Developmental Disabilities Inst., Inc. v Chancellor, New York City Dept. of Educ.

2010 NY Slip Op 32431(U)

August 11, 2010

Sup Ct, NY County

Docket Number: 116438/2009

Judge: O. Peter Sherwood

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[* 1] SCANNED ON 8/16/2010

SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: O. PETER SHERWOOD, *Justice* — **PART** 61

DEVELOPMENTAL DISABILITIES INSTITUTE, INC.,

Petitioner,

-against-

CHANCELLOR, THE NEW YORK CITY, DEPARTMENT OF EDUCATION, *et al.,*

Respondents.

INDEX NO. 116438/09

MOTION DATE April 7, 2010

MOTION SEQ. NO. 001

MOTION CAL. NO. 31

The following papers, numbered 1 to 5 were read on this petition pursuant to CPLR Article 78

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	1-3
Answering Affidavits — Exhibits	4-5
Replying Affidavits	

Cross-Motion: ☐ Yes ☑ No

Upon the foregoing papers, the petition pursuant to CPLR Article 78 is decided in accordance with the accompanying decision, order and judgment.

UNFILED JUDGMENT
This judgment has not been entered by the County Clerk and notice of entry cannot be served based hereon. To obtain entry, counsel or authorized representative must appear in person at the Judgment Clerk's Desk (Room 141B).

Dated: August 11, 2010

O. PETER SHERWOOD, J.S.C.

Check one: ☑ FINAL DISPOSITION ☐ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

☐ SUBMIT ORDER/JUDGMENT ☐ SETTLE ORDER/JUDGMENT

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 61
---X

DEVELOPMENTAL DISABILITIES INSTITUTE, INC.,

Petitioner,

In a Proceeding Commenced Pursuant to CPLR Article 78

-against-

CHANCELLOR, THE NEW YORK CITY DEPARTMENT OF EDUCATION and DIVISION OF FINANCIAL OPERATIONS, THE NEW YORK CITY DEPARTMENT OF EDUCATION,

Respondents.
---X

DECISION, ORDER AND JUDGMENT

Index No. 116438/2009

UNFILED JUDGMENT
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O. PETER SHERWOOD, J.:

This is a proceeding pursuant to Article 78 of the Civil Practice Law and Rules (CPLR) in which the petitioner, Developmental Disabilities Institute, Inc. ("DDI" or "petitioner"), seeks a judgment: (1) annulling the determination of respondents Chancellor and the Division of Financial Operations of the New York City Department of Education (collectively the "DOE" or "respondents"), dated July 28, 2009, to the extent it held that there had been an overpayment to DDI by respondents for the Fiscal Years 1996 to 2002 on the grounds that: (1) respondents are barred by the applicable six-year statute of limitations from recouping the overpayments; (2) respondents are precluded from recouping such overpayments by DDI's intervening bankruptcy; and (3) it is too late for respondents to collect the overpayments as such recoupment would be prejudicial to DDI which no longer has the relevant records. The petition is opposed by the DOE which contends that none of the arguments asserted by DDI preclude the DOE from recouping the overpayments. For the reasons that follow, the petition is granted in part.

From 1996 through the present, DDI, a not-for-profit corporation, provided non-public school educational services to New York City school age children, ages five through 21, with developmental disabilities who were referred to it by the DOE (Petition ¶¶1-2; Answer ¶ 22). Among the students who were served, some attended a Certified Residential Program ("CRP")

(Petition ¶ 2; Answer ¶ 22). The DOE paid the tuition for these students, the amount of which was set by the New York State Education Department ("SED") (Petition ¶ 4; Answer ¶ 22). Until July 1, 2007, the tuition for CRP students was paid directly to DDI by SED, through Medicaid (Answer ¶ 22). Effective July 1, 2007, section 3202 (5) of New York's Education law was amended to provide that local school districts would be responsible for payment of CRP tuition subject to reimbursement from the State (Answer, fn. 1, p. 4). DDI's current contract with the DOE for school age services other than CRP commenced in July 2005 and expired in June 2010 (Answer ¶ 23). A prior contract, which DOE alleges "upon information and belief would have contained similar provisions", ran from July 2000 to June 2005 (*id.*). Neither petitioner nor respondents have made any specific allegations as to the contents of the contract covering the period 1996 to June 2000.

In 2008, the DOE conducted a reconciliation of payments made to DDI for all periods from fiscal year 1996 through fiscal year 2008. By letter dated July 28, 2009, the DOE issued a determination based upon such reconciliation stating that DOE had overpaid DDI for the relevant fiscal years in the amount of $285,348.45 (Petition ¶ 7, Ex. "A"; Answer ¶ 24). The DOE contends that the overpayments resulted from payments made to DDI for CRP students because DDI included the CRP students' names in its monthly attendance reports and tuition for such students was paid by the SED rather than the DOE.

Petitioner then commenced this CPLR Article 78 proceeding to annul respondents' determination. Petitioner contends that the DOE can only seek reimbursement for overpayments within six years of the date the City learns of the overpayment. DDI argues that the DOE could have learned of any overpayments through the annual cost reports DDI filed every May 31st following a fiscal year. Thus, for example, the DOE could have learned of any overpayment for fiscal year 2002 on or before May 31, 2003 (Petition ¶¶ 8-9). On that basis, petitioner claims that the DOE's attempt to collect overpayments on July 28, 2009, more than six years after May 31, 2003, is time-barred (*id.* ¶ 12).

DDI also argues that as a matter of policy it keeps records of the type involved in this matter for only eight years and is, therefore, prejudiced by the DOE's effort to recoup overpayments as it only learned on July 28, 2009, of the overpayments dating back to 1996, and lacks the relevant records to contest the DOE's determination as to the alleged overpayments (*id.* ¶¶ 13-15). Therefore,

due to its unreasonable delay, the DOE should be barred from seeking the recoupment of overpayments for fiscal years 1996 through 2002.

Lastly, DDI contends that it filed a Chapter 11 petition in bankruptcy in the United States District Court for the Eastern District of New York on February 9, 2001, and that respondents were listed as creditors in such proceeding. Petitioner contends that under bankruptcy laws respondents are precluded from pursuing the claimed overpayments.

Respondents contend that pursuant to the contracts between DDI and DOE, respondents had the right to conduct a fiscal audit of DDI and the subject contracts contain no time limitation for such audits. Respondents argue that if there is no time limitation for the conduct of audits, DOE is also not prohibited on the basis of any period of limitations from asserting its right to recoup overpayments that the contract with DDI did not require DOE to make. The contract further provides that DOE may adjust its schedule of payments to DDI for tuition payments made by other public or private entities. The bulk of the overpayments at issue related to tuition payments made for CRP services.

Alternatively, respondents contend that even if the Court were to find that the portion of the overpayments for periods prior to 2003 are barred by the applicable six-year statute of limitations, such time-barred pre-2003 overpayments could nevertheless be considered under the equitable doctrine of recoupment as set-offs against any underpayment revealed in the reconciliation.

With respect to any prejudice to DDI resulting from its disposal of relevant records, respondents contend that since the contracts between the parties contained no time limitation for the conduct of fiscal audits, DDI discarded its records at its own risk. In any event, DOE has all the relevant records necessary to conduct the audit and determine its accuracy.

Lastly, respondents contend that the equitable doctrine of recoupment also disposes of DDI's argument concerning the discharge in bankruptcy of the recoupment of overpayments. They argue that such claims arising out of the same transaction or occurrence as any underpayments can survive the bankruptcy.

In reply, petitioner challenges respondents' argument, that under the equitable doctrine of recoupment its effort to recoup overpayments more than six years after such overpayments were made is permissible because such overpayments made in the 1990s and the underpayments made in

the last decade are part of the "same transaction", as absurd. Petitioner notes that different contracts, different students and different programs were involved and that respondents apparently do not have a copy of the contract covering the 1990s. In any event, respondents have conceded that the bulk of the overpayments made in the 1990s related to CRP payments which were not covered by the contracts. Petitioner also disputes respondents' argument that the overpayment claims arising prior to the confirmation date in the federal bankruptcy proceeding were not discharged in bankruptcy as they arose form the same transaction as the post-bankruptcy petition payments. Rather, petitioner argues that payments made by DOE in each year are independently determinable and are based upon different contracts, different programs and different students. On this basis, petitioner avers that the general rule in bankruptcy regarding pre-petition claims must be applied.

It is well settled that in a CPLR Article 78 proceeding judicial review is limited to a determination of whether the administrative action was made in violation of a lawful procedure, was affected by an error of law or was arbitrary and capricious and without a rational basis in the administrative record (*see,* CPLR 7803; *Pell v Board of Education,* 34 NY2d 222, 231 [1974]). The court may not conduct a de novo review of the facts and circumstances or substitute its own judgment for that of the administrative agency (*see, Greystone Management Corp. v Conciliation and Appeals Bd.*, 94 AD2d 614, 616 [1st Dept 1983], *affd.* 62 NY2d 763 [1984]). Rather, the court should review the record as a whole to determine whether a rational basis exists to support the findings of the administrative agency (*see, Nelson v Roberts,* 304 AD2d 20 [1st Dept 2003]). Moreover, where the administrative determination requires an evaluation of the facts within an area of the administrative body's expertise, the determination must be accorded great weight and judicial deference (*see, Flacke v Onondaga Landfill Systems, Inc.*, 69 NY2d 335, 363 [1987]). An action is arbitrary and capricious when the action is taken "without regard to the facts" (*Pell v Board of Education, supra*).

Upon review of the record in this proceeding, the court is of the opinion that respondents' attempt to collect overpayments for the fiscal years 1996 to 2002 is time-barred by the applicable six-year statute of limitations. The Court of Appeals decision in *Matter of Blossom View Nursing Home v Novello* (4 NY3d 581 [2005]), cited by petitioner, is instructive. In that case, the court granted Article 78 prohibitory relief on the ground of inordinate delay after finding that the

Department of Health offered no explanation for its six- to seven-year delay in conducting audits of patient review instruments (PRIs) other than "administrative oversight (meaning inadvertence, not supervision)" (*Blossom*, 4 NY3d at 595). The *Blossom* court also distinguished audits of PRIs from audits of nursing home fiscal records. By regulation, audits of nursing home fiscal records were required to be conducted within six years of filing and such records were required to be retained for such six-year period. No such requirement was applicable to audits of PRIs. The regulation governing PRIs did not impose any specific deadline for PRI audits and instead simply instructed that they must be timely conducted. In addressing this difference and finding the Department of Health's delay in the audit of PRIs untimely as a matter of law, the court stated: "Although PRI audits are not subject to the six-year limitations period * * * 'timely' is not synonymous with 'timeless.'"

Respondents distinguish *Blossom* from the instant matter on the ground that here the relevant contracts contain no time limitation for DOE to conduct an audit of DDIs records, nor a commensurate time period for DDI to retain the relevant records. This distinction is unpersuasive, particularly since, as the court recognized in *Blossom,* the regulations governing PRIs, unlike the statutes applicable to nursing home fiscal records, contained no specific deadline for conducting PRI audits. Similarly, here, as respondents note, the applicable contract contains no deadline for the conduct of fiscal audits. The court notes, in this regard, that only the contract for the period July 1, 2005 through June 30, 2010, is contained in the record and DOE has advised that it could not locate any previous contract between DDI and DOE (Respondents' Memorandum of Law in Opposition, p. 4, fn. 3). Accordingly, DOE cannot prove that it has a contractual right which is not time limited to conduct audits of DDI. Nevertheless for purposes of this proceeding, the court will accept respondents' assertion that the previous contracts, aside from the contract dates, were essentially identical (*id.*). Thus, while a specific time for conducting an audit may not be contained in the relevant contracts, that does not mean that DOE's entitlement to conduct fiscal audits is timeless. Respondent has proffered no explanation, reasonable or otherwise, for its extended delay in conducting a fiscal audit of DDI's records. DDI has been actually prejudiced as a result of the delay as its ability to counter the results of the audit has been compromised by its destruction of relevant records pursuant to agency policy. The fact that respondents have records upon which their audit

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is based is no substitute for DDI having access to its own records to verify, contradict, explain and otherwise inform the accuracy or interpretation of records respondents might offer in an audit. Thus, this court finds that the recoupment for overpayments of the period 1996 to 2002 is time-barred and respondents may recompute the amount of any overpayment alleged to be due for fiscal years 2003 through 2008 only.

Alternatively, respondents contend that any time-barred overpayments should be considered set-offs against the remaining payments under the equitable doctrine of recoupment. Respondents assert this claim in response to petitioner's limitations argument, as well as to its contention that under bankruptcy law respondents cannot recoup any overpayments prior to the time DDI declared bankruptcy. The court finds this argument to be lacking in merit. DDI filed a Chapter 11 petition in bankruptcy in the Bankruptcy Court for the United States District Court for the Eastern District of New York on February 9, 2001 and DDI's bankruptcy plan was confirmed on August 15, 2002 (Petition ¶¶ 17, 19). It is axiomatic (and respondents do not dispute) that under the Bankruptcy Code the confirmation of a reorganization plan discharges the debtor from any debt that arose before the date of the confirmation (*see,* 11 USC § 1141 [d][1]; *In re Manville Forest Products Corp.*, 209 F3d 125, 128 [2d Cir 2000]). Thus, generally, any claims to overpayments arising prior to August 15, 2002, would be discharged. However, respondents contend in reliance upon a decision of the Ninth Circuit in *TLC Hospitals v United States Department of Health and Human Services* (224 F2d 1008 [2000]) that pre-petition overpayment claims can survive bankruptcy where they arise from the same transaction or occurrence as post-petition overpayments. Respondents argue that is the case here.

The Second Circuit has taken a more restrictive view of the doctrine of equitable recoupment. It has held that the recoupment doctrine is a limited one and should be narrowly construed (*see, In re Malinowski v New York State Dept. of Labor*, 156 F3d 131, 133 [2d Cir 1998]). Thus, in bankruptcy cases the doctrine is limited to cases in which both pre-confirmation and post-confirmation debts arise out of a single integrated transaction. A mere logical relationship between the two is not enough. Applying this reasoning, the *Malinowski* court rejected the State Labor Department's claim for pre-petition recoupment of unemployment benefits finding that the overpayment and the current underpayment resulted from different claims for unemployment insurance, each with eligibility based upon different periods of unemployment. As such, the claims

were not related for recoupment purposes. The court noted that even where the parties' claims arise from a single contract, if "the contract itself contemplates the business to be transacted as discrete and independent units", recoupment may not be applied (*id.* at 135).

The same reasoning militates against permitting recoupment in this case. Different contracts govern the periods for which DOE seeks to recover overpayments and each period involves different years, different students and different programs. Under the circumstances of this case, to apply recoupment now would be inequitable.

Accordingly, it is

ADJUDGED, that the petition is granted to the extent that the determination of respondent The New York City Department of Education, dated July 28, 2009, finding overpayments were made to petitioner, Developmental Disabilities Institute, Inc., for the fiscal year 1996 to fiscal year 2002 is annulled and respondents are barred from seeking overpayments for the periods from fiscal year 1996 through fiscal year 2002; and it is further

ORDERED AND ADJUDGED that the matter is remanded to the New York City Department of Education, Division of Financial Operations, for reconciliation of the period from fiscal year 2003 to fiscal year 2008.

This constitutes the decision, order and judgment of the court.

DATED: August 11, 2010

ENTER

O. PETER SHERWOOD
J.S.C.

UNFILED JUDGMENT
This judgment has not been entered by the County Clerk and notice of entry cannot be served based hereon. To obtain entry, counsel or authorized representative must appear in person at the Judgment Clerk's Desk (Room 141B).