to protect the State and counties against either legal or moral obligations incurred by the State or county officials in excess of the taxes levied; or the amounts appropriated for the purposes specified by the levy or appropriation.

Long v. Dunlap, 87 S.C. 8, 68 S.E. 801. Long also concludes that § 11-1-40 represents a limitation or constraint upon an agency's general authority to contract. The case concludes that so long as an agency possesses appropriated funds 'in [its] hands' an agency may contract and obligate those funds pursuant to its general power, and the contract is enforceable, if such funds are 'within the terms of the appropriation. . . .' Supra, at 17. The obvious implication is that a contractual obligation which includes funds not yet appropriated by the General Assembly, is invalid and unenforceable. While the facts of the case do not specifically address the situation of a contract which obligates public funds beyond the fiscal year, this type of contract would normally be made without a sufficient existing appropriation, since appropriations routinely extend only for the fiscal year. Thus, it would not represent an unfair extension of Long to conclude that such a contract would be invalid pursuant to § 11-1-40.

The same reasoning may be applied on the basis of a more recent case, Beacham v. Greenville County, supra. There, the Greenville County Board of Commissioners contracted with an architect for the purpose of improving the county courthouse; the contract was silent as to costs. The fee was fixed at six percent of costs. At the ensuing session of the General Assembly, the Legislature appropriated funds authorizing the county to contract for repair of the courthouse. The Court construed legislative intent as limiting the amount appropriated to $400,000. However, the architect proceeded with the work and he ultimately concluded the project would cost $863,000; thus, the project was abandoned.

***5** The architect sued the county on the contract. The county defended on the basis, inter alia that the contract was void, because made without an existing appropriation in violation of § 11-1-40. The lower court granted the county's motion for nonsuit and the Supreme Court affirmed, concluding that 'the General Assembly has not delegated legislative powers to the Greenville Board. . . .' Responding to the architect's argument that the County was estopped to deny liability, the Court stated: There was no misleading of the appellant; on the contrary, he was charged with knowledge of the limited power and authority of the Board, had actual knowledge of their intentions that the project should cost $400,000 and, finally, he had actual and constructive notice of the amount of the legislative appropriation for the project which was contained in the ratifying Act of 1946.

Supra at 188. In short, the Court evidently concluded that without the subsequent legislative ratification, the contract would be without any validity; the ratification, which had been made in the same fiscal year as the contract, itself covered only a portion of the total costs, however; while the Court ultimately concluded that the law relating to contracts with architects who exceed their estimated costs was controlling, it is clear from the opinion that at most the contract would have been valid only for $400,000, the amount of the legislative appropriation. Again, the issue in Beacham was not precisely the one which you raise, the agency's contracting beyond the fiscal year; however, as in Long, it would appear that Beacham's principle, where the appropriation did not cover the total obligation of public funds imposed by the contract, would be applicable to the situation which you pose.

Both the Beacham and Long cases, together with the wording of § 11-1-40 itself, strongly indicate that a contract made by a public officer, which seeks to obligate state funds beyond the fiscal year, where there is no existing appropriation providing for the expenditure of such funds is invalid. Unless the Legislature subsequently authorizes or ratifies the contract in the form of an appropriation, as the General Assembly did in Beacham, the contract may not be enforced. [1] Such a reading of the South Carolina cases construing § 11-1-40 is in accord with the general authority elsewhere where such statutes exist. See, 81A C.J.S., States, § 156; see especially, White v. Jones, Tex., 177 S.W.2d 603; but see, City of Big Spring v. Board of Control, 404 S.W.2d 810.

Moreover, § 11-9-220, when read in conjunction with § 11-1-40 further strengthens this conclusion. § 11-9-220 makes it unlawful

. . . for any department, institution, commission or board of the State government or officer or agent of the State government authorized to make contracts or draw appropriations to contract indebtedness in excess of the amount specifically provided in the annual appropriation act. (emphasis added).

***6** While, unlike § 11-1-40, no major cases construe § 11-9-220, the latter provision is very similar to § 11-1-40, and on its face, seems to limit the contract to whatever is authorized by the annual appropriations act. Almost without exception, appropriations are tied to the fiscal year. Therefore, § 11-9-220 also seems to prohibit a contract which obligates public monies beyond the fiscal year. See also, 81 C.J.S., States, § 160. [2]

The only basis on which the State or an agency thereof could validly enter into a contract obligating public funds for a period beyond the fiscal year as determined by the constitution and statutes of this State, [3] would be the inclusion of a proviso which would make continuation of the contract term contingent upon the fact that the General Assembly appropriated sufficient funds, from year to year, to pay the consideration under the contract as to be solely determined by the State or its agency. The present contracts between the nursing homes and the Department of Social Services are specifically limited to the fiscal year from July 1 through June 30 of the succeeding year, and we see no basis upon which this procedure can be validly changed.

(3) Your next question is: if the State now changes its reimbursement policy by excluding lease costs (rent) as a basis for future reimbursement rates only upon 'historical costs', does the State have any continuing responsibility because of the lease agreements which have been entered into and referred to in Section 1. In the opinion of this office, the State does not have any continuing responsibility with respect to the present rate of reimbursement under the contract.

Federal regulations afford the State considerable flexibility in determining the amount of reimbursement to nursing home providers. Nowhere in the regulations is there stated a federal requirement that lease costs must be paid. Moreover, on September 30, 1981, the Department of Health and Human Services published new rules and regulations concerning payment for services under Title 19 of the Social Security Act (Medicaid). Federal Register, Vol. 46, No. 189, P.47971 et seq. Under these new regulations, no longer are states required to reimburse either hospitals or long term care facility services by rates which must be based upon reasonable costs. The Medicaid agency must now use 'rates that are reasonable and adequate to meet the costs that must be incurred by efficiently and economically operated providers to provide services in conformity with applicable State and Federal laws, regulations, and quality and safety standards.' The State Medicaid agency (DSS) possesses great flexibility in making the determination whether a particular service for which reimbursement is sought meets these new criteria. Clearly then, under federal law, the State is not obligated to continue payment of lease costs as part of its reimbursement to nursing home providers, when such costs were previously paid under a different federal standard. [4]

***7** Neither does State law make such an obligation continuing. Past reimbursement for lease costs, made under another other source of authority, cannot estop the State from denying future payments, where there exist new standards which would govern future contracts. Again, any assurances by state officers that such reimbursements would continue, even if made, would be without authority and could not bind the State. Carolina Nat. Bank v. State of South Carolina, supra; see also, (1), supra. Nor can the State be estopped in matters such as here, which involve policy and where the public welfare is concerned, where public revenues are affected, and the purpose of its laws and the exercise of governmental functions would be thwarted. Heyward v. S.C. Tax Commission, 240 S.C. 347, 126 S.E.2d 15; Dept. of Social Services v. Parker, 275 S.C. 176, 268 S.E.2d 282.

Footnotes

1 Still would remain the question as to whether the whole contract would be invalid or whether the contract would be invalid or whether the contract is severable, and, thus, only the parts extending the obligation of public funds beyond the fiscal year would fail. The basic question remains whether a contract which expends public funds beyond the fiscal year without legislative authorization or ratification is valid. In addition to Beacham, supra, see: Briggs v. Greenville County, 137 S.C. 288, 135 S.E. 153.

2 Art. 10, § 9 of the Constitution supra, would also seem to prohibit such contracts. See, Beacham v. Greenville County, supra; South Carolina v. Corbin and Stone, supra; see also, McDougall v. Board of Land Commissioners of State of Wyoming, 49 P.2d 663.

3 It should be remembered that the provisions cited prohibit contracts only in terms of exceeding appropriated public funds. There does not appear to exist any general prohibition upon an agency's power to contract beyond the fiscal year where the contract involves

no expenditures of public monies. This is in accord with statutes which give most state agencies the general authority to contract, limited only by specific prohibitions such as § 11-1-40. Beacham, supra.

4 Even under the previous regulations, nowhere was there a mandate that a state make specific minimum payments. Briarcliff Haven, Inc. v. Dept. of Human Resources of State of Georgia, supra.

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