



MEMORANDUM

December 11, 2015

TO: Contract Support Cost Clients
FROM: HOBBS, STRAUS, DEAN & WALKER, LLP
RE: ***IHS Contract Support Cost Workgroup Meets in Denver,
Works on Draft CSC Policy***

The Indian Health Service (IHS) convened its Contract Support Cost (CSC) Workgroup on December 7-8 in Denver. The meeting was the Workgroup's first since IHS placed the reigns of CSC policy development in the hands of new Deputy Director Mary Smith. The primary purpose of the meeting was to work through the draft tribal redline CSC Policy transmitted to IHS on November 23, 2015.¹ The meeting almost blew up due to festering tribal distrust and a disturbing federal misstep. Ultimately, however, the workgroup stayed the course and made significant progress.

Introductory Remarks

Ms. Smith began the meeting by reaffirming the Secretary's commitment to completing a CSC policy that implements full funding and is not unduly burdensome. She stressed the need for an aggressive timeline to develop the policy and distribute it for tribal consultation and Department approval so that it can be finalized before the end of the Obama Administration.

Mickey Peercy of the Choctaw Nation of Oklahoma struck a less optimistic note. After 25 years of working on CSC issues, he concluded that "IHS is no longer a partner" but rather an adversary. He told Ms. Smith that she was doomed to fail because the career staff and Office of General Counsel (OGC) attorneys would not let her succeed. (In light of later events described below, these remarks would prove prophetic.) Mr. Peercy said the Oklahoma congressional delegation was prepared to hold IHS's feet to the fire and convene hearings to determine why IHS seems intent on complicating rather than resolving CSC issues.

Other tribal representatives also expressed frustration and mistrust. Workgroup Tribal Co-Chair Andy Joseph of the Confederated Tribes of the Colville Reservation mentioned IHS's \$80 million settlement with employee unions for overtime compensation

¹ See our memorandum of November 25, 2015 and attached draft policy.

as an example of IHS making major decisions behind closed doors, without consulting with tribes, using money tribes didn't even know the agency had.² Chief Lynn Malerba of the Mohegan Tribe reminded the group that, in the context of massive underfunding of Indian health, CSC is not a big-ticket item. The CSC policy must be simplified, streamlined, and completed so that tribal leaders can move on to bigger issues. Rhonda Butcher of the Citizen Potawatomi Nation remarked that after tribes won the *Ramah* decision that mandated full funding of CSC, IHS reacted by changing the definition of what "full CSC" is, erecting two major barriers: the "costs incurred" approach and the categorical duplication argument (more on both below).

Ms. Smith acknowledged these concerns, but stressed the opportunity ahead. The *Ramah* decision, she said, "was a victory for all of us." The new policy will start from the premise that full funding of CSC is required. Federal and tribal parties need only reach agreement on how to fulfill this commitment, she said. And they will: "We cannot allow ourselves to fail."

Schedule for Next Steps

Before launching into the policy review, the group agreed on a process and schedule for moving the policy towards completion.

- December 14: Tribal and federal sides will exchange summaries of the discussion at the Denver meeting, in preparation for a conference call later that week.
- December 16, 1-3 pm EST: The Workgroup will hold a teleconference to clarify the federal and tribal understandings of key issues based on the meeting summaries.
- Before Christmas: IHS will provide a written response to the Tribal Redline, identifying specific revisions to address any issues IHS has with the tribal positions. While Ms. Smith made clear this "counterproposal" would likely be unpolished and may not address every issue, it will be as complete as possible given the time frame.
- January 14-15, 2016: The full Workgroup will meet in Washington, DC, to continue to work on the Policy.
- January 29, 2016: If necessary, the Workgroup could meet in Washington, DC following the Self-Governance conference there to tie up loose ends.
- February 22-25, 2016: IHS initiates tribal consultation by rolling out the draft Policy at the NCAI Executive Council Winter Session.

² See "Dear Tribal Leader" Letter from Mr. McSwain dated May 22, 2015, *available at* <https://www.ihs.gov/newsroom/index.cfm/triballeaderletters/> (describing settlement).

Review of Tribal Redline of IHS CSC Policy

The bulk of the meeting consisted of the Workgroup moving section-by-section through the Tribal Redline, a copy of which we attach.³ IHS representatives asked questions and sought clarification, while tribal representatives explained the reasoning behind their proposed language and sought to draw out the IHS positions on central issues. In some cases, alternative language was suggested, but for the most part the discussion remained at the level of basic principles, with details to be ironed out in the process described above. Below we summarize discussion of the major topics addressed at the meeting: duplication, direct CSC, and reconciliation to costs incurred.

Duplication

As we have reported, IHS has recently adopted an interpretation of the non-duplication provision in the Indian Self-Determination and Education Assistance Act (ISDEAA) that would greatly reduce CSC entitlements for many if not most tribes and tribal organizations.⁴ This provision says that costs cannot be recovered twice—once as part of the Secretarial or 106(a)(1) amount and again as CSC. Obviously this makes sense, and several safeguards are in place to prevent duplication. The Interior Business Center and the Department of Health and Human Services Cost Allocation Services, the agencies that negotiate indirect cost rate agreements, carefully examine proposed direct costs and indirect cost pools to weed out duplication. In the IHS CSC Policy, the tribal shares 80/20 rule avoids duplication of administrative costs by deeming 20% of tribal shares available for indirect costs, reducing the CSC entitlement accordingly. But IHS has recently argued that the ISDEAA prohibits not just duplication of funding, but duplication of funding categories. In other words, if the Secretarial amount contains *any* funding for a category—say, facilities—no CSC can be awarded for facilities, even if the additional costs are reasonable, allocable to the contract, and would otherwise be allowable.

In Denver, the parties recognized a deep division on this issue, making compromise difficult. Nonetheless, the Workgroup held an extensive discussion in an attempt to understand the positions and find common ground. Ms. Smith asked whether the motivation for the categorical duplication rule was simplicity, since it would be easier to apply duplication to categories than to funding within categories. Ms. Butcher responded that the motive is more likely a desire to minimize CSC payments to tribes. Tribal representatives noted the safeguards against duplication already in place—for example, in the ratemaking process and the 80/20 rule. Notably, the Bureau of Indian Affairs (BIA) has never proposed to bar categorical duplication.

³ See also our report of November 25, 2015 at 1-2 (discussing Tribal Redline).

⁴ See our memorandum of November 25, 2015 at 2-3.

Perhaps an hour after this discussion, tribal representatives became aware of a letter from IHS Principal Deputy Director McSwain, dated three days earlier, on the subject of categorical duplication. The letter, a copy of which is attached, staked out the agency's litigation position and left no room for compromise, rendering the Workgroup's discussion a monumental waste. Tribal representatives immediately brought the letter to the attention of Ms. Smith, who appeared blind-sided, and called for a tribal caucus.

While Ms. Smith had clearly had no prior knowledge of the duplication letter, at least three of the OGC and career staff on the agency CSC team obviously did have such knowledge. Yet they failed to inform not only tribal representatives on the Workgroup but their own superior, undercutting her authority and their own credibility. The tribal response ranged from disappointment to anger to betrayal.

Ms. Smith expressed similar feelings when the federal contingent rejoined the meeting. Tribal criticism focused not on Ms. Smith, but on IHS itself, which in the tribal view has allowed OGC and litigation fears to drive agency policy. If IHS has dug into litigation positions on incurred costs and duplication, a mutually acceptable policy may be unattainable. Chief Malerba asked if IHS's goal is to help Indian people or protect its own bureaucracy. One tribal representative remarked that the relationship between IHS and tribes may be the worst he has seen in over 20 years of working with the agency. Ms. Smith did not disagree. But she reiterated the Administration's and her personal commitment to getting the policy done: "Everything I said this morning still goes." She suggested a way forward by distinguishing two tracks: litigation and policy. The latter, she said, "is going to move in a different direction."

Ms. Smith appears to have the backing of agency head Bob McSwain on this issue. The next day during a tribal caucus, tribal representatives called Mr. McSwain, who said that the duplication letter reflected the IHS litigation position, as staked out by OGC, but not the necessarily the agency's position moving forward. He acknowledged that if the 106(a)(1) amount for an administrative expense is insufficient, a tribe ought to be able to recover it in the indirect cost pool. It remains to be seen, however, how IHS will deal with this issue in its written counterproposal to the Tribal Redline.

Direct CSC

A major innovation in the Tribal Redline is that the recurring amount of direct CSC (DCSC) would be inflated each year by the Consumer Price Index medical inflation rate, rather than the lower non-medical rate as the policy provides at present. This would make a significant difference. According to a study done by Dave Mather, between 2000-2014 the non-medical index rose a cumulative 37%, while the medical index rose by 66%. Liz Fowler of IHS said that when tribes first floated this proposal two years ago, IHS took it to OMB, who rejected it on the basis that the costs covered were primarily non-medical. At Ms. Smith's request, tribal representatives will develop a proposal explaining to OMB why the medical inflation rate would be more appropriate.

IHS proposed that a rolling three-year average of inflation rates be applied to DCSC. Tribes expressed a willingness to consider this idea, should IHS include it in their redline counterproposal.

IHS also proposed a far more controversial idea: that the policy include some mechanism limiting how long DCSC may recur before a tribe would be forced to renegotiate. IHS explained that many tribes have not renegotiated for many years, if ever, and the agency feels that at some point it should be able to examine DCSC for duplication with the 106(a)(1) amount and the indirect cost pool. This “expiration” proposal caught tribal representatives by surprise, and seemed a step in the wrong direction. Requiring periodic renegotiation by every tribe and tribal organization would make the CSC process more complex and burdensome, and would not necessarily result in greater accuracy in the absence of historical data about what was transferred in the 106(a)(1) amount.

Reconciliation to Costs Incurred

The biggest single impediment to a mutually acceptable policy has been IHS’s insistence that CSC payments for a given year must be reconciled to costs incurred—expenditures—in that year.⁵ Tribes, by contrast, believe that payments should be reconciled to the amounts *owed*, with a tribe free to expend that entire amount in the given year or carry some of it over to the next, as authorized by the ISDEAA. Recently it appears that IHS’s political leadership has directed the agency’s CSC team to back off its hardline incurred-cost approach. One of the guiding principles Ms. Smith herself proposed is that “Costs incurred do not have to be reconciled to a single fiscal year.”⁶ More indications of a softening position on this issue came in Denver. Liz Fowler spoke in favor of a simple closeout process reconciling CSC needs to payments—not expenditures—although she acknowledged that this idea “has not been fully vetted with IHS yet.” Most tellingly, in the teleconference with Mr. McSwain, he again echoed Ms. Smith in separating litigation and policy tracks. The incurred-cost approach is justified, he said, in the context of retrospective analysis of CSC claims,⁷ but lacks that rationale in the context of estimating CSC needs moving forward. He too envisioned a simple reconciliation process. He said IHS knows how much it is paying tribes, and knows tribes are going to spend those amounts. The costs will be incurred.

⁵ For a detailed description of the legal and practical problems with IHS’s costs-incurred methodology, please see our memorandum of June 30, 2015, reporting on and attaching a letter from the Tribal Self-Governance Advisory Committee critiquing the IHS approach.

⁶ Tribal Redline, § 6-3.1.A, principle #2.

⁷ We respectfully disagree with Mr. McSwain that the retrospective costs-incurred approach is justified even in the claims context, because it rewards the agency for beaching the contract and underpaying CSC, causing the tribe to spend less (incur fewer costs) than it would have if IHS had paid in full.

Even the OGC appeared to be searching for a way out of the incurred-cost box. On the second day of the meeting, OGC attorney Melissa Jamison, the lead advisor to IHS on CSC issues, summarized the IHS position on costs incurred, but stressed that the agency is looking for a “process” to achieve “solutions”—appearing to open the door to a more pragmatic approach. She suggested that since most tribes spend more on health care than IHS gives them each year, a “reasonable assumption” that all IHS CSC is spent each year could be supported. In other words, IHS (and OMB) could assume that the tribe spent IHS money first, and any carryover was composed of supplemental funds. Dave Mather proposed a more empirical approach to showing that all CSC funding goes to costs actually incurred. He noted that in any year a tribe does not spend its full CSC and carries some forward to the next year, it may well have spent CSC carried forward *into* that year from a previous one. He said that IHS has the data to establish that, over time, incurred-cost adjustments zero out.

Roselyn Tso of IHS suggested that each tribe could sign a certification that it expended all its CSC during the year—a suggestion that was roundly rejected by tribal representatives. IHS quickly backed off, but even this terrible idea showed the agency struggling to come up with some means of retaining accountability but escaping the accounting nightmares caused by reconciliation to costs incurred.

While the discussion in Denver was encouraging in some respects, IHS’s written response to the Tribal Redline will be more telling. Again, IHS pledged to provide that document before Christmas.

CSC Negotiation Template

After wrapping up review of the Tribal Redline on the first day, the second day of the meeting was devoted primarily to more technical issues (as well as the discussion of costs incurred described above). IHS presented a revised version of its CSC negotiation template, known as the Annual CSC Calculation (ACC) template. The ACC, an electronic copy of which is attached, is a work in progress that will ultimately become an attachment to the CSC Policy. It is meant to serve as a tool for negotiating CSC needs at the beginning of the year, for adjusting CSC amounts during the year, and for reconciling CSC payments at the end of the year.

The “Summary Worksheet” tab is similar to previous iterations of the ACC—essentially a shortfall report entry in vertical format. But this version of the spreadsheet contains several other tabs with supporting documentation and calculations, all of which feed into the cells in the Summary Worksheet. Some of these are noncontroversial, but others will require more discussion. For example, the “Funding Support” tab contains a list of “Funding Ineligible for CSC” that includes categories not all tribes will agree with (e.g., CHEF, MSPI, and DVPI). The “DCSC Negotiation” tab includes a controversial cap on

salaries of 62% of IHS funding for purposes of calculating fringe benefits.⁸ And the “Duplication” tab will need to be reworked or even removed depending on the resolution of that issue in the policy.

IHS is working on a guidance document with detailed instructions for IHS staff on implementing the ACC tool. Tribes sought, and received, assurance that they will have an opportunity to provide input on that important document. Although the issues above (and others) need to be worked out, tribal representatives agreed that, in principle, the ACC workbook is a helpful tool for negotiating, adjusting, and reconciling CSC needs and payments.

FY 2014 and 2015 Closeout

IHS has still not completed reconciliation of FY 2014, over 14 months after the end of the year, underscoring the need for a simple and efficient process to be put in place. As shown in the attached funding summary sheet, IHS still had \$3,464,183 in FY 2014 funding as of October 2015, but it had additional need of \$4,902,109. In theory, the agency should be able to cover the difference by recouping some of the \$5,583,029 in overpayments.

The FY 2015 funding summary appears to indicate a more disturbing problem. As of October 2015, after the completion of the fiscal year, IHS had over \$46.7 million in unspent funding allocated to CSC. No additional CSC needs are identified; in fact, the summary indicates tribes were overpaid \$5,240,320. Because CSC funding was allocated from IHS’s lump-sum Services appropriation, surplus funds could have been reprogrammed to fund other Indian health needs. Instead, the vast majority of this \$46.7 million will likely sit unused in the IHS FY 2015 account for five years, at which point it will revert to the Treasury.⁹ This result highlights the need for CSC to be appropriated to, and paid from, a separate account rather than competing with program funding. We understand that the FY 2015 omnibus appropriations bill currently under consideration would establish CSC as a separate, indefinite appropriation.

Conclusion

We will continue to follow CSC developments in both IHS and BIA on your behalf. If you have any questions about this memorandum, please do not hesitate to contact Joe Webster (jwebster@hobbsstrauss.com or 202-822-8282), Geoff Strommer, (gstrommer@hobbsstrauss.com or 503-242-1745), or Steve Osborne (sosborne@hobbsstrauss.com or 503-242-1745).

⁸ For a detailed discussion of IHS’s recent position on DCSC negotiation, please see our memorandum of September 2, 2015, at 2-3.

⁹ Some of the funding could still be used to satisfy obligations incurred, but not paid, in FY 2015. Typically this amount is not large.