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# POVERTY REVENUE: THE SUBVERSION OF FISCAL FEDERALISM

Daniel L. Hatcher\*

*Fiscal federalism is a staple of economic theory that underlies the federal–state partnership in the nation’s largest federal grant-in-aid programs, such as Medicaid and Title IV-E Foster Care. The theory is founded on a simple principle, the collaboration of the federal government’s financial power and stability and state governments’ ability to deliver services tailored to regional needs. However, the theory ignores a vast industry that has grown around the flow of federal funds. In addition to providing operational and consulting services for all aspects of government aid, this poverty industry—which usurps inherently governmental functions and is rife with organizational conflicts of interest and a revolving door of personnel—has now tapped into grant-in-aid funding at its source. Through revenue maximization contracts, the poverty industry helps states increase claims for federal aid, and the additional funding is often diverted from its intended purpose. The contractors take as much as 25% as a contingency fee and assist cash-strapped states with strategies to route the aid dollars into general revenue rather than targeted assistance. Then, while maximizing claims on behalf of state clients, the industry simultaneously contracts with the federal government to reduce payout of the same federal funds. Analogous to the iron triangle formed by the military–industrial complex, the vertical relationship between the federal and state governments in grant-in-aid programs has been transformed by a poverty–industrial complex. And as the structure of fiscal federalism is subverted, the benefits of the theory break down. As the intended social welfare maximization goals of government turn to revenue maximization, and intergovernmental collaboration turns to conflict, the integrity of fiscal federalism in grant-in-aid programs is undermined and statutory purpose is lost.*

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## INTRODUCTION

Poverty, it turns out, is a lucrative business. MAXIMUS, Inc. has grown to become one of the world's largest private providers of government services by contracting to help operate and guide government programs, with a substantial focus on services for the poor. Since the company's origins in the basement of its founder in 1975,<sup>1</sup> MAXIMUS has grown to "more than 6,500 employees located in more than 220 offices in the United States, Canada, Australia, the United Kingdom, and Israel."<sup>2</sup> MAXIMUS is emblematic of a growing industry that has mined into the foundations of fiscal federalism. As billions in federal dollars intended to assist low-income adults and children flow through a regulatory maze, and as states have clambered to claim their share, American capitalism has taken notice. An entire poverty industry has formed around the federal-state partnership in grant-in-aid programs, and it now undermines the legal and economic structure upon which the programs were built.

Much has been written regarding the economic theory of fiscal federalism and its application to federal grant-in-aid programs, addressing the vertical division of financing and program control among the multiple levels of government.<sup>3</sup> The theory's preference for centralized federal financial support and decentralized state administration has provided the core structure for federal aid programs such as Medicaid and Title IV-E Foster Care, where the federal government provides matching funds intended to increase states' ability to provide program services.<sup>4</sup> Long-held beliefs in the theory's benefits stem from the historical rationales for federalism itself—including fiscal accountability, efficiency of shared governance, and a collaboration of relative strengths.<sup>5</sup> The

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1. Nicholas Riccardi, *Political Struggle Centers on Welfare-to-Work Contractor*, L.A. TIMES, June 20, 2000, at B1.

2. Press Release, MAXIMUS, MAXIMUS Reports Strong Fiscal 2010 First Quarter Results (Feb. 4, 2010), available at <http://phx.corporate-ir.net/phoenix.zhtml?c=88279&p=irol-newsArticle&ID=1382929&highlight=>.

3. E.g., U.S. ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, PUB. NO. M-190-II, SIGNIFICANT FEATURES OF FISCAL FEDERALISM: REVENUES AND EXPENDITURES (1994); RICHARD A. MUSGRAVE, THE THEORY OF PUBLIC FINANCE: A STUDY IN PUBLIC ECONOMY (1959); WALLACE E. OATES, FISCAL FEDERALISM (1972) [hereinafter OATES, FISCAL FEDERALISM]; THE POLITICAL ECONOMY OF FISCAL FEDERALISM (Wallace E. Oates ed., 1977); Steven D. Gold, *State Finances in the New Era of Fiscal Federalism*, in THE CHANGING FACE OF FISCAL FEDERALISM 88 (Thomas R. Swartz & John E. Peck eds., 1990); Clifford Larsen, *States Federal, Financial, Sovereign and Social: A Critical Inquiry into an Alternative to American Financial Federalism*, 47 AM. J. COMP. L. 429 (1999); Wallace E. Oates, *An Essay on Fiscal Federalism*, 37 J. ECON. LITERATURE 1120 (1999) [hereinafter Oates, *An Essay*]; Wallace E. Oates, *Toward A Second-Generation Theory of Fiscal Federalism*, 12 INT'L TAX & PUB. FIN. 349 (2005) [hereinafter Oates, *Second-Generation*]; Ilya Somin, *Closing the Pandora's Box of Federalism: The Case for Judicial Restriction of Federal Subsidies to State Governments*, 90 GEO. L.J. 461 (2002); David A. Super, *Rethinking Fiscal Federalism*, 118 HARV. L. REV. 2544 (2005).

4. See generally Charles C. Brown & Wallace E. Oates, *Assistance to the Poor in a Federal System*, 32 J. PUB. ECON. 307 (1987).

5. E.g., Patricia L. Bellia, *Federalization in Information Privacy Law*, 118 YALE L.J. 868, 893 (2009) (discussing efficiency as one of the benefits of federalism);

theory pairs the federal government's financial power and ability to withstand economic downturns with the ability of states to better understand—and act with flexibility to meet—the regional needs of their citizens.<sup>6</sup>

While analysis of fiscal federalism and debate regarding the appropriate balance of intergovernmental collaboration in grant-in-aid programs is extensive, the literature addressing fiscal federalism theory largely ignores the relationships of the federal and state governments with the growing poverty industry. Comparable to the iron triangle interrelationships between government and private industry in the military-industrial complex,<sup>7</sup> a vast structure of contractual connections between government and private industry has developed around the billions in grant-in-aid dollars flowing from the federal government to the states.

This poverty-industrial complex is expansive,<sup>8</sup> to the point where private companies now provide services in virtually every aspect of government-funded programs for the poor, at every agency level.<sup>9</sup> Products of this extensive complex include a revolving door of personnel between the agencies and industry, pay-to-play tactics, contractors performing inherently governmental functions, and potential organizational conflicts of interest.<sup>10</sup> Further, in addition to directly operating government programs, companies within the poverty industry have raced to become hired guides for states searching for a greater percentage of the federal funds. These revenue maximization consultants explore the boundaries of federal grant-in-aid programs, enticing their cash-strapped state clients with contingency-fee contracts through which the states only make payments as a percentage of any additional federal dollars claimed.<sup>11</sup>

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Susan Rose-Ackerman, *Cooperative Federalism and Co-Optation*, 92 YALE L.J. 1344, 1345–46 (1983) (providing rationales for cooperative federalism in grant-in-aid programs); Super, *supra* note 3, at 2586–88 (discussing the development of federal matching programs).

6. See Oates, *An Essay*, *supra* note 3, at 1121–22.

7. GORDAN ADAMS, *THE IRON TRIANGLE: THE POLITICS OF DEFENSE CONTRACTING* 24 (1981); see also Arthur S. Miller, *Pretense and Our Two Constitutions*, 54 GEO. WASH. L. REV. 375, 382 (1986) (describing “the notorious ‘iron triangles’ . . . that exist in Washington, D.C.” and noting that “[no] doubt the most prominent triangle is the military-industrial complex, but many others exist”).

8. The phrase “poverty industrial complex” is not new. For example, a small Ohio newspaper used a variation of the phrase almost forty years ago for an article addressing “people and companies devoted to reaping profit from the nation’s legitimate interest in education and welfare.” Kevin P. Phillips, *The Education-Poverty Industrial Complex*, THE BRYAN TIMES, Sept. 23, 1972, at 4 (quoting Congresswoman Edith Green), available at <http://news.google.com/newspapers?nid=799&dat=19720923&id=aBQLAAAIBAJ&sjid=81EDAAAIBAJ&pg=7514,5450047>.

9. See *infra* Part II.A.

10. See *infra* Part II.A.1–3.

11. See ADAM CARASSO & ROSEANA BESS, URBAN INSTITUTE, *THE DISPOSITION OF FEDERAL DOLLARS IN FLORIDA’S SOCIAL SERVICES: INFORMING A FEDERAL FUNDING MAXIMIZATION STRATEGY* 32–34 (2003), available at [http://www.urban.org/UploadedPDF/410822\\_federal\\_dollars.pdf](http://www.urban.org/UploadedPDF/410822_federal_dollars.pdf); Daniel L. Hatcher, *Foster Children Paying for Foster Care*, 27 CARDOZO L. REV. 1797, 1807–10 (2006).

The use of revenue maximization consultants is widespread and defended as necessary to improve the ability of underfunded state agencies to maximize federal funds.<sup>12</sup> However, the agencies rely on consultant recommendations without sufficient oversight,<sup>13</sup> and the additional federal funds are often diverted from their intended purposes. Private consultants take up to 25% as their contingency fee.<sup>14</sup> Then, through fiscal maneuvers, the remaining amounts are often routed by states into their general coffers rather than to increase services to the poor.<sup>15</sup> When Judd Gregg was Governor of New Hampshire, he instituted a practice to claim additional Medicaid funds for general state use, resulting in a new general revenue line item accounting for 28% of New Hampshire's total general fund revenue in the first year the practice was implemented.<sup>16</sup> Through such practices, the intended beneficiaries continue to go without much-needed services while billions of federal grant-in-aid dollars change hands. As MAXIMUS reports significant revenue growth,<sup>17</sup> and states convert federal Medicaid and foster care funds to general use, foster children often do not receive even basic health care services.<sup>18</sup>

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12. *E.g.*, U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-05-748, MEDICAID FINANCING: STATES' USE OF CONTINGENCY-FEE CONSULTANTS TO MAXIMIZE FEDERAL REIMBURSEMENTS HIGHLIGHTS NEED FOR IMPROVED FEDERAL OVERSIGHT 8 (2005) [hereinafter GAO, MEDICAID FINANCING], available at <http://www.gao.gov/new.items/d05748.pdf> ("States that lack sufficient in-house resources can turn to consultants to add staff or needed expertise. Contingency-fee consultants are particularly attractive to budget-constrained states because the states do not need to pay them up front, agreeing to pay instead a percentage of any additional amounts saved or collected (the contingency fee). Consultants may also cost states less than developing in-house expertise.").

13. *See infra* notes 161–64 and accompanying text.

14. U.S. GEN. ACCOUNTING OFFICE, GAO/T-HEHS-99-148, MEDICAID: QUESTIONABLE PRACTICES BOOST FEDERAL PAYMENTS FOR SCHOOL-BASED SERVICES 8–9 (1999), available at <http://www.gao.gov/archive/1999/he99148t.pdf> ("Some school districts employ private firms to facilitate their efforts to claim Medicaid reimbursement. . . . By receiving a percentage rather than a fixed fee, these firms have an incentive to maximize the amount of reimbursements claimed. Some school districts . . . paid these firms fees ranging from 3 percent to 25 percent of the federal reimbursement amount.").

15. *See infra* Part II.B.2.

16. *See infra* notes 193–97 and accompanying text.

17. *See* Press Release, MAXIMUS, *supra* note 2 ("Revenue for the fiscal 2010 first quarter increased 19.2% to \$202.4 million."). Although MAXIMUS was a leader in revenue maximization services, it stopped entering new contingency-fee revenue maximization contracts soon after settling the False Claims Act allegations regarding its contract with the District of Columbia. *See infra* note 169 and accompanying text.

18. *See, e.g.*, ROB GEEN ET AL., THE URBAN INST., MEDICAID SPENDING ON FOSTER CHILDREN 5–6 (2005), available at [http://www.urban.org/UploadedPDF/311221\\_medicaid\\_spending.pdf](http://www.urban.org/UploadedPDF/311221_medicaid_spending.pdf) (explaining that foster children, even though enrolled in Medicaid, often do not adequately benefit from spending on health care services). For example, 83% of all foster children did not receive "targeted case management" (TCM) services designed to increase access to medical, educational, and other services, and spending for dental care services occurred only on behalf of 24% of Medicaid-eligible foster children who were not receiving TCM services. *Id.* For foster children receiving TCM services, still only 44% benefited from spending on dental care

The scope of the poverty industry's relationships with the federal and state governments weakens the intended benefits of fiscal federalism. The theory's belief in the ability of state governments to better serve the regional needs of their unique populations anticipates that government functions will be carried out by government actors. This perceived strength does not contemplate a private industry working towards the goal of maximizing profit rather than the Pareto-efficient distribution of services and resources to those in need.<sup>19</sup> Further, the industry's development of revenue maximization strategies is directing the federal aid away from its intended purposes and subverting the assumption inherent in fiscal federalism theory that state governments will seek to maximize the welfare of their citizens rather than simply maximizing state revenue.<sup>20</sup> Simultaneously, the anticipated intergovernmental cooperation that capitalizes on the strengths of each level of government has become a culture of conflict and distrust.<sup>21</sup> And the poverty industry that spurs the conflict also benefits from the conflict, contracting first with states to maximize federal grant-in-aid claims and then with the federal government to audit and reduce the payout of those same federal dollars.<sup>22</sup>

In addition to weakening the foundational integrity of fiscal federalism theory, practices within the poverty-industrial complex result in conflict with statutory purpose and regulatory requirements to the point of illegality.<sup>23</sup> In 2007, MAXIMUS agreed to pay \$30.5 million to resolve an investigation by the U.S. Department of Justice (DOJ) into False Claims Act allegations.<sup>24</sup> In a deferred-prosecution agreement, the company admitted responsibility for causing the District of Columbia to request Medicaid reimbursement as if the city's foster care

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services. *Id.*; see also *Health Care for Children in Foster Care: Hearing Before the Subcomm. on Income Security and Family Support of the H. Comm. on Ways and Means, 110th Cong. (July 19, 2007) (Statement of Child Welfare League of America), available at <http://webharvest.gov/congress110th/20081217020725/http://waysandmeans.house.gov/hearings.asp?formmode=view&id=7115> (discussing recent federal data, including that “[o]nly one state was found to be in substantial compliance of meeting both children’s physical and mental health needs”).*

19. Oates, *Second-Generation*, *supra* note 3, at 350.

20. *Id.* at 351.

21. See generally SONYA SCHWARTZ ET AL., NAT’L ACAD. FOR STATE HEALTH POLICY, MOVING BEYOND THE TUG OF WAR: IMPROVING MEDICAID FISCAL INTEGRITY, NATIONAL ACADEMY FOR STATE HEALTH POLICY (2006).

22. See *infra* notes 139–44, 168–81 and accompanying text; see also CTRS. FOR MEDICARE & MEDICAID SERVS./MEDICAID INTEGRITY GRP., INCREASING MEDICAID INTEGRITY THROUGH SUPPORT & OVERSIGHT (2008), available at <http://womeningovernment.org/files/file/medicare/resources/MICFactSheet508.pdf>; MEDICARE RECOVERY AUDIT CONTRACTOR (RAC) PROGRAM, UPDATE TO THE EVALUATION OF THE 3-YEAR DEMONSTRATION (2009), available at <http://www.cms.gov/RAC/Downloads/AppealUpdatethrough83108ofRACEvalReport.pdf>.

23. See *infra* Part III.

24. The investigation was spurred by a qui tam complaint filed by a former MAXIMUS division manager. Complaint at 1, 4, *United States ex rel. Turner v. Maximus Inc.*, No. 1:05-cv-01215 (D.D.C. June 22, 2005); Press Release, U.S. Dep’t of Justice, Virginia Company Enters into Deferred Prosecution Agreement & Agrees to Pay \$30.5 Million (July 23, 2007), available at [http://www.justice.gov/opa/pr/2007/July/07\\_civ\\_535.html](http://www.justice.gov/opa/pr/2007/July/07_civ_535.html).

agency provided reimbursable services to every single foster child “when, as Maximus then well knew, that was not true.”<sup>25</sup> The DOJ described the settlement as demonstrating “strong commitment to vigorously pursuing those companies that defraud the Medicaid program.”<sup>26</sup> However, both before and during the course of the litigation, MAXIMUS was almost inextricably linked to federal and state government agencies through contracts to provide services in Medicaid, Medicare, and other aid programs.<sup>27</sup> Thus, the available sanction of exclusion from continued participation in federal aid programs was explicitly avoided as part of the settlement.<sup>28</sup> Within two months of the settlement regarding allegedly fraudulent Medicaid claims, MAXIMUS won a five-year contract with the state of New York to provide Medicaid fraud-consulting services.<sup>29</sup> Within three months, the District of Columbia extended the same Medicaid revenue maximization contract with MAXIMUS that resulted in the alleged false claims.<sup>30</sup> From the time of the settlement through the end of 2008, MAXIMUS entered into or extended contracts related to Medicaid or Medicare worth more than \$240 million, including millions of dollars in contracts directly with the Centers for Medicare and Medicaid Services (CMS)—the federal agency to which the allegedly fraudulent claims had been submitted.<sup>31</sup> Then, one year after the DOJ settled its possible claims against

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25. Deferred Prosecution Agreement at 3, United States *ex rel.* Turner v. Maximus Inc., No. 1:05-cv-01215, (D.D.C. July 23, 2007); *see also* U.S. SEC. & EXCH. COMM’N, FORM 8-K: MAXIMUS, INC. (July 20, 2007), *available at* [http://edgar.brand.edgar-online.com/EFX\\_dll/EDGARpro.dll?FetchFilingHTML1?ID=5318470&SessionID=c\\_QaWFq\\_OCzCG47](http://edgar.brand.edgar-online.com/EFX_dll/EDGARpro.dll?FetchFilingHTML1?ID=5318470&SessionID=c_QaWFq_OCzCG47) (providing language from the deferred-prosecution agreement as part of the SEC filing).

26. Press Release, U.S. Dep’t of Justice, *supra* note 24.

27. *See infra* notes 29–32, 110–16 and accompanying text.

28. United States’ Notice of Intervention and Settlement at 7, United States *ex rel.* Turner v. Maximus Inc., No. 1:05-cv-01215 (D.D.C. July 20, 2007) (“In consideration of the obligations of Maximus in this agreement . . . the OIG-HHS agrees to release and refrain from instituting, directing, or maintaining any administrative action seeking exclusion from Medicare, Medicaid or other Federal health care programs . . . against Maximus under 42 U.S.C. § 1320a-7a . . . or 42 U.S.C. § 1320a-7a(b)(7).”).

29. Press Release, MAXIMUS, New York Awards Medicaid Fraud Contract to MAXIMUS (Sept. 13, 2007), *available at* <http://phx.corporate-ir.net/phoenix.zhtml?c=88279&p=irol-newsArticle&ID=1051158&highlight=>.

30. Bill Myers, *D.C. Hands Money to Company Tied to Fraud Scandal*, EXAMINER, Oct. 30, 2007, *available at* [http://www.examiner.com/a-1017751~D\\_C\\_hands\\_money\\_to\\_company\\_tied\\_to\\_fraud\\_scandal.html](http://www.examiner.com/a-1017751~D_C_hands_money_to_company_tied_to_fraud_scandal.html). The District of Columbia then initiated its own civil False Claims Act proceedings against MAXIMUS in 2009, but apparently decided to voluntarily dismiss the complaint without prejudice. *See* U.S. SEC. & EXCHANGE COMM’N, FORM 10-K, MAXIMUS, INC. 14 (2009).

31. Press Release, MAXIMUS, MAXIMUS Awarded \$15 Million Medicaid Contract by Indiana (Nov. 19, 2007), *available at* <http://phx.corporate-ir.net/phoenix.zhtml?c=88279&p=irol-newsArticle&ID=1079216&highlight=>; Press Release, MAXIMUS, MAXIMUS Wins Rebid for California Medicaid Program (Apr. 9, 2008), *available at* <http://phx.corporate-ir.net/phoenix.zhtml?c=88279&p=irol-newsArticle&ID=1127455&highlight=> (\$208.4 million contract); Press Release, MAXIMUS, MAXIMUS Awarded Renewal on Medicare Appeals Contract (May 14, 2008), *available at* <http://phx.corporate-ir.net/phoenix.zhtml?c=88279&p=irol-newsArticle&ID=1145758&highlight=> (contract renewal valued at \$14 million); Press

MAXIMUS, the company won a contract to insert its services within the DOJ itself, to provide “investigative and analytical support, consulting, technical services, financial management, and case-related professional support during the investigation and prosecution of criminal cases.”<sup>32</sup>

The poverty industry’s impact upon fiscal federalism’s intended federal–state partnership in grant-in-aid programs has been little understood and is largely ignored in scholarship. This Article begins the analysis. Part I examines the intended flow of grant-in-aid funds through principles of fiscal federalism, including a specific discussion of two of the largest federal matching programs: Medicaid and the Title IV-E Foster Care program. Part II explains the scope and impact of the poverty industry’s relationships with the federal and state governments, including description of contingency-fee revenue maximization strategies and the breakdown of the perceived benefits of fiscal federalism theory. In Part III, the Article analyzes resulting conflicts with statutory purpose and policy. Part IV concludes with recommendations to restore fiscal and legal integrity to fiscal federalism in federal grant-in-aid programs.

## I. MONEY FLOW:

### FISCAL FEDERALISM AND FEDERAL GRANT-IN-AID PROGRAMS

Federal grant-in-aid programs are structured as a partnership between the federal government and the states, a collaboration of shared finance and governance intended to increase services and programs for those in need of assistance.<sup>33</sup> This Part sets out the underpinnings of the fiscal federalism theory upon which the grant-in-aid programs are structured, and describes the specific framework of two of the larger federal aid programs: Medicaid and Title IV-E Foster Care. These programs provide the basis for much of the analysis that follows, including an explanation of how the fiscal federalism structure has been undermined by the poverty–industrial complex.

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Release, MAXIMUS, MAXIMUS Awarded \$7.2 Million Medicare Task Order (May 21, 2008), *available at* <http://phx.corporate-ir.net/phoenix.zhtml?c=88279&p=irol-newsArticle&ID=1148902&highlight=>; Press Release, MAXIMUS, MAXIMUS Awarded Medicare Part A West Appeals Contract, Expands Company’s Role as a Leading Medicare Claims Processor (Nov. 20, 2008), *available at* <http://phx.corporate-ir.net/phoenix.zhtml?c=88279&p=irol-newsArticle&ID=1228642&highlight=> (contract valued at \$4.1 million).

32. Press Release, MAXIMUS, MAXIMUS Awarded Professional Services Contract to Support U.S. Department of Justice (July 21, 2008), *available at* <http://phx.corporate-ir.net/phoenix.zhtml?c=88279&p=irol-newsArticle&ID=1177115&highlight=>. Also, MAXIMUS has faced additional controversy with other contracts. *See, e.g.,* Jessica Bock, *Missouri’s Billing of Medicaid is Disputed*, ST. LOUIS POST-DISPATCH, Mar. 27, 2010, [http://www.stltoday.com/news/local/education/article\\_d76d90a5-39e3-576a-bdeb-9b740b87a040.html](http://www.stltoday.com/news/local/education/article_d76d90a5-39e3-576a-bdeb-9b740b87a040.html); Dave Ranney, *Firm’s Medicaid Advice May Backfire for State*, LAWRENCE J.-WORLD & NEWS, Aug. 28, 2006, [http://www2.ljworld.com/news/2006/aug/28/firms\\_medicaid\\_advice\\_may\\_backfire\\_state/?state\\_regional](http://www2.ljworld.com/news/2006/aug/28/firms_medicaid_advice_may_backfire_state/?state_regional).

33. *See infra* notes 62–64 and accompanying text.



### A. Fiscal Federalism

The United States was founded upon principles of federalism, a shared governance between the individual states and the national government.<sup>34</sup> The balance in the partnership has continuously shifted to reflect the nation's changing practical necessities and political culture: from the tug-of-war at our country's founding between the Federalists' hopes for a strong central government and the Anti-Federalists' opposition to centralization,<sup>35</sup> through the clash between national government and the states in the Civil War,<sup>36</sup> into the Progressive Era and the Depression leading up to the New Deal,<sup>37</sup> shifting back towards state autonomy with Ronald Reagan's "New Federalism,"<sup>38</sup> and a reassertion of central power during the recent financial crisis.<sup>39</sup>

Throughout the historical shifts in the balance of power between the national government and the states, numerous values and benefits of federalism have been asserted. In addition to the prevention of tyranny and promotion of democracy,<sup>40</sup> federalism has been lauded as promoting efficiency,<sup>41</sup> providing

34. E.g., *Younger v. Harris*, 401 U.S. 37, 44–45 (1971) (“It should never be forgotten that this slogan, ‘Our Federalism,’ born in the early struggling days of our Union of States, occupies a highly important place in our Nation’s history and its future.”).

35. Andrew I. Gavil, *Reconstructing the Jurisdictional Foundation of Antitrust Federalism*, 61 GEO. WASH. L. REV. 657, 711 n.249 (1993).

36. See generally Roy F. Nichols, *Federalism versus Democracy: The Significance of the Civil War in the History of the United States Federalism*, in FEDERALISM AS A DEMOCRATIC PROCESS 49 (1942).

37. See Erin Ryan, *Federalism and the Tug of War Within: Seeking Checks and Balance in the Interjurisdictional Gray Area*, 66 MD. L. REV. 503, 630 (2007) (“The model of federalism adopted during the New Deal era was a reaction to the period immediately prior, characterized by the Progressive movement and the Supreme Court’s infamous *Lochner* era.”).

38. See generally TIMOTHY CONLAN, *NEW FEDERALISM: INTERGOVERNMENTAL REFORM FROM NIXON TO REAGAN* (1988).

39. See Steven M. Davidoff & David Zaring, *Regulation by Deal: The Government’s Response to the Financial Crisis*, 61 ADMIN. L. REV. 463, 535 (2009) (“On the other hand, those public law scholars inclined to focus on the importance of states in our federal system must consider the all-but-nonexistent role that states have played in the crisis response. If anything, the bailout phenomenon of states lining up for a piece of the federal bailout, and the ensuing prospect of federal supervision over the money, is a rebuke to the often too hopeful fans of federalism. The states have had almost nothing useful to add to the federal government’s response to the crisis.”).

40. See William W. Buzbee, *Asymmetrical Regulation: Risk, Preemption, and the Floor/Ceiling Distinction*, 82 N.Y.U. L. REV. 1547, 1617 n.253 (2007) (listing public participation among the multiple benefits of federalism); Brian Galle & Mark Seidenfeld, *Administrative Law’s Federalism: Preemption, Delegation, and Agencies at the Edge of Federal Power*, 57 DUKE L.J. 1933, 1971 (2008) (referencing “the potential benefits of abstract federalism—protection against tyranny by either sovereign”).

41. E.g., Bellia, *supra* note 5, at 893 (discussing efficiency as one of the benefits of federalism).

flexibility for regional choice,<sup>42</sup> and providing encouragement for local experimentation.<sup>43</sup>

Theories addressing the appropriate balance in federalism have largely focused on the division of regulatory authority,<sup>44</sup> with political science scholarship primarily focused on finding the best structure for achieving stability.<sup>45</sup> Carrying the shared governance structure into the field of economics, the focus is different. While “political scientists take federalism as a necessity in large, diverse societies and have been preoccupied with avoiding its greatest perils: instability, despotism, and war,” economists begin with an assumption that political turmoil and instability do not exist—and rather focus on fiscal efficiency and accountability.<sup>46</sup> Also, “though regulatory federalism primarily seeks to define and protect separate zones of authority for the two levels of government, much of fiscal federalism addresses more subtle problems that occur when both levels are involved concurrently.”<sup>47</sup>

Thus, fiscal federalism has developed as an economic theory designed to address the division of public sector financing and program administration among the vertical layers of government.<sup>48</sup> Wallace E. Oates, one of the first economic scholars to write extensively about the theory, describes it as follows:

As a subfield of public finance, fiscal federalism addresses the vertical structure of the public sector. It explores, both in normative and positive terms, the roles of the different levels of government and the ways in which they relate to one another through such instruments as intergovernmental grants.<sup>49</sup>

The normative framework of the theory contemplates that the central government should take the lead role “for the macroeconomic stabilization function and for income redistribution in the form of assistance to the poor,” and that the decentralized local governments should take more control of allocation

42. See Buzbee, *supra* note 40, at 1617 n.253 (also referencing “giving citizens choices” as a benefit of federalism).

43. E.g., Brian Galle & Joseph Leahy, *Laboratories of Democracy? Policy Innovation in Decentralized Governments*, 58 EMORY L.J. 1333, 1335 (2009) (explaining that “[t]he American vision of federalism likens decentralized government to a host of civic Marie Curies, each tirelessly in pursuit of discoveries to better mankind,” and referencing Justice Louis Brandeis’ famous description of “state and local governments as the ‘laboratories’ of democracy” (citing *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting))); Yair Listokin, *Learning Through Policy Variation*, 118 YALE L.J. 480, 491 (2008) (noting that “‘Experimentalists’ . . . typically extol the virtues of federalism (and of other forms of decentralized decision making) because of its learning benefits”).

44. Super, *supra* note 3, at 2549.

45. See JONATHAN A. RODDEN, HAMILTON’S PARADOX, THE PROMISE AND PERIL OF FISCAL FEDERALISM 17–18 (2006).

46. *Id.* at 18.

47. Super, *supra* note 3, at 2551.

48. See generally MUSGRAVE, *supra* note 3; OATES, FISCAL FEDERALISM, *supra* note 3.

49. Oates, *An Essay*, *supra* note 3, at 1120.

and consumption so that local needs and preferences are addressed.<sup>50</sup> A core principle in fiscal federalism theory is a purist view of public-sector functions: government steps in where the private market system fails, and “government agencies, as ‘custodians of the public interest’ . . . seek to maximize social welfare.”<sup>51</sup> This principle assumes that the various levels of government will each maximize the social welfare based upon the scope and makeup of their respective populations.<sup>52</sup> Decentralized local governments, therefore, will be more focused on the localized interests of their own unique constituencies as compared to a centralized government, which would provide a uniform approach to meeting the aggregate interests across all the various jurisdictions.<sup>53</sup> Formalizing the principle into the “Decentralization Theorem,” Oates explains the benefits of the decentralized provision of government services in terms of economic efficiency:

For a public good the consumption of which is defined over geographical subsets of the total population, and for which the costs of providing each level of output of the good in each jurisdiction are the same for the central or for the respective local government it will always be more efficient (or at least as efficient) for local governments to provide the Pareto-efficient levels of output for their respective jurisdictions than for the central government to provide any specified and uniform level of output across all jurisdictions.<sup>54</sup>

However, assumptions inherent in the theorem often do not hold true,<sup>55</sup> and local governments often do not have the financial capacity to provide sufficient levels of services during economic turmoil.<sup>56</sup> As states face lean economic times, services for the poor—although in higher demand in a bad economy—are often among the first programs states will cut.<sup>57</sup> Thus, seeking to balance the strengths and weaknesses between purely centralized and decentralized models, fiscal federalism theory has formed the basis of federal grant-in-aid program structure for providing safety net services to the poor.<sup>58</sup>

Matching grant programs, such as Medicaid and Title IV-E Foster Care, are primary examples. In a 1986 article in the *Journal of Public Economics*, co-

50. *Id.* at 1121–22 (“Decentralized levels of government have their *raison d’être* in the provision of goods and services whose consumption is limited to their own jurisdictions. By tailoring outputs of such goods and services to the particular preferences and circumstances of their constituencies, decentralized provision increases economic welfare above that which results from the more uniform levels of such services that are likely under national provision.”).

51. Oates, *Second-Generation*, *supra* note 3, at 350.

52. *Id.* at 351.

53. *Id.*

54. OATES, FISCAL FEDERALISM, *supra* note 3, at 35; *see also id.* at 54.

55. *E.g.*, Oates, *Second-Generation*, *supra* note 3, at 359–62.

56. Super, *supra* note 3, at 2586–93.

57. Jon Donenberg, *Medicaid and Beneficiary Enforcement: Maintaining State Compliance with Federal Availability Requirements*, 117 *YALE L.J.* 1498, 1515–16 (2008).

58. *See* Super, *supra* note 3, at 2586–88; *see also* Rose-Ackerman, *supra* note 5, at 1345–46 (providing rationales for cooperative federalism in grant-in-aid programs); Somin, *supra* note 3, at 464–80 (critiquing historic rationales for federal subsidization of state programs).

authors Oates and Charles C. Brown considered the “roles of different levels of government in assisting the poor,” and concluded that “the pure economics of the matter suggests a system of matching grants to local jurisdictions.”<sup>59</sup> Scholars describe the resulting federal–state partnership in terms of cooperation,<sup>60</sup> highlighting the perceived benefits of the federal and state governments working together cooperatively to maximize each other’s strengths in the provision of funds and services.<sup>61</sup>

The following Sections describe two specific federal grant-in-aid programs that are structured as matching grants, Medicaid and Title IV-E Foster Care. Then, in Part II, the Article describes how traditional fiscal federalism theory has not addressed the transformative impact of the poverty–industrial complex.

### ***B. Fiscal Federalism as Applied to Federal Grant-In-Aid Programs***

In addition to tax and debt instruments for raising revenue, intergovernmental grants are a primary tool for different levels of government to carry out their respective roles, and thus are a key application of fiscal federalism theory.<sup>62</sup> In the United States, intergovernmental grants typically take the form of federal grant-in-aid programs, and the modern trend in the application of fiscal federalism to such aid programs has been to devolve more discretion and control to the states and local governments.<sup>63</sup> The grant programs generally fall into three categories: matching programs such as Medicaid and Title IV-E Foster Care where state spending is required at a certain percentage match to receive additional federal funds; block grants like the current welfare cash assistance program (Temporary Aid to Needy Families, or TANF), which require states to maintain a certain level of state spending to receive the full federal block grant; and programs that are fully funded by the federal government but administered by the states, such as the Food Stamps Program.<sup>64</sup>

Total federal spending on two of the largest matching grant programs, Medicaid and Title IV-E Foster Care, is projected to reach almost \$300 billion in

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59. Brown & Oates, *supra* note 4, at 307.

60. E.g., Nicole Huberfeld, *Bizarre Love Triangle: The Spending Clause, Section 1983, and Medicaid Entitlements*, 42 U.C. DAVIS L. REV. 413, 419 (2008) (describing Medicaid as “a classic example of cooperative federalism”); Super, *supra* note 3, at 2562–79.

61. E.g., *Wis. Dep’t of Health & Family Servs. v. Blumer*, 534 U.S. 473, 495 (2002) (“The Medicaid statute . . . is designed to advance cooperative federalism.”); Lisa B. Deutsch, *Medicaid Payment for Organ Transplants: The Extent of Mandated Coverage*, 30 COLUM. J.L. & SOC. PROBS. 185, 207–08 (1997) (“The cooperative federalism relationship that the Medicaid Act sought to encourage between the federal government and the individual state governments was designed to accommodate change and to provide flexibility.”).

62. Oates, *An Essay*, *supra* note 3, at 1124.

63. Super, *supra* note 3, at 2549 (2005) (“One of the most important aspects of contemporary fiscal federalism is the transfer of responsibility for these [low-income assistance] programs from the federal government to the states.”).

64. CARASSO & BESS, *supra* note 11, at 32.

2010.<sup>65</sup> The programs are frequently targeted for contractor operational and consulting services and have been the subject of increased federal scrutiny into revenue maximization strategies.<sup>66</sup> The programs provide an excellent example of intended fiscal federalism structure and the transformative effects that occur as the poverty industry's relationships with both the state and federal governments continue to grow. Before analyzing the impact, the structural complexities of these two grant-in-aid programs should first be examined.

### 1. Medicaid

Enacted in 1965 to provide for the medical needs of the poor, Medicaid is the largest federal grant-in-aid program.<sup>67</sup> The program accounts for 40% of all federal funds received by state governments.<sup>68</sup> Medicaid operates as a matching program, where states have the option of receiving the federal funds to help pay the costs of health care and long-term care for low-income state residents.<sup>69</sup> The percentage match a state receives depends on an established formula, the federal medical assistance percentage (FMAP), largely based upon the state's relative wealth.<sup>70</sup> The matching funds provided by the federal government, known as federal financial participation, are available without any cap in order to incentivize states to expand their spending on covered services.<sup>71</sup> The more states use their own funds to pay for Medicaid-eligible services, the more federal matching funds the states can claim.<sup>72</sup>

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65. Memorandum from Larry Goolsby, Dir., Legislative Affairs, Am. Pub. Human Servs. Ass'n, Highlights of President Obama's Detailed FY 2010 Budget Proposal (May 8, 2009), available at <http://www.aphsa.org/Home/Doc/FY2010budgetmemo.pdf>. The budget's projected spending on the Medicaid program in 2010 is \$290 billion, and total projected spending for the Title IV-E programs is approximately \$7.1 billion, including a proposed \$4.68 billion for the Title IV-E foster care program and \$2.46 billion for the Title IV-E adoption assistance program. The estimate does not include the increase in spending that will result if health care reform legislation is enacted this year. The President's budget includes a set aside of \$635 billion over ten years to finance the anticipated reform package. *Id.*

66. See *infra* notes 171–81 and accompanying text.

67. Sara Rosenbaum, *Medicaid at Forty: Revisiting Structure and Meaning in a Post-Deficit Reduction Act Era*, 9 J. HEALTH CARE L. & POL'Y 5, 10–11 (2006); see also Huberfeld, *supra* note 60, at 418–28 (describing history and framework of Medicaid program).

68. Rosenbaum, *supra* note 67, at 10–11.

69. ANDY SCHNEIDER ET AL., KAISER COMM'N ON MEDICAID & THE UNINSURED, THE MEDICAID RESOURCE BOOK 86 (2002), available at <http://www.kff.org/medicaid/2236-index.cfm>.

70. *Id.* at 94 (“States with per capita incomes above the national level receive a lower federal matching percentage.”). As of 2001, the FMAP ranged from 50% to 77%. *Id.*; see also Nicole Huberfeld, *Clear Notice for Conditions on Spending, Unclear Implications for States in Federal Healthcare Programs*, 86 N.C. L. REV. 441, 475–76 (2008) (describing Medicaid program and FMAP).

71. SCHNEIDER ET AL., *supra* note 69, at 86 (“Medicaid's federal-state matching arrangements represent a fiscal incentive for states to extend coverage for health and long-term care services to their low-income residents.”).

72. *Id.*

The Medicaid program results in two types of entitlements: an entitlement to individuals where any person who meets the eligibility requirements has a right to coverage, and an entitlement to states where each state has a right to federal matching funds triggered by state expenditures for covered services to individuals enrolled in the program.<sup>73</sup> Although eligible individuals are entitled to Medicaid coverage, those individuals do not actually receive Medicaid payments. Rather, Medicaid is a “vendor payment” program in which state Medicaid programs make payments to health care providers or managed care plans that provide the eligible services.<sup>74</sup> Those state payments then entitle the states to federal matching at the relative FMAP.<sup>75</sup>

The process begins when a Medicaid-eligible individual receives services from a health care provider, often a hospital, physician, or nursing home, and the provider then bills the state Medicaid program for the services provided.<sup>76</sup> The state pays the health care provider from both state funds and federal funds already advanced by the federal Centers for Medicare & Medicaid Services (CMS), and then submits an expenditure report to CMS that requests the federal share of the Medicaid expenditures and that reconciles the state’s expenditures with the CMS advance.<sup>77</sup> The state may claim reimbursement for the medical services provided, and also reimbursement for certain administrative costs in operation of the state Medicaid program.<sup>78</sup> Because of the complexities and the desire to maximize the claiming of federal funds, states often contract with private consultants to assist in the claiming process.<sup>79</sup> The claims for Medicaid reimbursement, including those prepared by revenue maximization consultants, must comply with numerous federal requirements.<sup>80</sup>

## 2. Title IV-E Foster Care

The Title IV-E Foster Care program provides a federal funding stream to assist states in providing foster care services.<sup>81</sup> Similar to Medicaid, Title IV-E is a

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73. *Id.* at 87.

74. *Id.* at 100.

75. *Id.*

76. GAO, MEDICAID FINANCING, *supra* note 12, at 8.

77. *Id.* at 8–9.

78. *Id.* at 9.

79. *Id.* at 8, 12; *see also* Hatcher, *supra* note 11, at 1807–09 (discussing this phenomenon in the context of Title IV-E).

80. Examples include the Social Security Act requirement that states ensure Medicaid payments are “consistent with efficiency, economy, and quality of care,” 42 U.S.C. § 1396a(A)(30) (2006), the CMS policy generally prohibiting states from claiming federal reimbursement for contingency-fee payments to consultants, GAO, MEDICAID FINANCING, *supra* note 12, at 9–10, and requirements to comply with the Office of Management and Budget (OMB) cost principles and procedures, *id.* at 10 n.12 (explaining that OMB Circular A-87, which applies to federal grants to state and local governments, “establishes principles and standards to provide a uniform approach to determining allowable costs and promoting effective program delivery, efficiency, and better relationships between federal and other governmental units”).

81. Other funds, such as for adoption assistance and family preservation, are also available under Title IV-E and IV-B. *See* Hatcher, *supra* note 11, at 1821.

matching program where states are required to spend a certain percentage of state dollars to receive federal assistance.<sup>82</sup> The funding is structured as an entitlement and thus limited only by the number of eligible children.<sup>83</sup> Although Title IV-E funds are considered income to the individual children, in reality the funds are paid to the states to provide federal financial participation in foster care services.<sup>84</sup> Children do not receive an actual cash payment.<sup>85</sup> Payments are often described in terms of reimbursement of a percentage of state spending; like Medicaid, however, the federal funds are actually provided in advance through a process of estimation and reconciliation.<sup>86</sup>

The eligibility rules and fiscal-matching requirements for Title IV-E funds are burdensome for states and localities. To establish basic IV-E eligibility for a child, the state must meet multiple legal and administrative hurdles.<sup>87</sup> And

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82. Goodwin Liu, *Interstate Inequality in Educational Opportunity*, 81 N.Y.U. L. REV. 2044, 2120 n.273 (2006) (explaining that the “federal aid formulas for foster care, adoption assistance, and the Children’s Health Insurance Program also use the federal matching rate under Medicaid” (citing 42 U.S.C. §§ 674(a)(1)–(2), 1397ee(a)(1))).

83. *See id.*

84. U.S. DEP’T OF HEALTH & HUMAN SERVS., OFFICE OF THE ASSISTANT SEC’Y FOR PLANNING & EVALUATION, FEDERAL FOSTER CARE FINANCING: HOW AND WHY THE CURRENT FUNDING STRUCTURE FAILS TO MEET THE NEEDS OF THE CHILD WELFARE FIELD 3 (2005), available at <http://aspe.hhs.gov/hsp/05/fc-financing-ib/ib.pdf> (“It should be noted that while Title IV-E eligibility is often discussed as if it represents an entitlement of a particular child to particular benefits or services, it does not. Instead, a child’s Title IV-E eligibility entitles a State to Federal reimbursement for a portion of the costs expended for that child’s care.”).

85. *Id.*

86. The Title IV-E Foster Care program initially did not provide for advance payments, but a technical amendment was soon added to provide the advance payment process. *See* U.S. DEP’T. OF HEALTH & HUMAN SERVS., ADMIN. FOR CHILDREN & FAMILIES, ACYF-PR-82-02, FINAL FISCAL REGULATION – P.L. 96–272 (Aug. 13, 2002), available at [http://www.acf.hhs.gov/programs/cb/laws\\_policies/policy/pr/pr8202.htm](http://www.acf.hhs.gov/programs/cb/laws_policies/policy/pr/pr8202.htm) (“At this time, title IV-E does not authorize the Secretary to make estimated payments in advance of State expenditures. Therefore, Federal funds will be available on a reimbursement basis only. The Congress has passed a technical amendment to the Act to permit the making of estimated payments in advance of State expenditures.”); Act of Dec. 28, 1980, Pub. L. No. 96-611, 94 Stat. 3566 (codified at 42 U.S.C. § 674(b)) (amending Title IV-E to provide for advance payments).

87. For example, legal authority for child removal must exist either through appropriate voluntary placement or a court order specifically finding that the child’s continued presence in the family home “would be contrary to the welfare of such child.” 42 U.S.C. § 672(a)(2)(A)(ii) (2006); *see also* U.S. DEP’T OF HEALTH & HUMAN SERVS., *supra* note 84, at 7. A judicial determination is required within sixty days of a child’s removal that “reasonable efforts” were made to maintain the family unit and avoid the need for removal. Foster Care Maintenance Payments Program Implementation Requirements, 45 C.F.R. § 1356.21(b)(1) (2010). The state must show that the child was removed from a home that would have been eligible for welfare assistance under the old Aid to Families with Dependent Children (AFDC) rules. 42 U.S.C. § 672(a)(1)(B). The child must be placed in a licensed foster care home or facility; criminal background and safety checks for prospective foster care parents are required. *Id.* § 671(a)(20)(A). Also, additional special requirements exist in the circumstances of voluntary placements. *Id.* § 672(d).

after initial Title IV-E eligibility is established, stringent requirements must be met to maintain continued eligibility.<sup>88</sup> In addition to the eligibility requirements, states must meet certain spending requirements to claim the federal funds. The state match percentages for foster care maintenance and Title IV-E adoption assistance payments are set at the same percentage as the state's Medicaid match percentage (the federal medical assistance percentage).<sup>89</sup>

As with the Medicaid program, the complexity of the Title IV-E claiming process and resulting administrative burden on states has led many states to turn to revenue maximization consultants for assistance—often the same companies that offer similar services to states seeking to maximize Medicaid claiming.<sup>90</sup> The consultants develop strategies to help states increase their “penetration rates,” the percentage of foster children who are eligible for Title IV-E funding, and also to help states develop creative financing schemes so fewer state dollars are necessary to claim the maximum amount of federal Title IV-E funds.<sup>91</sup>

## II. SUBVERSION OF FISCAL FEDERALISM

The principle of fiscal federalism, upon which the Medicaid and Title IV-E programs are structured, is simple: a federal–state partnership of funding and governance based upon the federal government's financial power and stability and the state governments' ability to deliver services tailored to meet regional needs.<sup>92</sup> However, with billions in federal dollars changing hands through a regulatory web, the opportunity for private industry with an expertise in navigating bureaucracy to reap financial benefits has grown. Spurred by many of the same companies that starred in the military–industrial complex, a poverty industry has taken considerable hold of federal grant-in-aid programs.<sup>93</sup>

The following Sections describe the interrelationships between the federal government, state governments, and private industry that are ignored in the vertical structure of fiscal federalism theory. These Sections explore the scope and impact of the resulting poverty–industrial complex, analyze revenue maximization practices, and explain how the perceived benefits of fiscal federalism theory begin to break down. The Decentralization Theorem at the core of fiscal federalism's preference for decentralized government control in order to better serve regional needs is subverted as welfare maximization goals are replaced with revenue maximization strategies—guiding funds intended to help the poor into private profits and state general revenue.<sup>94</sup> Further, the ideal of a “cooperative fiscal

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88. See U.S. DEP'T. OF HEALTH & HUMAN SERVS., ADMIN. FOR CHILDREN & FAMILIES, TITLE IV-E FOSTER CARE ELIGIBILITY REVIEW GUIDE, CH. 4 (2007), available at [http://www.acf.hhs.gov/programs/cb/laws\\_policies/policy/im/2001/im0111a1d\\_2007.htm](http://www.acf.hhs.gov/programs/cb/laws_policies/policy/im/2001/im0111a1d_2007.htm) (summarizing initial and continuing Title IV-E eligibility requirements).

89. See U.S. DEP'T OF HEALTH & HUMAN SERVS., *supra* note 84, at 5. Further, the state match for administrative Title IV-E administrative expenses is set at 50%, the match for training is 75%, and the match for required data-collection systems is 50%. *Id.*

90. Hatcher, *supra* note 11, at 1808–09.

91. See *infra* Part III.A.

92. Oates, *An Essay*, *supra* note 3, at 1121–22.

93. See *infra* Part II.B.1.

94. OATES, FISCAL FEDERALISM, *supra* note 3, at 35, 54.



federalism” partnership between the federal government and state governments has become a relationship of tension and distrust, as state efforts to maximize federal funds encounter federal efforts to curb inappropriate claiming practices.<sup>95</sup> The poverty industry that adds to the tension has, in turn, further capitalized on the tension, as the industry is providing both aggressive revenue maximization services to help states claim federal funds while simultaneously providing services to the federal government to audit state claims and reduce excess payments.<sup>96</sup>

### *A. Scope of the Poverty–Industrial Complex*

Missing from the linear analyses of fiscal federalism theory are additional lines connecting the federal and state governments to the poverty industry. This Section describes the extent and tactics of contractor services to the federal and state governments, and, to illustrate their scope, includes legal analyses of possible organizational conflicts of interest and contractors performing inherently governmental functions. Revenue maximization strategies are then described in Part II.C. Part II.D considers the resulting impact on the structure and perceived benefits of fiscal federalism theory.

Privatization has been a component of social services for the poor in the United States since the founding of our country.<sup>97</sup> However, while the history is long, the intensity is increasing.<sup>98</sup> With some of the same defense contractors from the military–industrial complex leading the way, private contractors have now embedded their services into virtually every aspect and agency level of government-funded services for the poor. The services range from running entire government programs to simply making copies of government documents. In addition to building submarines and countless other military contracts, Northrop Grumman’s “technical solutions span the entire spectrum of human service programs—from Child Care to Child Support.”<sup>99</sup> When the Social Security

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95. Super, *supra* note 3, at 2588 (“States’ zeal in constructing these ‘creative financing’ or ‘maximization’ schemes, along with the federal government’s efforts to shut them down, have led to considerable tension between the two levels of government.”); see also SCHWARTZ ET AL., *supra* note 21.

96. See *supra* note 22 and accompanying text.

97. For an excellent history of privatization in the provision of welfare services, from private philanthropies of our early American history through the broad growth in privatization after the 1996 Welfare Reform Act, see Michele Estrin Gilman, *Legal Accountability in an Era of Privatized Welfare*, 89 CALIF. L. REV. 569, 581–95 (2001).

98. *Id.* Several scholars have considered the pros and cons of privatization theory in the context of federal aid programs. E.g., *id.*; Matthew Diller, *Form and Substance in the Privatization of Poverty Programs*, 49 UCLA L. REV. 1739 (2002); Jody Freeman, *Extending Public Law Norms Through Privatization*, 116 HARV. L. REV. 1285 (2003); Martha Minow, *Public and Private Partnerships: Accounting for the New Religion*, 116 HARV. L. REV. 1229, 1259–66 (2003); Chris Sagers, *The Myth of “Privatization,”* 59 ADMIN. L. REV. 37 (2007); David Saperstein, *Public Accountability and Faith-Based Organizations: A Problem Best Avoided*, 116 HARV. L. REV. 1353 (2003); David A. Super, *Privatization, Policy Paralysis, and the Poor*, 96 CALIF. L. REV. 393 (2008).

99. *Human Services, Technology with a Human Touch*, NORTHROP GRUMMAN, <http://www.it.northropgrumman.com/serve/statelocal/humanserv.html> (last visited Aug. 1, 2010).

Administration needed assistance in making digital copies of documents, the agency signed a five-year contract worth \$124 million with one of the nation's largest military contractors, Lockheed Martin.<sup>100</sup>

Numerous private companies have not only recognized the money to be made from poverty programs, but have concentrated on that niche as the core of their business offerings. With a mission of “[h]elping Government Serve the People,” MAXIMUS provides operational and consulting services for almost all aspects of government health and human services programs.<sup>101</sup> Similarly, the Public Consulting Group (PCG) was founded in 1986 as a consulting firm serving state and local health and human services agencies.<sup>102</sup> Although PCG's 700 employees are only about one-tenth of the size of MAXIMUS's workforce, the company has grown to thirty offices across the United States and in Montreal and Quebec.<sup>103</sup> Health Management Systems (HMS) describes itself as the “leader in coordination of benefits and program integrity services for government healthcare programs.”<sup>104</sup> The company's clients “include health and human services programs in more than 40 states, over 90 Medicaid managed care plans, the Centers for Medicare and Medicaid Services (CMS), and Veterans Administration facilities.”<sup>105</sup>

The poverty industry thrives on bad times. While many companies' stocks were diving, MAXIMUS announced increased cash dividends to its shareholders.<sup>106</sup> Similarly, HMS Holding Corporation announced record earnings in the third quarter of 2008,<sup>107</sup> and a transcript from HMS's earning call explains:

In general, the macroeconomic environment continues to play its fiscal duress on our government clients, which in turn generates opportunity for HMS.

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100. SOC. SEC. ADMIN., OFFICE OF THE INSPECTOR GEN., A-04-08-18066, AUDIT REPORT: CONTRACT WITH LOCKHEED MARTIN GOVERNMENT SERVICES, INC. FOR DIGITAL IMAGING SERVICES 2 (Nov. 2008), available at <http://www.ssa.gov/oig/ADOBEPDF/A-04-08-18066.pdf>.

101. *Services*, MAXIMUS, <http://www.maximus.com/services> (last visited Aug. 1, 2010).

102. *About Public Consulting Group (PCG)*, PUBLIC CONSULTING GROUP, <http://www.publicconsultinggroup.com/About/index.html> (last visited Aug. 1, 2010).

103. *Id.*

104. Press Release, HMS Holdings Corp., HMS Awarded Third Party Data Match and Recovery Contract by Mississippi Medicaid (July 7, 2009), available at <http://www.hms.com/docs/pr/MSpressreleaseFINAL7709.pdf>.

105. Press Release, HMS Holdings Corp., CMS Awards Medicaid Integrity Program Contract to HMS (May 11, 2009), available at [http://www.hms.com/docs/pr/CMS\\_MIC\\_TO3\\_Press\\_Release\\_%20FINAL.pdf](http://www.hms.com/docs/pr/CMS_MIC_TO3_Press_Release_%20FINAL.pdf).

106. Press Release, MAXIMUS, MAXIMUS Increases Quarterly Cash Dividend to \$0.12 per Share (Dec. 17, 2008), available at <http://phx.corporate-ir.net/phoenix.zhtml?c=88279&p=irol-newsArticle&t=Regular&id=1237323&>.

107. HMS Holdings Corp., Q3 2008 Earnings Call (Nov. 13, 2008) (statement of Walter Hosp, Senior Vice President & Chief Financial Officer), available at <http://seekingalpha.com/article/103287-hms-holdings-corp-q3-2008-earnings-call-transcript>.

. . . We believe the economic backdrop for the remainder of 2008 and for 2009 will support continued strong demand for HMS's services. . . . [T]he unemployment rate is the most important leading indicator of growth in the Medicaid program and growth in the Medicaid program was one of the most important drivers of HMS's revenue.<sup>108</sup>

MAXIMUS also noted in its 2008 fourth quarter earnings call that there are "more unemployed people and they look for job opportunities, and that plays right into the sweet spot for our welfare to work programs."<sup>109</sup>

The depth and scope of the poverty industry's role in federal grant-in-aid programs and funds is striking, spurred in part by lobbying efforts, campaign contributions, and a revolving door of personnel between private industry and government leadership. The poverty-industrial complex has grown to the point where seemingly any task—regardless of possible conflicts or limitations regarding inherently governmental functions—can be contracted out.

### 1. *Pay-to-Play*

A few years before former Illinois Governor Rod Blagojevich faced impeachment for allegedly trying to sell a U.S. Senate seat, he faced media scrutiny for his dealings with MAXIMUS. In 2005, The Chicago Sun Times reported on possible links between the company's receipt of state contracts and campaign contributions to Governor Blagojevich made by MAXIMUS and the company's lobbyists.<sup>110</sup> According to the paper, MAXIMUS initially contracted with the state to develop a new plan to maximize federal aid dollars, and the company was then "handed a waiver from state contracting rules by Blagojevich's administration so it [could] bid on the lucrative contract proposal it helped the state develop."<sup>111</sup> The company had apparently given Blagojevich's political fund \$25,500, and the company's lobbying firm—which employed the governor's former congressional chief of staff—donated another \$80,300 to the governor.<sup>112</sup>

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108. *Id.* (statements of Bill Lucia, President & Chief Operating Officer, & Bob Holster, President, Director, & Chief Executive Officer) ("Virtually all of our state clients have reported that they will be in deficit this fiscal year. And the deficits are extremely large . . . . As a result, clients are increasingly focused on cost containment, and that means more new program integrity procurement opportunities and more willingness to expand the scope of existing engagements to incorporate cost saving ideas. . . . If we see significantly higher Medicaid enrollment as a result of unemployment, it will have a favorable effect on our results.").

109. MAXIMUS, F4Q08 (Qtr. End 9/30/08) Earnings Call (Nov. 13, 2008) (statement of Richard Montoni, President & Chief Executive Officer), *available at* <http://seekingalpha.com/article/105919-maximus-f4q08-qtr-end-9-30-08-earnings-call-transcript?page=-1&find=maximus>.

110. *See, e.g.,* Dave McKinney, *Governor's Donor Gets Chance at Contract*, CHI. SUN TIMES, Mar. 7, 2005, at 8 [hereinafter McKinney, *Governor's Donor*]; Dave McKinney, *Lawmakers Say Firm Awarded State Pact Had 'Inside Track'*, CHI. SUN TIMES, July 18, 2005, at 26.

111. McKinney, *Governor's Donor*, *supra* note 110.

112. *Id.*

Such scrutiny then reached to the west coast. According to the Los Angeles Times, when MAXIMUS faced the risk of losing a \$32 million welfare-to-work contract with Los Angeles County, the company reacted by outspending its competitor on lobbying efforts by eight to one.<sup>113</sup> The county's Department of Public Social Services concluded another company's bid was better, and a review panel and the auditor-controller upheld the decision on appeal.<sup>114</sup> But after MAXIMUS spent \$200,000 in lobbying fees and thousands more in campaign contributions,<sup>115</sup> the paper explains, Los Angeles's five county supervisors voted to ignore the year-long review process and re-bid the contract to give MAXIMUS another chance.<sup>116</sup>

Other private contractors have faced similar questions regarding alleged pay-to-play tactics. In 2008, Pennsylvania's Patriot-News reported on Deloitte Consulting's receipt of over \$400 million in state contracts, and noted that "[t]he bulk of the money . . . was for work done at the state Department of Public Welfare."<sup>117</sup> The report examined the company's extensive connections to Governor Rendell's administration.<sup>118</sup> Further, the press reported that Deloitte employees made tens of thousands of campaign contributions to Pennsylvania Republicans and Democrats in state races, including \$46,250 to Governor Rendell.<sup>119</sup> Responding to months of criticism, Governor Rendell announced in March 2009 that he "would sign legislation to ban the practice of awarding state contracts to large political donors, maintaining that his administration hasn't engaged in so-called 'pay-to-play' activity."<sup>120</sup>

## 2. Revolving Door

In addition to the influence of money and lobbying, there is a continuous flow of leadership between the ranks of government agencies and private contractors involved in federal grant-in-aid programs. While Governor of Wisconsin, Tommy Thompson was on the national forefront of the charge to

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113. Garrett Therolf, *Firm Courts Supervisors, Wins Reprieve*, L.A. TIMES, Nov. 19, 2008, <http://articles.latimes.com/2008/nov/19/local/me-maximus19> (noting that MAXIMUS spent \$200,000 on lobbying fees, compared to \$25,000 spent by Policy Studies, Inc.).

114. Garrett Therolf, *Low-Rated Firm Fights to Keep Rich County Work*, L.A. TIMES, Oct. 30, 2008, <http://articles.latimes.com/2008/oct/30/local/me-maximus30>.

115. Therolf, *supra* note 113.

116. *Id.*

117. Jan Murphy, *Consultant Reaps State Windfall*, PATRIOT-NEWS, Feb. 24, 2008, at A1.

118. *Id.* (reporting that a former Deloitte partner served as the governor's deputy chief, the state's Chief Information Officer was a Deloitte employee, the Deputy Chief Information Officer for the California Health and Human Services Agency was a Deloitte public sector consultant, and the state's Deputy Secretary for Procurement for the Department of General Services was married to a Deloitte partner).

119. *Id.*

120. Brad Bumsted, *Rendell Denies Use of 'Pay-to-Play' Deals*, PITTSBURGH TRIBUNE-REVIEW, Mar. 10, 2009, [http://www.pittsburghlive.com/x/pittsburghtrib/news/s\\_615249.html](http://www.pittsburghlive.com/x/pittsburghtrib/news/s_615249.html).

privatize welfare and other poverty programs,<sup>121</sup> and he took his championship of privatization to the national stage as Secretary of the U.S. Department of Health and Human Services.<sup>122</sup> When he left his federal post, Thompson was rewarded with multiple positions in the private sector. Simultaneously, Thompson joined Deloitte Consulting, leading the firm's Center for Health Solutions;<sup>123</sup> became a partner with Akin Gump Strauss Hauer & Feld LLP, where he "focuse[d] on developing solutions for clients in the health care industry, as well as for companies doing business in the public sector;"<sup>124</sup> joined former U.S. House Majority Leader Richard Gephardt as a member of the board of directors for Centene Corporation, a company that provides Medicaid managed care services in several states;<sup>125</sup> became the board chairman of Logistics Health Incorporated;<sup>126</sup> and joined the boards of directors of several private companies in the healthcare field.<sup>127</sup>

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121. See, e.g., Paul Kengor, *Competitive Contracting and Privatization Options in Wisconsin State Government*, WIS. POL'Y RES. INST. REP., Apr. 2001, at 1 ("The seeds are there for more privatization in Wisconsin. The receptivity is shown by the encouragement of the State Legislature and Governor Thompson, who together created the bipartisan Wisconsin Commission on Privatization, which in 1998 called for a comprehensive privatization plan.").

122. E.g. Susan Page, *Medicare Scrap Could Shove Aside Prescription-Drug Benefit*, USA TODAY, Jan. 29, 2003, [http://www.usatoday.com/news/health/2003-01-29-bush-healthcare\\_x.htm](http://www.usatoday.com/news/health/2003-01-29-bush-healthcare_x.htm) (describing Thompson's support for legislation that conditioned access to a prescription-drug benefit on enrolling in a private managed-care program).

123. Meet Tommy G. Thompson, DELOITTE, [http://www.deloitte.com/dtt/employee\\_profile/0,1007,sid%253D80772%2526cid%253D86217,00.html](http://www.deloitte.com/dtt/employee_profile/0,1007,sid%253D80772%2526cid%253D86217,00.html) (last visited Aug. 1, 2010); see also DELOITTE, GOVERNING FORWARD: NEW DIRECTIONS FOR PUBLIC LEADERSHIP 26 (2006), available at [http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/US\\_Governingforward\\_research.pdf](http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/US_Governingforward_research.pdf) (listing Secretary Thompson as the "Independent Chair" of the Center for Health Solutions). In addition to luring Tommy Thompson into its staff, Deloitte Consulting also convinced Wade Horn, an Assistant Secretary of HHS, to rejoin his former boss by becoming the director of Deloitte's public sector practice. Meet Dr. Wade F. Horn, Ph.D., DELOITTE, [http://www.deloitte.com/dtt/employee\\_profile/0,1007,sid%253D71273%2526cid%253D154741,00.html](http://www.deloitte.com/dtt/employee_profile/0,1007,sid%253D71273%2526cid%253D154741,00.html) (last visited Aug. 1, 2010).

124. Tommy G. Thompson, AKIN GUMP STRAUSS HAUER & FELD LLP, <http://www.akingump.com/tthompson/> (last visited Aug. 1, 2010).

125. Board of Directors, CENTENE CORP., <http://www.centene.com/investors/corporate-governance/board-of-directors/> (last visited Aug. 1, 2010); *Solutions*, CENTENE CORP., <http://www.centene.com/about-us/solutions/> (last visited Aug. 1, 2010); see also Christopher Lee, *Thompson's Medicaid Reforms Could Benefit His Employers*, WASH. POST, Aug. 8, 2006, <http://www.washingtonpost.com/wp-dyn/content/article/2006/08/07/AR2006080701088.html>.

126. Management Team, LOGISTICS HEALTH INC., <http://www.logisticshealth.com/aboutlhi/mgmt.aspx> (last visited Aug. 1, 2010).

127. E.g., Press Release, Medco, Tommy G. Thompson Elected to Medco Board of Directors (Oct. 16, 2006), available at <http://medco.mediaroom.com/index.php?s=43&item=230>; Press Release, Voyager Pharm., Former HHS Director Tommy Thompson Joins Voyager Board (Mar. 2, 2006), available at <http://www.wral.com/news/local/story/155109>; *Executive Management*, AGA MEDICAL

The exchange of personnel is commonplace at other companies in the poverty industry as well.<sup>128</sup> At the Public Consulting Group, the company's founder was previously the Assistant Revenue Director for the Massachusetts Department of Mental Health and Mental Retardation,<sup>129</sup> and PCG's leadership has included several other former government leaders from health and human services agencies.<sup>130</sup> Also, when the U.S. Department of Health and Human Services needed a new Assistant Secretary for Health in 2008, a vice president of MAXIMUS Federal Services was tapped.<sup>131</sup> And MAXIMUS also has former government leaders in its ranks. For example, the company's President of Human Services is the former Deputy District Director of the Los Angeles County Department of Public Social Services. The board of directors includes the former

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CORP., [http://www.amplatzer.com/about\\_aga/executive\\_team/tabid/68/default.aspx](http://www.amplatzer.com/about_aga/executive_team/tabid/68/default.aspx) (last visited Aug. 1, 2010) (listing Thompson as Chairman of the board of directors).

128. The examples provided in this Section are only a small sampling of the revolving door between government and the poverty industry. See, e.g., Gregg Jones, *Health-Care Law Had Revolving Door Spinning*, DALL. MORNING NEWS, Jan. 5, 2009, at 1A ("Some have benefited more than others: Former [Governor] Perry aides, state agency staff and legislators have gone to work for private companies that have profited from the outsourcing.").

129. *HMS Holdings Corp. Board of Directors*, HMS HOLDINGS CORP., <http://investor.hms.com/directors.cfm> (last visited Aug. 1, 2010) (listing William S. Mosakowski as a member of the HMS board of directors).

130. See PUB. CONSULTING GRP., TEX. HEALTH & HUM. SERVS. COMM'N, RFI NO. 529-06-0333 958-56, STAFF EXPERIENCE 1-9 (2006), available at [http://www.hhsc.state.tx.us/Contract/529060333/VendorResponses/7/Corporate\\_%20Qualifications Experience.pdf](http://www.hhsc.state.tx.us/Contract/529060333/VendorResponses/7/Corporate_%20Qualifications%20Experience.pdf) (listing PCG employees to include the former Connecticut Medicaid Director of Policy and Program Implementation, former agency staff from the Massachusetts Executive Office of Administration and Finance, the former Chief Deputy Director for the Iowa Department of Human Services, the former Senior Manager with the U.S. Health Care Financing Administration's (now CMS) Boston Regional Office, the former Assistant Secretary of the Executive Office of Elder Affairs in Massachusetts, and the former Medical Director of the Massachusetts Medical program (which implements Medicaid in the state)). In addition to staffing its own leadership with government connections, PCG has purchased connections in the expansion of its offerings. In 2008, PCG acquired F.M. Blake and Associates, a company founded by former Social Security Administration district managers that helps state agencies obtain social security benefits on behalf of foster children and convert the benefits into state revenue. *PCG Acquires F.M. Blake*, PUB. CONSULTING GRP. (Feb. 11, 2008), [http://www.publicconsultinggroup.com/news/archive/2008/PCG\\_Acquires\\_FM\\_Blake.html](http://www.publicconsultinggroup.com/news/archive/2008/PCG_Acquires_FM_Blake.html); see also Hatcher, *supra* note 11, at 1798-1801, 1808-09 (describing how states obtain foster children's social security benefits and then use the funds as a source of state revenue). By the time the company was acquired by PCG in 2008, F.M. Blake had become "the largest vendor for foster children's Supplemental Security Income (SSI) advocacy in the country." *SSI/SSDI Advocacy Services for Foster Care*, PUB. CONSULTING GRP. [http://www.publicconsultinggroup.com/humanservices/SSI\\_SSDI/ssi\\_for\\_fostercare.html](http://www.publicconsultinggroup.com/humanservices/SSI_SSDI/ssi_for_fostercare.html) (last visited Aug. 1, 2010).

131. Eric L. Hinton, *Dr. Joxel Garcia: Guarding the Nation's Health*, DIVERSITYINC.COM (July 11, 2008), available at <http://www.diversityinc.com/public/5201.cfm>.

governor of Illinois, James R. Thompson Jr., and Wellington E. Webb, the former mayor of Denver, Colorado.<sup>132</sup>

### 3. Organizational Conflicts of Interest

Federal contracting rules aim to limit organizational conflicts of interest (OCIs) that can result from the revolving door of personnel<sup>133</sup> and the multiple roles a company performs.<sup>134</sup> Generally defined, an OCI can result from “situations where an entity plays two or more roles that are, in some sense, at odds with one another.”<sup>135</sup> Based on language in the relevant Federal Acquisition Regulation (FAR),<sup>136</sup> the case law has generally recognized three categories of OCIs: (1) “biased ground rules,” (2) “unequal access to information,” and (3) “impaired objectivity.”<sup>137</sup> Agency contracting officers are charged with identifying and evaluating OCIs, and avoiding, neutralizing, or mitigating conflicts before a contract is awarded.<sup>138</sup>

Despite the OCI rules, there are several examples where potential conflicts may exist, but have either gone unnoticed or do not fall within the technical reach of the OCI process. For instance, one of PCG’s services is to assist its clients in increasing their claims for Medicaid, Medicare, and other federal grant-in-aid funds.<sup>139</sup> HMS, on the other hand, often helps its clients—including

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132. *Board of Directors*, MAXIMUS, <http://www.maximus.com/investor-relations/corporate-governance/board-of-directors> (follow “Governor James R. Thompson, Jr.” and “Mayor Wellington E. Webb” hyperlinks) (last visited Aug. 1, 2010).

133. Christopher R. Yukins, *Integrating Integrity and Procurement: The United Nations Convention Against Corruption and the UNCITRAL Model Procurement Law*, 36 PUB. CONT. L.J. 307, 322 n.47 (2007) (“The ‘revolving door’ also may create organizational conflicts of interest—conflicts of interest that disqualify an organization from competition because of an unfair advantage or a bias it would carry into its advice to the Government—as a result, for example, of special information that individuals carry into organizations from the Government.”).

134. Daniel I. Gordon, *Organizational Conflicts of Interest: A Growing Integrity Challenge*, 35 PUB. CONT. L.J. 25, 26 (2005).

135. *Id.* at 32.

136. See FAR 9.5, 48 C.F.R. § 9.500–.508 (2009) (incorporating FAR 2.101’s definition of a conflict of interest that arises where, “because of other activities or relationships with other persons, a person is unable or potentially unable to render impartial assistance or advice to the government, or the person’s objectivity in performing the contract work is or might be otherwise impaired, or a person has an unfair competitive advantage”).

137. Gordon, *supra* note 134, at 32 (citing Aetna Gov’t Health Plans, Inc.; Found. Health Fed. Servs., Inc., B-254397, 95-2 CPD ¶ 129, at 12–13 (Comp. Gen. July 27, 1995); Vantage Assocs., Inc. v. United States, 59 Fed. Cl. 1, 10 (2003)).

138. *Id.* at 37 (“FAR 9.504(a) requires agencies’ contracting officers to ‘(1) [i]dentify and evaluate potential organizational conflicts of interest as early in the acquisition process as possible; and (2) avoid, neutralize, or mitigate significant potential conflicts before contract award.’”).

139. *Medicaid Administrative Claiming*, PUB. CONSULTING GRP., <http://www.publicconsultinggroup.com/health/medicaidmedicare/adminclaiming.html> (last visited Aug. 1, 2010); *Medicare Part D Claiming and Recovery Services*, PUB. CONSULTING

the federal government—to reduce payout of Medicaid and Medicare funds.<sup>140</sup> In 2006, these companies entered into a strategic alliance after one of PCG’s practice areas merged into HMS,<sup>141</sup> and the president of PCG was elected to HMS’s board of directors.<sup>142</sup> After the partnership was formed, HMS was awarded multiple contracts with CMS to reduce the payout of federal Medicaid and Medicare funds,<sup>143</sup> while PCG has continued its contracts with state clients to increase the payout of the same federal funds.<sup>144</sup>

Also illustrative is a 2005 audit report by the U.S. General Accounting Office (GAO) regarding contingency-fee contractors, which exposed potentially conflicting contracts in Massachusetts.<sup>145</sup> Although it is a public entity, the University of Massachusetts Medical School (UMMS) includes a consulting division that contracts with state agencies to provide revenue maximization and other services like those provided by private contractors.<sup>146</sup> UMMS received contingency fees to maximize school-based Medicaid claims in Massachusetts while operating under another contract with the state to monitor the integrity and appropriateness of school-based Medicaid claims.<sup>147</sup> However, Massachusetts refused to acknowledge that such an arrangement posed a conflict: “Massachusetts

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GRP., <http://www.publicconsultinggroup.com/health/medicaidmedicare/medicarepartd.html> (last visited Aug. 1, 2010).

140. *About HMS*, HMS HOLDINGS CORP., [http://www.hms.com/about\\_us/index.asp](http://www.hms.com/about_us/index.asp) (last visited Aug. 1, 2010) (“HMS is the nation’s leader in cost containment, program integrity, and coordination of benefit solutions for government-funded and commercial healthcare entities. . . . HMS helps our clients to ensure that healthcare claims are paid correctly and by the responsible party, and that those enrolled to receive program benefits meet qualifying criteria. By deploying our proven approaches, HMS not only recovers in excess of \$1 billion for our clients every year, but we also help our clients realize billions of dollars in additional savings by avoiding erroneous payments.”).

141. Press Release, HMS Holdings Corp., HMS Holdings Corp. Completes Acquisition of Public Consulting Group’s Benefit Solutions Practice Area (Sept. 13, 2006) (on file with the Arizona Law Review).

142. Press Release, HMS Holdings Corp., HMS Holdings Corp. Elects William Mosakowski to Board of Directors (Dec. 13, 2006) (on file with the Arizona Law Review).

143. See U.S. DEP’T OF HEALTH & HUMAN SERVS., CTR. FOR MEDICARE AND MEDICAID SERVS., THE MEDICARE RECOVERY AUDIT CONTRACTOR (RAC) PROGRAM: AN EVALUATION OF THE 3-YEAR DEMONSTRATION 11–15 (June 2008), *available at* <http://www.cms.gov/RAC/Downloads/RACEvaluationReport.pdf> (listing HMS as one of the RAC contractors); Press Release, HMS Holdings Corp., *supra* note 105.

144. See, e.g., STATE OF MICH. DEP’T OF MGMT. & BUDGET PURCHASING OPERATIONS, CHANGE NOTICE NO. 3 TO CONTRACT NO. 071B7200037 BETWEEN THE STATE OF MICHIGAN AND PUBLIC CONSULTING GROUP (2009), *available at* [http://www.michigan.gov/documents/buymichiganfirst/7200037\\_246622\\_7.pdf](http://www.michigan.gov/documents/buymichiganfirst/7200037_246622_7.pdf) (relating to contract for “Medicaid School Based Services/Random Moment Time Study” with contract period from 2006 to 2010); *Medicaid Administrative Claiming*, *supra* note 139.

145. GAO, MEDICAID FINANCING, *supra* note 12, at 15–43.

146. See *Commonwealth Medicine: Financing*, UNIV. OF MASS. MED. SCH., <http://www.umassmed.edu/commed/financing/index.aspx> (last visited Aug. 18, 2010) (describing services provided to public agency and nonprofit clients, including federal and state “comprehensive claiming processes and unique analytical abilities” to “enhance revenue for our clients”).

147. GAO, MEDICAID FINANCING, *supra* note 12, at 35–36.



disagreed with our view that UMMS's role as a contingency-fee consultant working for school districts to prepare their claims and as a contingency-fee consultant working for the state to monitor school district claims creates the appearance of a conflict of interest."<sup>148</sup>

Further, some companies that have contracted to provide independent reviews of benefit-eligibility decisions may actually be reviewing the decisions made by a subsidiary or affiliate.<sup>149</sup> Palmetto GBA, a subsidiary of Blue Cross Blue Shield of South Carolina, has contracts with CMS to process Medicare claim decisions in many states.<sup>150</sup> Although different independent contractors are intended to handle second-level appeals of the Medicare claim decisions, one of the few companies to win a contract with CMS to serve as the Qualified Independent Contract (QIC) to conduct the appeals was q2a, a subsidiary of Palmetto.<sup>151</sup>

#### 4. *Inherently Governmental Functions*

While aiming to limit organizational conflicts of interest, federal policies also limit the scope of work performed by contractors. Under longstanding executive policy set out in an OMB circular,<sup>152</sup> private government contractors are prohibited from performing "inherently governmental functions," defined as follows:

[A]n activity that is so intimately related to the public interest as to mandate performance by government personnel. These activities require the exercise of substantial discretion in applying government authority and/or in making decisions for the government.<sup>153</sup>

However, the limitation is engulfed within a broader effort to increase the role of private industry in the provision of government services. As part of an effort to encourage greater contracting-out of government jobs, the OMB circular

148. *Id.* at 88–89.

149. See Ctr. for Medicare Advocacy, Inc., *A New Meaning to "Independent" in Qualified Independent Contractor (QIC)*, 1 (Nov. 17, 2005), <http://www.medicareadvocacy.org/News/WeeklyAlerts/AlertPDFs/2005/11.17.05.IndependentReview.pdf>.

150. Press Release, U.S. Dep't of Health & Human Servs., Ctrs. for Medicare & Medicaid Servs., CMS Selects Final Five Medicare Contractors to Administer Medicare Claims Payments in 14 States (Jan. 7, 2009), available at [http://insurancenewsnet.com/article.aspx?n=1&neID=20090107665.21\\_8ccb00377756c45f](http://insurancenewsnet.com/article.aspx?n=1&neID=20090107665.21_8ccb00377756c45f).

151. See Ctr. for Medicare Advocacy, Inc., *supra* note 149; see also Ken Stammen, *South Carolina Medicare Appeals Firm Plans Columbus, Ohio, Office*, COLUMBUS DISPATCH, Oct. 5, 2005, available at [http://www.redorbit.com/news/health/260931/south\\_carolina\\_medicare\\_appeals\\_firm\\_plans\\_columbus\\_ohio\\_office/index.html](http://www.redorbit.com/news/health/260931/south_carolina_medicare_appeals_firm_plans_columbus_ohio_office/index.html).

152. OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, OMB CIRCULAR NO. A-76, Attachment A (2003) [hereinafter OMB CIRCULAR NO. A-76], available at [http://www.whitehouse.gov/omb/circulars/a076/a76\\_incl\\_tech\\_correction.pdf](http://www.whitehouse.gov/omb/circulars/a076/a76_incl_tech_correction.pdf); see also Martha Minow, *Outsourcing Power: How Privatizing Military Efforts Challenges Accountability, Professionalism, and Democracy*, 46 B.C. L. REV. 989, 1014–15 (2005).

153. OMB CIRCULAR NO. A-76, *supra* note 152, at Attachment A.

was amended in 2003 to incorporate the Federal Activities Inventory Reform Act (FAIR), requiring that agencies take inventories to identify activities as either commercial or inherently governmental.<sup>154</sup> This increased emphasis on privatization adds to disagreements over the scope of the limitation, resulting in uncertainty as to the limits of the restricted activities.<sup>155</sup>

With clarity lacking, the poverty–industrial complex often pushes—if not breaks—the boundaries of the contracting limitations. Contract administration falls squarely in the realm of inherently governmental functions,<sup>156</sup> but these functions are still sometimes contracted out. For example, the Substance Abuse and Mental Health Services Administration within HHS posted an announcement in 2009 explaining the agency “does not maintain adequate resources to support the number of contract proposal reviews that require detailed cost and price analysis and financial audits” and therefore needs assistance from private contractors.<sup>157</sup>

Also, the inherently governmental limitation is interpreted to prohibit contractors from making eligibility decisions for entitlement benefits:

The regulations . . . require that officials of the State agency perform administrative functions that require the exercise of discretion and do not permit the State agency to delegate such functions. Under long-standing Departmental policy that originates with the 1939 amendments to the [Social Security] Act, the determination of an individual’s eligibility for a Federal entitlement is considered an inherently governmental function that requires the exercise of discretion. The determination of eligibility is

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154. Minow, *supra* note 152, at 1014–15; Paul R. Verkuil, *Public Law Limitations on Privatization of Government Functions*, 84 N.C. L. REV. 397, 437–39 (2006).

155. Minow, *supra* note 152, at 1015.

156. Susan L. Turley, *Wielding the Virtual Gavel—DOD Moves Forward with Reverse Auctions*, 173 MIL. L. REV. 1, 37 (2002) (“The OFPP has specifically categorized approving contract documents, awarding contracts, and administering contracts as inherently governmental functions.” (citing OFFICE OF MGMT. & BUDGET, OFFICE OF FED. PROCUREMENT POLICY, POLICY LETTER 92-1 ON INHERENTLY GOVERNMENTAL FUNCTIONS, 57 Fed. Reg. 45, 101, para. 5 (Jan. 2, 1992))). The issue of contractors engaged in contract administration can also raise conflict of interest concerns. See *Contractors Awarding Contracts: Conflict of Interest?*, NAT’L ASS’N OF GOV’T CONTRACTORS (Mar. 26, 2008), <http://web.archive.org/web/20080408072334/http://www.governmentcontractors.org/article/a.539.asp> (accessed by searching for <http://www.governmentcontractors.org/> in the Internet Archive index).

157. DEP’T OF HEALTH & HUMAN SERVS., SUBSTANCE ABUSE & MENTAL HEALTH SERVS. ADMIN., SOLICITATION NO. 283-09-0275, COST ANALYSIS AND AUDIT SUPPORT FOR THE SUBSTANCE ABUSE AND MENTAL HEALTH SERVICES ADMINISTRATION (2009), *available at* [https://www.fbo.gov/index?s=opportunity&mode=form&id=5dec21914813105b1270b1c153dee391&tab=core&\\_cview=0&cck=1&au=&cck=](https://www.fbo.gov/index?s=opportunity&mode=form&id=5dec21914813105b1270b1c153dee391&tab=core&_cview=0&cck=1&au=&cck=) (“SAMHSA requires financial management support to determine the allowability, allocability, and reasonableness of proposed costs; financial capability of contractor organizations; and adequacy of accounting and other financial management systems for administering Federal contracts. Specific tasks to be performed by the contractor, as further described below, include cost and price analysis and audit support for the review of business proposals for new performance-based contracts and bilateral contract modifications; audit support services for review of contract invoices and closeouts; and general financial management support.”).

fundamental to the administration of an entitlement program because it is the basis for the flow of funds.<sup>158</sup>

The limitation applies to federal grant-in-aid programs, including the Title IV-E Foster Care program: “[the] determination of title IV-E foster care candidacy is a type of eligibility determination because title IV-E funds are expended as the result of this determination.”<sup>159</sup> However, as described in more detail below, private contractors are helping states maximize their claims for Title IV-E and other grant-in-aid funds, including eligibility determinations.<sup>160</sup> Even if the state arguably makes the final determination in claims for entitlement benefits by signing off on contractor recommendations, the state’s role can be illusory. State agencies often seek contractor assistance because the agencies lack sufficient internal capacity to administer the eligibility and claiming process.<sup>161</sup> The lack of capacity, in turn, will often result in complete reliance on contractor recommendations without meaningful participation or oversight by the state agencies.<sup>162</sup> For example, an audit of school-based Medicaid claims in Washington state concluded that the use of contingency-fee revenue maximization consultants “may increase the risk of claims being submitted that were not properly scrutinized for allowable costs.”<sup>163</sup> The audit found that “school officials at this district were not aware of the procedures to properly determine and report accurate administrative costs,” and “[t]he school district relied almost entirely on the

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158. Administrative Costs for Children in Title IV-E Foster Care, 70 Fed. Reg. 4803, 4805 (proposed Jan. 31, 2005) (to be codified at 45 C.F.R. pt. 1356).

159. *Id.*; see also Request for Public Comment on Contracting for the Performance of Title IV-E Administrative Functions, 65 Fed. Reg. 50,203, 50,204 (Aug. 10, 2000) (citing OMB CIRCULAR NO. A-76, *supra* note 152, and explaining that “inherently governmental functions” which “must be performed by government employees” are “those activities which require either the exercise of discretion in applying Governmental authority or the use of value judgment in making decisions for the Government,” and then concluding that “[t]he determination of a child’s eligibility for title IV-E is, for example, an inherently governmental function”).

160. See *infra* Part II.B.2.

161. See GAO, MEDICAID FINANCING, *supra* note 12, at 8 (“Consultants can provide a wide range of services to states, including serving state Medicaid programs. States that lack sufficient in-house resources can turn to consultants to add staff or needed expertise. Contingency-fee consultants are particularly attractive to budget constrained states because the states do not need to pay them up front, agreeing to pay instead a percentage of any additional amounts saved or collected (the contingency fee). Consultants may also cost states less than developing in-house expertise, as states can hire them for short-term or specific projects rather than commit full-time state personnel.”).

162. See JOINT LEGISLATIVE COMM. ON PERFORMANCE EVALUATION & EXPENDITURE REVIEW (PEER), REPORT TO MISSISSIPPI LEGISLATURE: THE DEPARTMENT OF HUMAN SERVICES’ USE OF REVENUE MAXIMIZATION CONTRACTS, PEER REPORT #413, at 19 (Dec. 6, 2000), available at <http://www.peer.state.ms.us/reports/rpt413.pdf> (“[I]f agency staff members do not have the level of basic program knowledge necessary to identify available federal funds, the staff cannot effectively oversee the work of a consultant in this area and the agency thereby runs the risk of incurring significant audit exceptions.”).

163. U.S. DEP’T OF HEALTH & HUMAN SERVS., OFFICE OF INSPECTOR GEN., NO. A-10-01-00011, REVIEW OF WASHINGTON STATE’S ADMINISTRATIVE COSTS CLAIMED FOR MEDICAID SCHOOL-BASED HEALTH SERVICES IN STATE FISCAL YEAR 2000, at 8 (May 2002), available at <http://oig.hhs.gov/oas/reports/region10/h0100011.pdf>.

consultant to calculate the claim and submit it to the State.”<sup>164</sup> In such an example, even if the contractor does not sign off on the final claim submission, the contractor’s control over the claiming function violates the spirit of the OMB inherently governmental limitation.

As illustrated above, the poverty industry is now deeply entrenched in the provision of poverty services that result from the flow of federal grant-in-aid dollars. Also, in addition to providing contractual services to help states use the federal money when received, the industry has developed an even bolder profit strategy of increasing—and taking a direct percentage of—the flow of federal funds. The next Section explores the role and impact of revenue maximization consultants.

### ***B. Money Guides***

Besides providing operational and consulting services to both the federal and state governments, the poverty industry has now inserted itself directly into the flow of federal funds. Federal grant-in-aid funds are mired in complex regulatory frameworks governing eligibility and claiming, and state and local agencies often lack the resources and expertise to fully capture the available funds.<sup>165</sup> Revenue maximization consultants have capitalized on the confusion by offering assistance to states in claiming the federal funds, often on a contingency basis.<sup>166</sup> As states face bleak budget outlooks, and social service programs are among the first budgetary cuts, such contracts become increasingly attractive.<sup>167</sup> As described in Part II.B.2 below, states often use the revenue maximization consultants to help guide the increased funds into general state revenue, rather than using the federal aid for the intended statutory purposes of increasing services for the poor.

#### *1. Contingency-Fee Revenue Maximization Consultants*

Revenue maximization consultants assist states in pursuing funds from numerous federal grant-in-aid programs, often focusing on the Medicaid program and foster care funds available under Title IV-E.<sup>168</sup> Before selling its federal claiming practice, MAXIMUS was a leader in the revenue maximization business.<sup>169</sup> PCG also has a significant focus on helping states increase revenue through enhanced claiming of federal funds.<sup>170</sup>

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164. *Id.* at 8–9.

165. *See supra* Part I.B.1–2.

166. Hatcher, *supra* note 11, at 1808–09.

167. Donenberg, *supra* note 57, at 1561 n.100 (“Medicaid and other social programs are the first in line for cuts in cash-strapped states desperate for revenue.” (quoting Letter from Sen. Barbara A. Mikulski et al. to Sen. Max Baucus, Chairman, Senate Fin. Comm. & Sen. Charles Grassley, Ranking Member, Senate Fin. Comm. (Jan. 29, 2008), available at <http://mikulski.senate.gov/record.cfm?id=291443>)).

168. GAO, MEDICAID FINANCING, *supra* note 12; Hatcher, *supra* note 11, at 1807–10.

169. *See About Us*, SIVIC SOLUTIONS GRP., [http://sivicsolutionsgroup.com/About\\_Me.html](http://sivicsolutionsgroup.com/About_Me.html) (last visited Aug. 1, 2010). After settling the investigation into False Claims Act allegations, described in the Article’s introduction, MAXIMUS decided to stop

To increase Title IV-E foster care claims, a primary emphasis of revenue maximization strategies is to increase the eligibility rate for children in state care.<sup>171</sup> The Title IV-E eligibility rules are complex, but the core policy is that only children removed from poor families are eligible.<sup>172</sup> Consultants help states develop their “penetration rate” goals and strategies—seeking to increase the percentage of foster children who are eligible for Title IV-E funding because they were removed from low-income families and meet the other eligibility requirements.<sup>173</sup> In addition to the eligibility rate, consultants also give states strategies to increase federal funds for Title IV-E administrative costs (including retroactive claims) and Title IV-E training funds.<sup>174</sup>

Efforts to maximize Medicaid dollars are even more extensive than in the Title IV-E program, and the strategies more complex. The GAO determined that the majority of states were using contingency-fee consultants to maximize Medicaid claims as of 2004, and the numbers were increasing quickly.<sup>175</sup> Examples of Medicaid maximization strategies are numerous, including intergovernmental transfers (IGT),<sup>176</sup> upper payment limits (UPL),<sup>177</sup> random

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providing contingency-fee revenue maximization services. Jim McElhatton, *Maximus Will Ditch Contingency Contracts*, WASH. TIMES, July 25, 2007, at B2.

170. See e.g., *Revenue Enhancement Services*, PUB. CONSULTING GRP., <http://www.publicconsultinggroup.com/health/medicaidmedicare/revenueenhancement.html> (last visited Aug. 1, 2010); *SSI/SSDI Advocacy Services for Foster Care*, *supra* note 130 (noting how PCG’s services to increase claims for SSI and SSDI will lead to enhanced revenue for human services agencies).

171. Hatcher, *supra* note 11, at 1821–22.

172. *Id.*

173. *Id.*

174. See CARASSO & BESS, *supra* note 11, at 53–56.

175. GAO, MEDICAID FINANCING, *supra* note 12, at 4 (“Most states have used contingency-fee consultants to help implement a wide range of projects to maximize federal Medicaid reimbursements. CMS reports that, according to a survey it conducted in 2004, 34 states had used contingency-fee consultants for this purpose, an increase from 10 states reported to have done so in 2002.”).

176. U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-05-836T, MEDICAID: STATES’ EFFORTS TO MAXIMIZE FEDERAL REIMBURSEMENTS HIGHLIGHT NEED FOR IMPROVED FEDERAL OVERSIGHT 7 (2005), [hereinafter GAO, Medicaid Testimony] (testimony of Kathryn G. Allen, Director, Health Care, before the Senate Finance Committee), *available at* <http://www.gao.gov/new.items/d05836t.pdf>. The testimony describes the intergovernmental transfer process, how states make large Medicaid payments to local government providers to create “the illusion of valid expenditures for services delivered by local-government providers to Medicaid-eligible individuals and enable states to claim large federal reimbursements.” *Id.* However, the states then require the local governments to return the money through IGT process. *Id.* Thus, “[o]nce states receive the returned funds, they can use them to supplant the states’ own share of future Medicaid spending or even for non-Medicaid purposes.” *Id.*; see also U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-04-574T, MEDICAID: INTERGOVERNMENTAL TRANSFERS HAVE FACILITATED STATE FINANCING SCHEMES (2004), *available at* <http://www.gao.gov/new.items/d04574t.pdf> (focusing on concerns with intergovernmental transfer strategies).

177. U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-04-228, MEDICAID: IMPROVED FEDERAL OVERSIGHT OF STATE FINANCING SCHEMES IS NEEDED 1 (2004), *available at*

moment time studies (RMTS) and other administrative cost strategies,<sup>178</sup> school-based Medicaid claiming,<sup>179</sup> and Targeted Case Management (TCM) strategies.<sup>180</sup> To illustrate the scope, the Medicaid revenue maximization strategies in just two states from 2000 to 2004 resulted in additional federal Medicaid payments of more than \$2 billion, with more than \$90 million of the Medicaid funds paid to the consultants as a contingency fee.<sup>181</sup>

In recent years, revenue maximization strategies have received increased scrutiny. When Senator Charles Grassley was Chairman of the U.S. Senate Committee on Finance in 2004, he expressed concerns regarding revenue maximization consultants in a letter to the Secretary of the Department of Health and Human Services: “I am extremely disconcerted that Medicaid monies intended to benefit low-income Americans, pregnant women and poor children, may instead be lining the coffers of consulting firms.”<sup>182</sup> Also, the 2005 GAO report on contingency-fee contractors indicated urgency: “[t]he concerns we identified with the appropriateness of states’ Medicaid claims stemming from contingency-fee projects illustrate the urgent need to address the issues we have identified with

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<http://www.gao.gov/new.items/d04228.pdf> (explaining how upper payment limit strategies are an often used example of intergovernmental transfers). The GAO reports that:

The UPL is the upper bound on what the federal government will pay as its share of the Medicaid costs . . . and it often exceeds what states actually pay providers for services. Some states exploited the UPL loophole by paying nursing homes and hospitals owned by local governments much more than the established Medicaid payment rate, and requiring the providers to return the excess payments to the state.

*Id.*

178. *E.g.*, U.S. DEP’T OF HEALTH & HUMAN SERVS., OFFICE OF THE INSPECTOR GEN., A-07-05-03063, REVIEW OF KANSAS’S MENTAL HEALTH CENTER MEDICAID ADMINISTRATIVE COST FOR THE QUARTERS ENDED DECEMBER 31, 2002 AND MAR. 31, 2003, at 1 (2006), available at <http://oig.hhs.gov/oas/reports/region7/70503063.pdf>. The audit provides an example investigation of state use of revenue maximization consultants to increase administrative claims through random moment time sampling. *Id.* The audit describes how MAXIMUS developed the Kansas Mental Health Administration Claiming Handbook, which included “instructions for calculating administrative costs by using random moment time studies, costs associated with administrative time, and Medicaid utilization data.” *Id.* The OIG concluded that “[t]he State agency used a statistically invalid random moment time study to allocate costs because it had inadequate oversight and the system did not have adequate capacity to process all of the time studies” and thus set aside the \$3,060,098 of Federal reimbursement for CMS adjudication. *Id.*; see also CARASSO & BESS, *supra* note 11, at 54 (describing RMT strategy in the context of Title IV-E).

179. *E.g.*, U.S. GOV’T ACCOUNTABILITY OFFICE, GAO/HEHS/OSI-00-69, MEDICAID IN SCHOOLS: IMPROPER PAYMENTS DEMAND IMPROVEMENTS IN HCFA OVERSIGHT (2000), available at <http://www.gao.gov/archive/2000/h600069.pdf> (describing concerns with school-based Medicaid claiming practices).

180. *E.g.*, GAO, MEDICAID FINANCING, *supra* note 12, at 19–21 (describing example concerns with states’ use of revenue maximization consultants to help claim federal reimbursement for Medicaid TCM services).

181. *Id.* at 4.

182. Press Release, Senator Chuck Grassley, Grassley Seeks Answers on States’ Use of Consultants to Increase Medicaid Funds (Feb. 13, 2004), available at <http://www.grassley.senate.gov/releases/2004/p04r02-13.htm>.

CMS's overall financial management of the Medicaid program."<sup>183</sup> Nonetheless, despite indications of increased scrutiny, as states continue to face bleak budget outlooks and insufficient resources for in-house revenue maximization, reliance on private consultants continues to increase.<sup>184</sup> Responding to the GAO report, Georgia indicated its frustration:

The Medicaid statute has been called "among the most completely impenetrable texts within human experience. . . . Congress also revisits the area frequently, generously cutting and pruning in the process and making any solid grasp of the matters addressed merely a passing phase." It is nearly impossible for state Medicaid agency staff to keep abreast of the multitude of both new requirements and new opportunities that result from Congress' frequent amendments to the Medicaid law. . . .

This complexity can and does compel states to turn to expert consultants for assistance.<sup>185</sup>

Thus, states increasingly seek out the expertise of consultants to assist in the claiming process to maximize grant-in-aid funds. And, as the next Section illustrates, the resulting revenue maximization strategies developed by the consultants often lead to the practice of states diverting the additional funds from their intended purpose.

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183. GAO, MEDICAID FINANCING, *supra* note 12, at 40. Further, the GAO also explained:

Because of its size, complexity, and federal-state structure, the Medicaid program has been subject to waste, abuse, and exploitation. Our work has found that projects developed by consultants who are paid a fee contingent upon additional federal reimbursements that they generate pose a financial risk to the program. It is not possible, however, to quantify the magnitude of this financial risk, because CMS does not routinely request information regarding states' use of contingency-fee consultants to assist with reimbursement-maximizing projects and associated claims.

*Id.* at 43.

184. Countless examples exist of audits exposing improper claims submitted with the assistance of revenue maximization consultants. *E.g.*, U.S. DEP'T OF HEALTH & HUMAN SERVS., OFFICE OF THE INSPECTOR GEN., A-02-06-01006, REVIEW OF NEW JERSEY MEDICAID CONTINGENCY FEE CONTRACT PAYMENTS FOR THE PERIOD APRIL 1, 1996, THROUGH JUNE 30, 2001, at i (2008) [hereinafter HHS, NEW JERSEY MEDICAID], available at <http://www.oig.hhs.gov/oas/reports/region2/20601006.pdf> (concluding that New Jersey improperly claimed \$15,956,556 (\$7,978,278 Federal share) in contingency fees paid to Deloitte Consulting and Health Care Resources, Inc., as reimbursable administrative costs under the Medicaid program); U.S. DEP'T OF HEALTH & HUMAN SERVS., *supra* note 178, at 6-7 (describing random moment time study developed by MAXIMUS that OIG concluded to be invalid); U.S. DEP'T OF HEALTH & HUMAN SERVS., OFFICE OF THE INSPECTOR GEN., A-01-02-00001, REVIEW OF MEDICAID PAYMENTS FOR SCHOOL-BASED HEALTH SERVICES, BOSTON, MASSACHUSETTS - JULY 1999 THROUGH JUNE 2000, at 4 (2003), available at <http://oig.hhs.gov/oas/reports/region1/10200001.pdf> (audit of school-based Medicaid claims for the Boston Public Schools, who had contracted with PCG to prepare and submit the claims, and the claims resulted in inappropriate overpayments of \$1,237,421).

185. GAO, MEDICAID FINANCING, *supra* note 12, app. IV at 67 (citation omitted).

## 2. Supplantation and General Revenue Enhancement

As states face record budget shortfalls and the number of low-income individuals needing public assistance continues to grow, strategies to maximize federal funds can help states provide crucially needed aid.<sup>186</sup> Revenue maximization services, if provided at a reasonable cost, can help fulfill this purpose. However, with the lure of increased company profits and states' hopes to replenish their general funds, the revenue maximization strategies (also referred to as "refinancing") can cause statutory purpose to be lost:

One of the great dangers of refinancing work is the risk that money produced by such efforts will not be used to advance the reform agenda for families and children. Refinancing proceeds usually take the form of state or local general fund revenue, which can be used for many different purposes, not necessarily those related to reform. . . . Without some way to protect the freed up money, it is likely that refinancing funds will return to the general treasury to be used for whatever priorities appear on the state or local political agenda at the time.<sup>187</sup>

Too often, rather than serving as catalysts for collaboration across the various levels of government, revenue maximization consultants can heighten a tension between the governmental perspectives. From the perspective of the federal government, "the purpose of federal entitlement and block grant programs is to finance safety net provisions more adequately; the federal formulas are intended to give states incentives to spend more on necessary programs they would not otherwise (fully) fund because of prohibitive cost."<sup>188</sup> On the other hand, states have means of raising revenue constrained by anti-tax sentiments, and often view the federal grant-in-aid dollars as means of replenishing their general funds. "From the state government perspective, revenue maximization often means just spending less state general revenue and more federal and/or local revenue."<sup>189</sup> For example, a 2000 GAO report found federal Medicaid funds received through school-based claims often went to the respective states' general coffers, rather than to the school

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186. See *id.* at 8.

187. MARK FRIEDMAN, CTR. FOR THE STUDY OF SOC. POLICY, "THE COSMOLOGY OF FINANCING" OR FINANCING REFORM OF FAMILY AND CHILDREN'S SERVICES, Part II (June 28, 1994), available at [http://www.fiscalpolicystudies.com/Documents/cosmology\\_of\\_financing.htm](http://www.fiscalpolicystudies.com/Documents/cosmology_of_financing.htm).

188. CARASSO & BESS, *supra* note 11, at 32.

189. *Id.* at iv; see also GAO, Medicaid Testimony, *supra* note 176, at 11 ("There is no assurance that these increased federal reimbursements are used for Medicaid services, since states use funds returned to them via these schemes at their own discretion. In examining how six states with large schemes used the federal funds they generated, we previously found that one state used the funds to help finance its education programs, and others deposited the funds into state general funds or other special state accounts that could be used for non-Medicaid purposes or to supplant the states' share of other Medicaid expenditures."); SCHNEIDER ET AL., *supra* note 69, at 112 ("A number of states have used some or all of the federal Medicaid matching funds received through UPL transactions for general fund budgetary purposes.").



districts that provided the reimbursable services.<sup>190</sup> The use of the funds to supplant state spending causes frustration at the federal level, and can lead to congressional backlash.<sup>191</sup>

Examples of supplantation and converted purpose are plentiful, as states increasingly view federal grant-in-aid funds as a source of general revenue rather than a means to enhance program services.<sup>192</sup> Once the bipartisan pick for Commerce Secretary in the Obama Administration, U.S. Senator Judd Gregg has since become a critic of the Administration's increased spending on federal aid programs to address the economic downturn and budget difficulties faced by states.<sup>193</sup> However, when Senator Gregg was governor of New Hampshire and faced a growing state budget deficit, he initiated a process of claiming additional federal Medicaid matching funds, but with no additional net outlay of state funds.<sup>194</sup> Then, rather than using the additional funds for Medicaid-related services, Gregg created a new general revenue line item in his state budget called "Medicaid Enhancement Revenue." Gregg converted additional federal Medicaid payments into general use rather than using the federal dollars for Medicaid programs and services.<sup>195</sup> The strategy led to such an increase in federal funds that the new general revenue line item accounted for 28% of New Hampshire's total general fund revenue in 1994.<sup>196</sup> Gregg balanced the state's budget—indeed, to the point of a surplus—by converting federal funds intended to aid the poor into general state revenue.<sup>197</sup>

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190. GAO, *supra* note 179, at 31 (noting that "in some states, schools could receive as little as \$7.50 in federal Medicaid reimbursements for every \$100 spent to pay for services and activities performed in support of Medicaid-eligible children").

191. CARASSO & BESS, *supra* note 11, at 32 ("If states exploit federal legislation in a program and claim a sufficient volume of services, in agreement or disagreement with federal intent, federal regulators and eventually Congress may have to revisit the legislation and restrict the purview of state claims in the future simply to limit the federal government's exposure to program costs. This has happened a number of times in the Medicaid program, for example."). Also, as the federal and state governments clash over purpose and funds, the local government programs are similarly frustrated: "[f]rom a local perspective, any additional local or federal funds should be used to expand a program, not relieve the burden on state general revenue." *Id.* at 33.

192. GAO, Medicaid Testimony, *supra* note 176, at 11; *see also* SCHWARTZ ET AL., *supra* note 21, at 1 ("From the federal perspective, states are engaged in a constant game of 'catch-me-if-you-can' in an effort to maximize receipt of federal matching funds. Some state efforts have enabled states to increase their receipt of federal funds without putting up additional state funds, thereby thwarting the intent of the federal-state matching structure."); Super, *supra* note 3, at 2570 (mentioning problem of supplantation in federal matching grant programs).

193. *See* Jeff Zeleny, *Gregg Ends Bid for Commerce Job*, N.Y. TIMES, Feb. 13, 2009, at A1.

194. Kevin Landrigan, *Feds Might Demand \$165m Payback: N.H. Official Warns Surplus at Risk over Medicaid 'Bonus'*, TELEGRAPH (Nashua, N.H.), Jan. 31, 2006.

195. *Id.*

196. *Id.*

197. *Id.*

While not as overt as Gregg's efforts in New Hampshire, several other states have implemented similar revenue strategies.<sup>198</sup> For example, Maine introduced emergency legislation in 2001 to address state budget concerns, including a provision to "[a]uthorize the Department of Behavioral and Developmental Services to credit Title IV-E federal reimbursement to the General Fund as undedicated revenue."<sup>199</sup>

In Montana, the state legislature enacted provisions requiring a statewide "refinancing" effort by the Department of Health and Human Services to replace state spending with increased federal funds.<sup>200</sup> Any resulting savings from the refinancing effort are to pay for the refinancing activities, maintain and help reinstate some services, and then "[a]dditional funds generated through refinancing savings . . . revert to the general fund."<sup>201</sup> In Montana's state budget documents related to the Child and Family Services Division, a line item for "Refinancing-Federal Funds" lists a resulting savings to the general fund of \$3 million each year

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198. Many other examples exist in addition to those addressed in this Part of the Article. See e.g., TEXAS COMPTROLLER OF PUBLIC ACCOUNTS, TEXAS PERFORMANCE REVIEW, AGAINST THE GRAIN: VOLUME 2, HEALTH AND HUMAN SERVICES (1993), available at <http://www.window.state.tx.us/tpr/atg/atg/atgtoc.html> (listing numerous suggested strategies to claim addition federal aid funds and to use the funds as state general revenue savings). For example, section HHS 13 of the report, "Maximize Federal Funding for Child Welfare Programs," explains how revenue maximization contractors are to be paid out of the increased federal funds, and the federal funds should be used to replace state spending:

A. The Legislature should direct the Department of Protective and Regulatory Services (DPRS) to immediately contract on a no-risk, contingency basis with a consulting firm experienced in Title IV-E revenue enhancements to assist the state in reviewing its federal reimbursements under the program. Revenue resulting from the contract should be appropriated to DPRS. The contractors should be paid from these appropriated funds.

B. The savings achieved by this recommendation should be obtained by reducing the general revenue appropriations to DPRS by the indicated amount and increasing funding from estimated federal funds by the same amount.

*Id.*

199. JOINT STANDING COMM. ON APPROPRIATIONS & FIN. AFFAIRS, AN ACT TO MAKE SUPPLEMENTAL APPROPRIATIONS AND ALLOCATIONS FOR THE EXPENDITURES OF STATE GOVERNMENT AND TO CHANGE CERTAIN PROVISIONS OF THE LAW NECESSARY TO THE PROPER OPERATIONS OF STATE GOVERNMENT FOR THE FISCAL YEARS ENDING JUNE 30, 2002 AND JUNE 30, 2003, LD 2080, 2d Sess., at 48 (Me. 2001), available at <http://www.maine.gov/legis/ofpr/afa02.pdf>. Another version of the legislation provided that "[n]otwithstanding any other provision of law, the Department of Behavioral and Developmental Services is authorized to collect \$500,000 as General Fund undedicated revenue in fiscal year 2002-03 from Title IV-E federal reimbursement." AN ACT TO MAKE SUPPLEMENTAL APPROPRIATIONS AND ALLOCATIONS FOR THE EXPENDITURES, LD 2080, 2d Sess., at G-1 (Me. 2001), available at [http://www.mainelegislature.org/legis/bills\\_120th/billtexts/LD208001-2.asp](http://www.mainelegislature.org/legis/bills_120th/billtexts/LD208001-2.asp).

200. MONT. CODE ANN. § 53-1-610 (2009) ("The department of public health and human services shall seek federal funds to offset general fund expenditures to the maximum extent possible.").

201. *Id.* § 53-1-612.

for fiscal years 2004 and 2005.<sup>202</sup> Then, while describing the use of the \$3 million in federal grant-in-aid funds for state general savings, the budget document simultaneously lists requests to cut the agency's funding for in-home services by over \$1.1 million, eliminate funding for the Big Brothers Big Sisters Program for savings of over \$183,000, eliminate the approximately \$325,000 in funding for Child Protective Services Day Care, cut funding for the Domestic Violence Program by more than \$77,000, and cut staff positions for savings of over \$261,000.<sup>203</sup>

Similarly, a 2004 Arizona budget report regarding the state's "Federal Revenue Maximization Initiative" explained how the savings created by the initiative "were not allocated to specific agency budgets; rather they were assumed as part of the overall 'balance sheet.'"<sup>204</sup> A report by Arizona's Office of the Auditor General describes the state's revenue maximization projects and how the resulting additional funds are used: "[i]f the project results in new revenues or cost savings, the agency's program budget may be reduced to return some newly generated revenues to the General Fund."<sup>205</sup> The report explains that PCG won a contract to help Arizona review past foster care placements to increase claims for Title IV-E foster care funds.<sup>206</sup> And after PCG receives its contingency fees, the remainder is used to offset "continuing budget shortfalls" as well as to cover state budget reductions "made in anticipation of increased federal revenues from this project."<sup>207</sup>

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202. MONT. OFFICE OF BUDGET & PROGRAM PLANNING, PUBLIC HEALTH AND HUMAN SERVICES-6901, at B-9 (2005), *available at* [http://budget.mt.gov/content/execbudgets/2005\\_budget/OBPPB.pdf](http://budget.mt.gov/content/execbudgets/2005_budget/OBPPB.pdf) ("The department is currently working on a 'refinancing' project, which saves \$3,000,000 general fund and increases \$3,000,000 in federal funds each year of the biennium.").

203. *Id.* at B-9 to B-10.

204. STATE OF ARIZ., JOINT LEGISLATIVE BUDGET COMM., GOVERNOR'S OFFICE OF STRATEGIC PLANNING AND BUDGETING – REPORT ON FEDERAL REVENUE MAXIMIZATION INITIATIVE Part 9, at 2 (Aug. 9, 2004), *available at* <http://www.azleg.gov/jlbc/jlbcag081704.pdf>.

205. STATE OF ARIZ., OFFICE OF THE AUDITOR GEN., NO. IB-0502 REVENUE MAXIMIZATION 2 (Dec. 1, 2005), *available at* [http://www.azauditor.gov/Reports/State\\_Agencies/Agencies/Economic\\_Security\\_Department\\_of/Performance/IB-0502/IB-0502.pdf](http://www.azauditor.gov/Reports/State_Agencies/Agencies/Economic_Security_Department_of/Performance/IB-0502/IB-0502.pdf).

206. *Id.* at 3.

207. *Id.* at 3–4 (explaining how two revenue maximization projects—one to increase the number of children receiving Title IV-E assistance and another to increase the amount of reimbursed Title IV-E administrative costs—were coordinated with state budget reductions of \$500,000 and \$900,000 made by the state legislature in anticipation of the increased federal revenue resulting from the projects); *see also* STATE OF ARIZ., JOINT LEGISLATIVE BUDGET COMM., MONTHLY FISCAL HIGHLIGHTS 1, 8 (June 2005), *available at* <http://www.azleg.gov/jlbc/mfh-jun-05.pdf> ("*Increased Title IV-E Administrative Claiming and Targeted Case Management*: The DCYF operating budget was reduced by \$0.9 million in FY 2006 in anticipation of the additional IV-E revenue. DES is submitting administrative claims, but will not be generating TCM claims for at least 6 months. *Title IV-E Funding for Out-of-Home Placement*: The DCYF Children Services budget was reduced by \$0.5 million in FY 2006 in anticipation of the additional IV-E revenue. DES anticipates submitting Title IV-E claims to the federal government by July 31, 2005.").

### *C. Impact on Fiscal Federalism Theory*

The poverty industry has a vast role in the flow of federal grant-in-aid dollars. The industry not only provides operational services and consulting services in virtually every aspect of the poverty programs, but now directly aims to increase the flow of funding from the source—and helps guide the federal aid away from its intended purposes.<sup>208</sup> This Section explains the system's effects on the intended benefits of fiscal federalism theory, beginning with a new construct to help consider how the interrelationships of the poverty-industrial complex have altered the theory's structure.

#### *1. Poverty's Iron Triangle*

Political science models demonstrate that relationships can exist between government actors and private interests, creating policy subsystems often described as “iron triangles.” This Section develops a new variation of the traditional iron triangle to provide a structure for framing the relationships between the poverty industry and the federal and state governments, and the resulting impact on fiscal federalism theory.

The iron triangle describes the self-serving interrelationships comprising various “subgovernment[s]” and their influence over government policy and funds.<sup>209</sup> Iron triangles illustrate how the purposes of government agency programs may be diverted to the detriment of the public interest the agencies are intended to serve.<sup>210</sup> The military-industrial complex of defense contracting, famously warned against by President Eisenhower in his farewell address,<sup>211</sup> is often discussed as an

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208. See *supra* Part II.B.2.

209. See ADAMS, *supra* note 7, at 24; DON K. PRICE, AMERICA'S UNWRITTEN CONSTITUTION: SCIENCE, RELIGION, AND POLITICAL RESPONSIBILITY 93 (1983), reviewed by Arthur S. Miller, *Myth and Reality in American Constitutionalism*, 63 TEX. L. REV. 181, 190–91 (1984); Nicholas Bagley & Richard L. Revesz, *Centralized Oversight of the Regulatory State*, 106 COLUM. L. REV. 1260, 1284–85 (2006); Suzanne J. Piotrowski & David H. Rosenbloom, *The Legal-Institutional Framework for Interest Group Participation in Federal Administrative Policymaking*, in THE INTEREST GROUP CONNECTION 258, 276–78 (Paul S. Herrnson ed., 2005).

210. Bagley & Revesz, *supra* note 209, at 1284; David Epstein & Sharyn O'Halloran, *The Nondelegation Doctrine and the Separation of Powers: A Political Science Approach*, 20 CARDOZO L. REV. 947, 955 (1999) (explaining how “iron triangles or subgovernments may form, in which congressional committees, interest groups and bureaucrats combine in an unholy trinity to deliver benefits to an interest group's members at the public's expense”).

211. President Dwight D. Eisenhower, Farewell Address, Jan. 17, 1961, available at <http://www.americanrhetoric.com/speeches/dwightdeisenhowerfarewell.html> (“Now this conjunction of an immense military establishment and a large arms industry is new in the American experience. The total influence—economic, political, even spiritual—is felt in every city, every Statehouse, every office of the Federal government. We recognize the imperative need for this development. Yet, we must not fail to comprehend its grave implications. Our toil, resources, and livelihood are all involved. So is the very structure of our society. In the councils of government, we must guard against the acquisition of unwarranted influence, whether sought or unsought, by the military-industrial complex. The

illustrative example of how funds intended to serve the public can be diverted to benefit defense contractors. Gordan Adams explains in *The Politics of Defense Contracting* that “[t]he distinction between public and private starts to disappear as a sector of industry begins to ‘appropriate’ Government authority.”<sup>212</sup> Applied at the federal level, the top corner of an iron triangle is typically occupied by the members and committees of Congress, with the power over legislation and funds.<sup>213</sup> At another corner is the bureaucracy, usually made up of federal government agencies, ostensibly serving a particular public function but seeking to expand its power base.<sup>214</sup> At the third corner is the private interest, which may include private industry and other interest groups that may be impacted by or seek to profit from the laws and money flowing from Congress to the bureaucracy.<sup>215</sup> The consumers, the intended beneficiaries of the government services, are noticeably left out.<sup>216</sup>

The iron triangle is one of multiple models of policy subsystems used by political science scholars to evaluate private interest groups’ influence on administrative behavior and policy making.<sup>217</sup> The construct has been criticized as overly simplistic. In his formulation of the more complex issue network model, Hugh Heclo suggested that rather than a triangle of three actors, the reality is that issue networks comprise “a large number of participants with quite variable degrees of mutual commitment or of dependence on others in their environment.”<sup>218</sup>

While Heclo’s issue networks may often accurately describe the amorphous nature of interest group influence in some areas of administrative function and policy making, application of the iron triangle construct continues.<sup>219</sup> In 2006, the Congressional Research Service (CRS), a research arm of the Library of Congress that provides nonpartisan reports and analysis to members of Congress,<sup>220</sup> issued a report regarding privatization in the federal government, cautioning that “[c]ontracting out can promote iron triangles and other corrupt

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potential for the disastrous rise of misplaced power exists and will persist. We must never let the weight of this combination endanger our liberties or democratic processes.”).

212. ADAMS, *supra* note 7, at 25.

213. *See id.* at 24–26.

214. *Id.*

215. *Id.*

216. *See* Sidney A. Shapiro & Christopher H. Schroeder, *Beyond Cost-Benefit Analysis: A Pragmatic Reorientation*, 32 HARV. ENVTL. L. REV. 433, 464 (2008) (“Consumer interests, environmental interests, and others who traditionally had stood outside of the traditional iron-triangles that dominated many agencies were too distrustful of those cozy relationships.”).

217. Piotrowski & Rosenbloom, *supra* note 209, at 276–78.

218. Hugh Heclo, *Issue Networks and the Executive Establishment*, in THE NEW AMERICAN POLITICAL SYSTEM 88, 102 (Anthony King ed., 1978).

219. JAMES E. ANDERSON, PUBLIC POLICY MAKING: AN INTRODUCTION 71 (6th ed. 2006) (explaining that while the literature frequently asserts that issue networks have replaced iron triangles, “[i]n reality, some iron triangles probably survive, especially in distributive policy”).

220. *What is the Congressional Research Service*, CONG. RESEARCH SERV., <http://www.loc.gov/crsinfo/whatscrs.html> (last visited Aug. 1, 2010).

relationships between the federal government and the private sector.”<sup>221</sup> Further, as James E. Anderson explains, “there is no need to assume that only one kind of subsystem can exist at a time.”<sup>222</sup> Rather, “[w]hy not rather assume that subsystems can take various forms that can be arrayed along a continuum?”<sup>223</sup> Thus, several variations of the iron triangle and other subsystem models can exist simultaneously or independently, depending on the subject and the nature of inquiry.

Although the iron triangle theory is perhaps oversimplified and not a perfect model, a modification of the theory provides a valuable framework to consider the impact of the poverty industry on the intended benefits of applying fiscal federalism theory as the structure for federal grant-in-aid. While the traditional iron triangle consists of the U.S. Congress at the apex, and the federal bureaucracy and the private interest at the other corners,<sup>224</sup> the corners of poverty’s iron triangle are occupied by the federal government, state governments, and private contractors. The intended vertical fiscal federalism relationship between the federal and state governments occupies the line between two corners of the triangle, and the poverty industry then occupies the third corner in the industry’s multiple capacities as direct service provider, revenue maximization consultant, and policy advocate.<sup>225</sup> Also, through its revenue maximization role, the poverty industry cuts a line from its corner through the middle of the triangle to tap into the line of funds from the federal government to the states. Similar to the result in traditional iron triangles, the intended consumers of the government services—the poor—are left out of the triangular relationship.

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221. KEVIN R. KOSAR, CONG. RESEARCH SERV., PRIVATIZATION AND THE FEDERAL GOVERNMENT: AN INTRODUCTION 11 (Dec. 28, 2006), available at <http://www.fas.org/sgp/crs/misc/RL33777.pdf>.

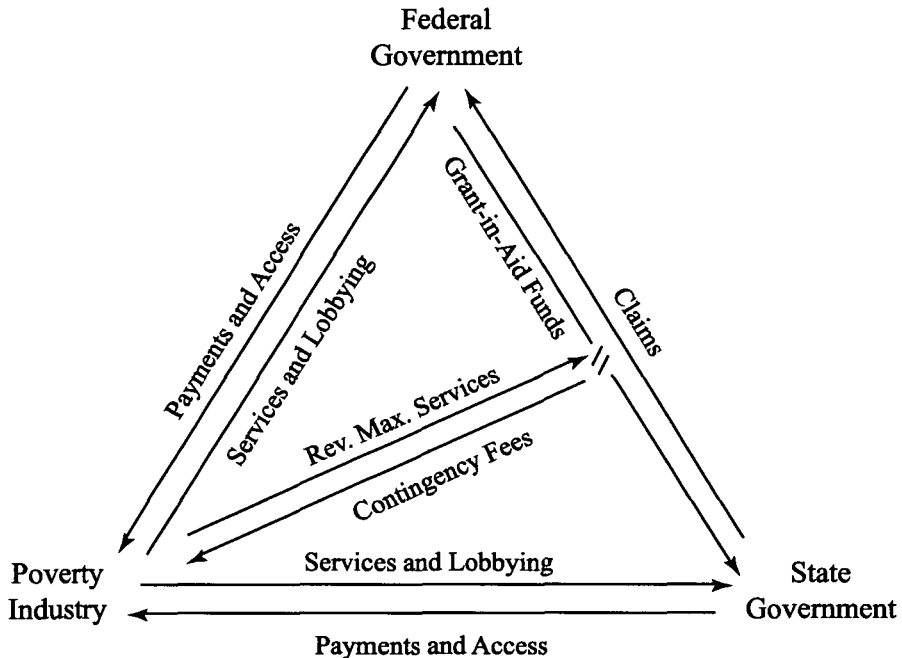
222. ANDERSON, *supra* note 219, at 71.

223. *Id.*

224. ADAMS, *supra* note 7.

225. See *supra* Part II.B.1.

Figure 1  
Poverty's Iron Triangle



This modified triangle does not follow the norms of traditional iron triangle theory, which contemplate the relationships with private actors occurring within one level of government. Further, the strong “cozy triangle” structure of mutually beneficial self-serving interrelationships in traditional iron triangles is rather a destabilized relationship in poverty’s iron triangle, as the poverty industry capitalizes on the self-interests of each level of government and adds to the intergovernmental conflict.<sup>226</sup> However, while this variation does not fit neatly within traditional iron triangle theory, the very fact of the ill fit is instructive: it illustrates the distortive effects on the anticipated benefits of the intended vertical structure of fiscal federalism. This modified iron triangle helps frame the preceding discussion regarding the scope of the poverty–industrial complex, as well as the analysis that follows regarding the impact on fiscal federalism’s intended benefits.

The discussions of fiscal federalism as applied to federal grant-in-aid programs consider only one side of poverty’s iron triangle: the relationship of

226. Poverty’s iron triangle is also more complex than the traditional iron triangle because a complicated interaction between the state governments and state and local agencies takes place at the bureaucratic corner through the state budgeting processes. Private companies may simultaneously contract with the state government, local governments, and directly with the state and local agencies. Thus, depending on state funding structures and contractual arrangements, additional sub-triangles may form—beginning with the state government at the apex.

funding and regulation between the federal government and state and local governments. The other lines of the triangle discussed above, comprising the relationships between the poverty industry and the federal and state governments, and the insertion of revenue maximization consultants across the triangle, have been largely ignored.<sup>227</sup> The following Sections explain the destabilizing effects of the missing lines upon the fiscal federalism relationship between the federal and state governments.

### 2. *Welfare Maximization Yields to Revenue Maximization*

At the heart of fiscal federalism theory is idealism, the belief that government is driven by an unwavering goal to maximize the social welfare of its citizens.<sup>228</sup> Because the different levels of government are each guided by the social welfare of their respective populations,<sup>229</sup> the theory asserts that decentralized governments will be better suited to maximize the welfare of their own local constituencies.<sup>230</sup> Thus, fiscal federalism embraces a preference for decentralized (state) government control over the allocation and consumption of federally funded benefits under the reasoning that such decentralized control will better serve local needs.<sup>231</sup> This preference is then balanced against the central government's financial power and stability, resulting in a partnership between the central and decentralized levels of government to provide needed aid.<sup>232</sup>

In the context of fiscal federalism, an unstated assumption necessarily accompanies the hopes pinned on the beneficial aims of government: that government function will be carried out by government actors. Economists view public sector function—and its goal of maximizing social welfare—as stepping in where the goals of private actors fail to meet societal need.<sup>233</sup> Thus, the influx of the poverty industry into the workings of federal grant-in-aid programs, and the resulting privatization of government function, strikes at the core of fiscal federalism's reliance upon the role of government. As private industry seeks to convert public aid dollars into private revenue, the profit seeking goals of the industry are steadily replacing the intended welfare maximization goals of government. The perceived benefit of state government function in allocating grant-in-aid to best meet the needs of its citizens is undermined if the government function is contracted out to a private industry focused on profit rather than social welfare.<sup>234</sup>

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227. Arthur S. Miller, *Myth and Reality in American Constitutionalism*, 63 TEX. L. REV. 181, 191 (1984) (“[I]f the reality of the iron triangles or issue networks is widely known, then why is that knowledge not reflected in the standard textbooks in constitutional and administrative law?”).

228. Oates, *Second-Generation*, *supra* note 3, at 350.

229. *Id.* at 351.

230. *Id.*

231. See *supra* notes 50–53 and accompanying text.

232. See *supra* notes 50–53 and accompanying text.

233. Oates, *Second-Generation*, *supra* note 3, at 350.

234. For discussion regarding the perils of privatization, see, for example, Gilman, *supra* note 97, and Super, *supra* note 3.



Further, in addition to ignoring the poverty industry's increasing control over government function, fiscal federalism's belief in the social welfare maximization goals of state governments fails to contemplate the governments' self-preservation concerns—and how the poverty industry capitalizes on governmental self-interest. Through the revenue maximization strategies, discussed above, private consultants convince cash-strapped states to institute questionable claiming strategies to increase federal aid.<sup>235</sup> Portions of the additional federal funds are often paid to the consultants, and states route the remaining funds into their general coffers rather than towards the intended targeted assistance. A welfare maximization strategy would consider the specific needs of state government citizens and the best means of meeting those needs. However, a revenue maximization strategy aims simply to increase claims of federal funds, regardless of specific needs, while simultaneously supplanting state spending. Thus, as the focus shifts to revenue maximization rather than welfare maximization, the intended benefit of decentralized government's role in grant-in-aid programs is undermined.<sup>236</sup>

### 3. Cooperation Becomes Conflict

*The Medicaid program must be a Federal–State partnership, not an exercise in financing gamesmanship.*

– Thomas Scully, CMS<sup>237</sup>

Underlying fiscal federalism's belief in the combined strengths of state and federal government is hope for collaboration, a harmonious pairing of a state government's ability to know and serve regional needs with the federal government's economic power and stability. Again, however, as the theory fails to consider the poverty industry's effect of encouraging a shift from welfare maximization goals toward revenue maximization strategies, fiscal federalism also does not adequately consider how the industry serves as a catalyst to conflict.<sup>238</sup>

Even without the poverty industry playing a role, tension would surely exist between the two levels of government in sharing the financing and administration of grant-in-aid programs: “[i]n any program that shares funding and administration between the federal government and the states, the two

235. See *supra* Part II.B.1.

236. For a study addressing states' diversion of Medicaid funds, see Katherine Baicker & Douglas Staiger, *Fiscal Shenanigans, Targeted Federal Health Care Funds, and Patient Mortality*, 120 Q.J. ECON. 345 (2005) (analyzing Medicaid matching grants for state hospitals and states' expropriation of the funds for other purposes).

237. *Hearing on Challenges Facing the Medicaid Program in the 21st Century Before the Subcomm. on Health of the H. Comm. on Energy and Commerce*, 108th Cong. 58 (2003) (statement of Thomas Scully, Administrator, Ctrs. for Medicaid & Medicare Servs. & Dep't of Health & Human Servs.), available at <http://www.hhs.gov/asl/testify/t031008.html>.

238. See Super, *supra* note 3, at 2588 (“States’ zeal in constructing these ‘creative financing’ or ‘maximization’ schemes, along with the federal government’s efforts to shut them down, have led to considerable tension between the two levels of government.”); see also SCHWARTZ ET AL., *supra* note 21.

governments will struggle over who is paying for what expense.”<sup>239</sup> But the inherent tension in the structure of shared governance is increasingly growing towards irreparable conflict as the poverty industry feeds upon the dispute—not taking sides but working to pit each level of government against the other.

Revenue maximization consultants, incentivized by contingency-fee payment structures, encourage states to implement strategies to claim additional federal aid while simultaneously supplanting state spending.<sup>240</sup> The claiming strategies have frustrated the federal government, as evidenced by numerous audits of individual state revenue enhancement schemes and broader policy reports condemning the practices.<sup>241</sup> Then, as the poverty industry exacerbates the conflict by entering into revenue maximization contracts with state clients, the industry further benefits from the tension by directing its expertise to the service of the federal government. While helping states maximize claims for federal aid, the poverty industry simultaneously contracts with the federal government to audit claims and reduce the payout of the same federal funds.<sup>242</sup> The cooperative hopes of fiscal federalism are threatened in the process, and as the next Section explains, legal conflict results.

### III. CONFLICT WITH STATUTORY PURPOSE AND POLICY

As the intended benefits and structure of fiscal federalism are eroded by state and federal government relationships with the poverty industry, conflicts with federal policy and statutory provisions also occur. This Section of the Article analyzes core legal and programmatic concerns not yet adequately addressed: the converted purpose of federal grant-in-aid funds, potential illegality of contingency-fee revenue maximization contracts, and False Claims Act liability that can arise from revenue maximization practices.

#### *A. Converted Purpose of Federal Grant-in-Aid Funds*

The intent behind federal grant-in-aid programs such as Medicaid and Title IV-E is to enable states to provide increased services to those in need.<sup>243</sup> The programs are structured under the fiscal federalism theory that the federal government is better situated to provide funds, and the states (and local governments) are better situated to provide services.<sup>244</sup> At the theoretical level, the structure makes perfect sense. But as theory meets the reality of the interrelationships with the poverty industry, the structure falters. As described above, revenue maximization consultants, while clearly encouraging the needed flow of the federal aid, are also siphoning off significant percentages of the funds. And the states, encouraged by the consultants’ promises of enhanced claiming and savings to state general funds, have increasingly come to view the increased funding as a revenue source rather than a means of maximizing constituents’

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239. SCHWARTZ ET AL., *supra* note 21, at 6.

240. *See supra* Part II.B.1–2.

241. *See supra* notes 175–84 and accompanying text.

242. *See supra* note 22 and accompanying text.

243. 42 U.S.C. §§ 670, 1396 (2006).

244. *See supra* notes 50–53 and accompanying text.

welfare.<sup>245</sup> Indeed, states are engaged in a constant game of “catch-me-if-you-can” in an effort to maximize receipt of federal matching funds. Some state efforts have enabled states to increase their receipt of federal funds without putting up additional state funds, thereby thwarting the intent of the federal–state matching structure.<sup>246</sup>

The diversion of the grant-in-aid funds to private industry and into state general revenue funds conflicts with the statutory purposes and parameters of the programs to the point of illegality.

### 1. Medicaid

When Congress established the Medicaid program as part of the Social Security Amendments of 1965, the intent was not to provide federal funds to replace already existing state spending on medical services for the needy—thus resulting in no net increase in medical services. Rather, Congress aimed to enhance state spending by providing the additional federal matching funds “so as to make medical services for the needy more generally available.”<sup>247</sup> In fact, to help ensure the federal funds provided under the new Medicaid program were used as intended, Congress initially included a “maintenance of state effort” provision to assure that the Federal funds, “which are to accrue to the States under the operation of the formula described above, shall be used directly in the public assistance program and may not be withdrawn from the program by the States.”<sup>248</sup> Although temporary in duration,<sup>249</sup> the maintenance of effort provision clearly highlights the intended statutory purpose of the federal Medicaid funds: to match state spending with additional federal dollars in order to increase medical services for the poor.<sup>250</sup>

Further, the purpose and structure of the Medicaid program clearly contemplate that the federal funds will expand upon state spending. The stated purpose of the program is to provide federal payments to enable states to provide medical assistance and rehabilitation services.<sup>251</sup> The program structure is intended

245. See *supra* Part II.B.2.

246. SCHWARTZ ET AL., *supra* note 21, at 1.

247. S. REP. NO. 89-404, at 66 (1965), *reprinted in* 1965 U.S.C.C.A.N. 1943, 2014.

248. *Id.* at 78, 245–46, *reprinted in* 1965 U.S.C.C.A.N. at 2025, 2211–12.

249. The initial effective dates of the provisions were January 1, 1966, to July 1, 1969, and the expiration date was then advanced to June 30, 1968. S. REP. NO. 90-744, at 155–56 (1967), *reprinted in* 1967 U.S.C.C.A.N. 2834, 3017–18.

250. See *Harris v. McRae*, 448 U.S. 297, 308–09 (1980) (explaining that “[t]he cornerstone of Medicaid is financial contribution by both the Federal Government and the participating State,” and that “the purpose of Congress in enacting Title XIX was to provide federal financial assistance for all legitimate state expenditures under an approved Medicaid plan” (citing S. REP. NO. 89-404, at 83–85; H. R. REP. NO. 89-213, at 72–74)).

251. 42 U.S.C. § 1396 (“For the purpose of enabling each State, as far as practicable under the conditions in such State, to furnish (1) medical assistance on behalf of families with dependent children and of aged, blind, or disabled individuals, whose income and resources are insufficient to meet the costs of necessary medical services, and (2) rehabilitation and other services to help such families and individuals attain or retain capability for independence or self-care, there is hereby authorized to be appropriated for

to incentivize states to increase Medicaid services, and use of the funds must be consistent with the states' Medicaid plans.<sup>252</sup> As part of the required state plans, states receiving the federal Medicaid payments must "provide such methods and procedures relating to the utilization of, and the payment for, care and services available under the plan . . . to assure that payments are consistent with efficiency, economy, and quality of care."<sup>253</sup> In addition to providing federal funds to participate in the financing of direct medical assistance services,<sup>254</sup> federal Medicaid funds help pay administrative, training, and other related operational costs, but only "as found necessary by the Secretary for the proper and efficient administration of the State plan."<sup>255</sup>

Structurally, the federal payments are provided as a match to state spending, and are considered federal financial participation (FFP).<sup>256</sup> The FFP structure requires that both the states and the federal government pay a matching percentage of the total spending, with the federal payments intended to supplement state spending.<sup>257</sup> Thus, if the federal funds are used instead to supplant state spending or bolster state general revenue, as in the examples described above, the statutory purpose and intended structure of the federal payments as "participation" are thwarted.

## 2. Title IV-E Foster Care

Similar to Medicaid, federal funds under the Title IV-E Foster Care program are intended to enable states to provide foster care and related services.<sup>258</sup> The federal funds match state spending, resulting in an increased net amount of funds available for foster care services.<sup>259</sup> The federal matching payments are intended "for the provision of child placement services,"<sup>260</sup> and are also made available to share in costs of the "proper and efficient administration of the State plan."<sup>261</sup>

Thus, as with the Medicaid program, Title IV-E funds are intended to enable states to provide needed foster care related services. The use of the funds to supplant state spending or increase state general revenue conflicts with the statutory purpose.

Title IV-E funds include an additional structural element. Whereas the payment of federal Medicaid funds is not treated as income to an individual

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each fiscal year a sum sufficient to carry out the purposes of this subchapter. The sums made available under this section shall be used for making payments to States which have submitted, and had approved by the Secretary, State plans for medical assistance.").

252. § 1396c.

253. § 1396a(a)(30)(A).

254. § 1396b(a)(1).

255. § 1396b(a)(2)-(7).

256. SCHNEIDER ET AL., *supra* note 69, at 93.

257. *See supra* notes 71-72 and accompanying text.

258. 42 U.S.C. § 670.

259. § 674(a).

260. § 674(a)(3).

261. *Id.*

beneficiary,<sup>262</sup> Title IV-E payments are considered income to eligible foster children. For example, when federal Title IV-E funds are claimed on behalf of a child who is disabled and eligible to receive Social Security Supplemental Security Income benefits, the Title IV-E funds count dollar for dollar against the child's right to receive the SSI funds.<sup>263</sup> This status of Title IV-E funds as income to the child adds an additional legal dimension when the funds are redirected from the provision of foster care services to state general revenue or private profits. When a child's income is taken by the state, without the child's notice or consent—and with no resulting benefit to the child—a constitutional takings analysis is implicated.<sup>264</sup>

Thus, the state supplantation and revenue enhancement practices discussed in Part II.B.2 are directly inconsistent with the statutory purpose and parameters of the Medicaid and Title IV-E programs. Such practices are encouraged by the use of contingency-fee revenue maximization consultants, and as the next Section explains, the contingency-fee structure itself is also legally suspect.

### ***B. Illegality of Contingency-Fee Structure***

In addition to the overarching concern regarding the diversion of federal grant-in-aid funds through supplantation and state budget tactics, the states' use of contingency-fee contractors to help claim additional federal funds can also conflict with the statutory framework. As described below, a 2005 GAO report lists specific examples of inappropriate claiming practices that were likely the result of contingency fees.<sup>265</sup> Further, this Section considers a broader concern that has not been adequately questioned—whether the contingency fee structure itself is consistent with the statutory framework.

As the GAO explains, the use of revenue maximization consultants may increase the likelihood of inappropriate claiming practices. In its 2005 audit report regarding contingency-fee contractors, the GAO highlighted its concerns: “[w]e identified claims from projects developed by contingency-fee consultants that appeared to be inconsistent with current CMS policy, claims that were inconsistent with federal law, and claims from projects that undermined the fiscal integrity of the Medicaid program.”<sup>266</sup> The report provided several examples. For instance, Georgia's revenue maximization consultant advised the state to increase its claims for rehabilitation services by basing claims on private facilities' estimated costs

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262. See *supra* note 74 and accompanying text.

263. *Program Operations Manual System (POMS): SI § 00830.410 Foster Care Payments*, SOC. SEC. ADMIN., <http://secure.ssa.gov/apps10/poms.nsf/lnx/0500830410> (last visited August 17, 2010) (“Foster care payments made under title IV-E (both the Federal amount and State amount) are considered income based on need . . . to the individual in care.”).

264. Although courts may likely be reluctant to find an unconstitutional takings has occurred, the analysis is certainly warranted. For an analogous Takings Clause analysis in the context of states' conversion of foster children's Social Security benefits into state revenue, see Hatcher, *supra* note 11, at 1838–41.

265. GAO, MEDICAID FINANCING, *supra* note 12, at 5.

266. *Id.* at 4–5.

rather than what the agencies actually paid the facilities, resulting in \$58 million in additional Medicaid claims.<sup>267</sup> Following the consultant's direction, Georgia claimed more Medicaid reimbursement for rehabilitation services alone than the total amount Georgia paid to the facilities for all services (not just rehabilitation services).<sup>268</sup> The GAO determined, and CMS agreed, that such practices are inconsistent with federal law.<sup>269</sup>

As another example, a contingency-fee consultant helped Massachusetts increase reimbursement claims for Medicaid Targeted Case Management (TCM) services, including a policy of multiple state agencies of billing Medicaid for TCM services for the same beneficiary.<sup>270</sup> Massachusetts defended the practice, contending that the TCM services were unique and did not constitute double billing.<sup>271</sup> However, the GAO determined that for two of the agencies, the descriptions of the TCM services were identical, and for all four of the state agencies billing for TCM services, the service descriptions were similar.<sup>272</sup> "State officials acknowledged that overlap in eligibility occurred among the agencies but said they were unaware of the number of Medicaid beneficiaries for whom two or more TCM services were claimed per month or the amount of reimbursements claimed for those beneficiaries."<sup>273</sup>

In reply to the GAO audit report regarding contingency-fee contractors, the Massachusetts Secretary of the Executive Office of Health and Human Services made the assertion "that nothing in the law prohibits contingency-fee contracts, as long as the rates fall within broad requirements for the efficient administration of Medicaid."<sup>274</sup> But the legal foundation for the Secretary's claim is not firm.

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267. *Id.* at 22–23.

268. *Id.* ("[T]he amount the state Medicaid agency reimbursed the Department of Juvenile Justice and the Division of Family and Children's Services in state fiscal year 2004 exceeded the total amount these agencies actually paid the facilities for all services, not just rehabilitation services. One facility, for example, was paid by the Division of Family and Children's Services \$37 per day per eligible child for all services covered by the per diem payment, but the state agency billed the Medicaid program \$62 per day for rehabilitation services alone.").

269. *Id.* at 23 ("CMS officials agreed with our conclusion that the claims from this contingency-fee project were inconsistent with federal law. Specifically, the arrangement was not in accord with the statutory requirement that payments be consistent with efficiency, economy, and quality of care. Further, federal Medicaid funds are intended for Medicaid-covered services for eligible individuals on whose behalf payments are made, not to subsidize non-Medicaid-covered services." (citing 42 U.S.C. §§ 1396, 1396a(a)(30))).

270. *Id.* at 41 ("Three other Massachusetts agencies—the Departments of Social Services, Youth Services, and Mental Health—billed Medicaid for TCM services even though the agencies could have been serving some of the same beneficiaries. A foster child served by the Department of Social Services, for example, could also be a juvenile offender served by the Department of Youth Services.").

271. *Id.* at 82–83, 90.

272. *Id.* at 41–42, 90.

273. *Id.* at 42.

274. *Id.* at 73.

The payment of a contingency-based finder's fee seems initially inconsistent with the statutory purposes of the federal funds, and directly conflicts with the structural requirements.<sup>275</sup> From the state's perspective, the argument can certainly be made that the fee structure is necessary to claim the full amount of federal funds to which the states are entitled, because states lack the in-house capacity to administer the claiming process.<sup>276</sup> However, following the logical flow of the statutory framework, such an argument falters. If the fee paid to revenue maximization consultants comes directly from federal Medicaid funds, which is the case under a contingency-fee structure,<sup>277</sup> then such use of funds is subject to statutory limitations. These limitations require Medicaid payments to be "consistent with efficiency, economy, and quality of care . . . ,"<sup>278</sup> and Medicaid funds are available only to help states with administrative, training, and other related operational costs if "found necessary by the Secretary for the proper and efficient administration of the State plan."<sup>279</sup> Thus, for contingency fees paid to revenue maximization consultants to be an allowable use of the federal funds, they must be considered necessary for "proper and efficient administration" and thus eligible for federal financial participation. But they are not. Federal policy prohibits the use of Medicaid funds to reimburse states for contingency fees as administrative costs,<sup>280</sup> and such use is accordingly illegal under the statutory scheme.

### C. False Claims Act Liability

When states use revenue maximization consultants to help increase the claiming of federal grant-in-aid funds, the contractors' incentive to increase profits under contingency fee arrangements and the states' desire to claim additional

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275. See *supra* Part III.A.

276. GAO, MEDICAID FINANCING, *supra* note 12, at 67 (providing Georgia's reply to the GAO report, which contended that "[i]t is nearly impossible for state Medicaid agency staff to keep abreast of the multitude of both new requirements and new opportunities that result from Congress' frequent amendments to the Medicaid law," and that the "complexity can and does compel states to turn to expert consultants for assistance").

277. See *id.* at 4 (concluding that revenue maximization contingency fee in Georgia was paid directly out of the additional Medicaid reimbursements).

278. 42 U.S.C. § 1396a(a)(30)(A) (2006).

279. § 1396b(a)(2)-(7); see also § 674(a)(3) (stating the same requirement under Title IV-E).

280. OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, OMB CIRCULAR NO. A-87, COST PRINCIPLES FOR STATE, LOCAL AND INDIAN TRIBAL GOVERNMENTS, Attachment B, § 33(a) (Aug. 29, 1997) [hereinafter OMB CIRCULAR NO. A-87] ("[C]osts of professional and consultant services . . . are allowable . . . when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Federal Government."); see also HHS, NEW JERSEY MEDICAID, *supra* note 184, at 4 (explaining the applicability of the OMB limitation to Medicaid administrative claims); U.S. DEP'T OF HEALTH & HUMAN SERVS., OFFICE OF THE INSPECTOR GEN., A-04-98-00126, REVIEW OF MISSISSIPPI'S RETROACTIVE CLAIM FOR FOSTER CARE ADMINISTRATIVE AND TRAINING COSTS AND MAINTENANCE PAYMENTS 3 (2000), available at <http://oig.hhs.gov/oas/reports/region4/49800126.pdf> (applying same conclusion to Title IV-E administrative costs).

federal dollars to bolster state general revenue can lead to inappropriate claiming practices. If the bounds are pushed too far, violations of the civil or criminal False Claims Acts (FCA) can result.<sup>281</sup>

The civil FCA in particular has been increasingly employed by the federal government to redress Medicaid and Medicare fraud, spurred in part by the Act's qui tam provision that encourages private individuals with inside information to file claims on behalf of the federal government.<sup>282</sup> Under the Act, a "person who knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval" to the federal government is liable for a "civil penalty of not less than \$5,000 and not more than \$10,000 . . . plus 3 times the amount of damages which the Government sustains because of the act of that person."<sup>283</sup>

While often applied in the context of fraudulent Medicaid and Medicare claims filed by health care providers, the FCA may also be applicable in circumstances where states employ the services of revenue maximization consultants. Under the parameters of the FCA, a revenue maximization consultant can face liability for knowingly causing a state agency to present false or fraudulent information in the claiming process for federal grant-in-aid funds. The specific intent to defraud is not a required element under the FCA.<sup>284</sup> Rather, as used in the Act, the terms "knowing" and "knowingly" are defined to mean that a person "(i) has actual knowledge of the information; (ii) acts in deliberate ignorance of the truth or falsity of the information; or (iii) acts in reckless disregard of the truth or falsity of the information."<sup>285</sup>

The FCA case against MAXIMUS in 2007, described in this Article's introduction, provides an example of the extent to which contractors may attempt to side-step statutory eligibility requirements in their efforts to maximize federal claims—and thereby maximize their contingency fee.<sup>286</sup> Also, in addition to cases where asserted facts are not true, a revenue maximization consultant can trigger FCA liability when the facts are true but the claims are ineligible for federal reimbursement based upon known policy interpretations. For example, federal policy has long made clear that contingency fees paid to maximize federal aid are not eligible for federal reimbursement as an administrative cost.<sup>287</sup> Nonetheless, countless claims for Medicaid and Title IV-E administrative cost reimbursement have included contingency fees paid to consultants.<sup>288</sup> If a contractor assists in preparing such claims, and knows or should have known the claims for contingency fees are not allowed, then the FCA may arguably be implicated. Further, as described in Part II.A.3., organizational conflicts of interest may be

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281. 31 U.S.C. §§ 3729–3733 (2006); 18 U.S.C. § 287 (2006).

282. 31 U.S.C. § 3730; *see also* Timothy Stoltzfus Jost, *Our Broken Health Care System and How to Fix It: An Essay on Health Law and Policy*, 41 WAKE FOREST L. REV. 537, 568 (2006) ("[Q]ui tam provisions of the federal civil False Claims Act encourage knowledgeable insiders to expose secret fraud and corruption.").

283. 31 U.S.C. § 3729(a).

284. § 3729(b).

285. *Id.*

286. *See supra* notes 24–28 and accompanying text.

287. OMB CIRCULAR NO. A-87, *supra* note 280.

288. For example audits, *see supra* notes 184–86, 192.



present in circumstances where a company's revenue maximization services are in conflict with another division of the company or an affiliate.<sup>289</sup> If such a conflict exists, but is not properly disclosed, FCA liability could result.<sup>290</sup>

Moreover, in addition to potential contractor FCA liability, questions can arise regarding liability of the government agencies that have contracted with revenue maximization consultants. Although the Supreme Court ruled in 2000 that a state is not a "person" for purposes of *qui tam* actions under the FCA,<sup>291</sup> the Court concluded in a 2003 decision that local governments (municipal corporations) can be subject to FCA *qui tam* actions.<sup>292</sup>

#### IV. RESTORING INTEGRITY TO FISCAL FEDERALISM

The idealistic hopes of fiscal federalism theory can come closer to fruition, but only if reality is confronted—that is, the mesh of interrelationships between the multiple levels of government and industry must be understood and appropriately addressed. The intended federal–state partnership of strengths must adequately contemplate the diversion of federal funds, the inherent intergovernmental tension, and the catalytic effect of the poverty industry.

The poverty industry's focus on the bottom line has encouraged states to focus on their own, looking towards enhanced revenue rather than enhancing services to those in need. State agencies, created to look outward to serve the needs of low-income individuals and maltreated children, are increasingly turning inward toward fiscal strategies of self-perpetuation. Further, this shift in agency focus is occurring within a broader perspective of the state that increasingly sees its agencies as conduits for general revenue. Agencies struggle for the funding to survive as cash-strapped states view the agencies as tools to divert federal grant-in-aid funds to bolster the states' own general budgets. As the money is diverted—and the intended beneficiaries suffer—the federal government grows increasingly frustrated, and the cooperative hopes of fiscal federalism are undermined.<sup>293</sup> Meanwhile, capitalizing on every stress point, the poverty industry is thriving.

To restore fiscal and legal integrity to federal grant-in-aid programs, several steps should be considered. First, the core statutory purpose of the federal aid programs must be preserved. Funds intended to increase services to the poor and to maltreated children must not be redirected to general state coffers.<sup>294</sup> Strict

289. See *supra* Part II.A.3.

290. See *United States ex rel. Harrison v. Westinghouse Savannah River Co.*, 352 F.3d 908, 919 (4th Cir. 2003) (finding that a contractor's certification of no organizational conflict of interest could result in FCA liability when a subcontractor's employee did in fact create in a conflict).

291. *Vt. Agency of Natural Res. v. United States ex rel. Stevens*, 529 U.S. 765 (2000).

292. *Cook County, Ill. v. United States ex rel. Chandler*, 538 U.S. 119 (2003).

293. *E.g.*, SCHWARTZ ET AL., *supra* note 21, at 1 ("This cycle of action and response has been repeated many times in the last 20 years, each time poisoning the critical intergovernmental relationship necessary for successful delivery of health services to our poorest citizens.").

294. See *supra* Part II.B.2; see also GAO, *MEDICAID FINANCING*, *supra* note 12, at 90 (discussing Massachusetts' Medicaid claims for disproportionate share hospital

maintenance of effort requirements,<sup>295</sup> or “supplement, not supplant limitations,”<sup>296</sup> must be imposed and monitored.

When funds are diverted contrary to statutory purpose, the states—and any consultants that aid in the practice—should be held accountable. For example, when such conflicts with statutory purpose occur, the Center for Medicare and Medicaid Services (CMS) should use its authority to ensure the integrity of the Medicaid program as a basis for redress. The statutory provision regarding “efficiency, economy and quality of care” has been interpreted as providing CMS with broad authority to control state practices that are inconsistent with the statutory scheme.<sup>297</sup> Already viewed by CMS as providing valid discretion to deny proposed state Medicaid plans that are inconsistent with the statutory purposes and framework,<sup>298</sup> the agency should construe the statutory authority as a broad means to address the inappropriate use of federal payments. States that misuse the federal aid should be subject to fines and increased audits, and should be required to redirect the funds to assist intended beneficiaries. And companies that develop or encourage inappropriate claiming practices should be pursued for financial redress under FCA provisions, and prohibited from further contractual participation with the federal programs.<sup>299</sup>

Significant analysis should be undertaken regarding the appropriate scope of the poverty industry’s involvement in federal grant-in-aid programs, including federal inquiry into the bounds of inherently governmental functions, and clarification and enforcement of organizational conflict-of-interest standards.<sup>300</sup> Further, because contingency-fee revenue maximization contracts are inconsistent with statutory purpose and create incentives for improper and inefficient claiming, the contingency-fee contracts should be curtailed by federal directive.<sup>301</sup> Ideally,

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payments, the GAO explained “our concern was that hospitals should benefit from increased federal reimbursements and Massachusetts’s arrangement appeared to result in lower payments to hospitals, despite increased claims for federal reimbursement”).

295. As an example, the welfare assistance block grants to states in the Temporary Assistance to Needy Families program (TANF) includes a maintenance of effort requirement. 42 U.S.C. § 609(a)(7) (2006).

296. For example, requirements that federal funds supplement, not supplant, non-federal spending on related services are included in federal aid programs to improve state education services. See Mariana Kihuen, *Leaving No Child Behind: A Civil Right*, 17 AM. U. J. GENDER SOC. POL’Y & L. 113, 130 n.108 (2009) (citing 20 U.S.C. §§ 6383(i), 6396(a)(1)(B)(iii), 6514(f), 6561b(b)(1)(F), 6536 (Supp. 2005); *id.* §§ 6613(f), 6623(b), 6662(a)(4), 6683(h)(2), 6763(b)(6); *id.* §§ 6914(h)(4), 6934(f)).

297. *Alaska Dep’t of Health & Soc. Servs. v. Ctrs. for Medicare & Medicaid Servs.*, 424 F.3d 931, 939–40 (9th Cir. 2005).

298. *Id.*; see also SCHWARTZ ET AL., *supra* note 21, at 13.

299. See *supra* note 28 and accompanying text.

300. See *supra* Part II.A.3.

301. The original version of the Deficit Reduction Act of 2005 introduced by the Senate included provisions to limit contingency fees for consultants in the Medicaid program, but that section of the bill was removed in conference before the final version was passed. See Deficit Reduction Omnibus Reconciliation Act of 2005, S. 1932, 104th Cong. § 6022 (2005) (“Limitation on use of contingency fee arrangements.”); Deficit Reduction

state agencies will develop the in-house capacity and expertise to process claims independently.<sup>302</sup> However, until such capacity is developed, contracts with revenue maximization consultants should be structured and sufficiently monitored to ensure integrity. Improved payment structures could include flat-fee payment arrangements or performance incentives focused on accuracy rather than amount.<sup>303</sup> Moreover, if such services continue, the contracts should be entered into with the appropriate governmental entities to best insure the proper use of funds. Revenue maximization contracts with the state agencies charged with providing the intended services may be less likely to result in diversion of funds than contracts with states at the executive level of administration in search of general revenue.<sup>304</sup>

Furthermore, if states are to improve the integrity of their claims for federal grant-in-aid funds, the federal government must improve the claiming process. For states to understand and follow the rules and better serve program beneficiaries, the rules and procedures should be simplified and better targeted toward programmatic purposes, and federal guidance and enforcement must be consistent.<sup>305</sup> Also, although increased audits are necessary to help ensure the proper use of federal funds, the federal government's reliance on private contractors to complete the audits risks further harm to fiscal federalism's goals.<sup>306</sup> Through the use of private contingency-fee contractors to audit and recover improper claims, the federal government is relying on the poverty industry to

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Omnibus Reconciliation Act of 2005, Text of Amendments, S. 1932, 104th Cong. (2005) (removing section regarding contingency fee arrangements).

302. See PEER, *supra* note 162, at 19 (“Logically, the ‘service’ of maximizing federal funding to a program would be performed most efficiently and effectively in-house. State program personnel should have sufficient knowledge of the programs that they administer to know what federal funds are available and what steps should be taken to obtain the funds. It is not cost-effective to pay a consultant a percentage of the federal funds due to an agency for work that agency staff should be performing as part of their routine job duties. Further, if agency staff members do not have the level of basic program knowledge necessary to identify available federal funds, the staff cannot effectively oversee the work of a consultant in this area and the agency thereby runs the risk of incurring significant audit exceptions.”).

303. In fact, MAXIMUS changed its practice of bidding on contingency-fee revenue maximization contracts in 2007, opting instead to pursue fee-for-service contracts in revenue maximization work. See Internal Memorandum, MAXIMUS, Advantages of Fee-Based Contracts Federal Healthcare Claiming: Good Policy and Good Business (July 2007) (on file with the Arizona Law Review).

304. FRIEDMAN, *supra* note 187.

305. See SCHWARTZ ET AL., *supra* note 21, at 11–19 (stating that states should not be held solely responsible for developing arrangements that inappropriately maximize federal reimbursements where policies have not been clear or clearly communicated or where CMS has known of risks for some time and has not acted to mitigate them).

306. The Obama Administration recently announced an increased focus on preventing Medicare and Medicaid fraud, including increased reliance on contingency-fee consultants to help reduce inappropriate payments. See Presidential Memorandum Regarding Finding and Recapturing Improper Payments, 2010 DAILY COMP. PRES. DOC. 162 (Mar. 10, 2010), available at <http://www.whitehouse.gov/the-press-office/presidential-memorandum-regarding-finding-and-recapturing-improper-payments>.

counteract the effects of the poverty industry. While assisting states in maximizing claims for federal grant-in-aid, the industry is simultaneously contracting with the federal government to reduce the federal aid payments.<sup>307</sup> Though lucrative for the industry, the result is detrimental to fiscal federalism's hopes for harmonious intragovernmental collaboration.

### CONCLUSION

The scope and effects of the federal–state linkages to the poverty industry pose significant questions regarding the viability of fiscal federalism theory as applied to federal grant-in-aid programs. Debate should thus continue regarding the appropriate balance of power and fiscal responsibility between the federal and state governments in the provision of needed aid.<sup>308</sup> Detailed analysis of possible alternative programmatic structures, along the continuum from complete federalization to unrestricted block grants, is beyond the scope of this Article. However, a strong argument can be made for a reduced state role in the administration of the Medicaid program.<sup>309</sup> As the states generally do not provide direct Medicaid services, but rather serve as conduits of funding to those organizations that do, a lessening—if not removal—of the states' responsibilities could certainly address many of the concerns raised in this Article. And at the opposite end of the spectrum, arguments have long been made for providing vastly increased flexibility to states in the provision of foster care services, where the states are already much more intimately involved in the direct provision of services.<sup>310</sup> However, the concern that cash-strapped states will redirect federal aid funds toward general revenue would certainly be heightened if the funds are provided with less federal control.

Nonetheless, as the appropriate balance of power is debated, the promise of fiscal federalism remains. The principle of shared governance can show its strength in the federal–state collaboration to provide needed services to low-income families and maltreated children, leveraging the federal government's

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307. See *supra* note 22 and accompanying text.

308. In 2005, an important discussion took place when various Medicaid stakeholder representatives came together to debate significant financing and programmatic concerns in the Medicaid program. Several initial ideas for program improvement were raised, and it is critical that such discussions continue. See generally SCHWARTZ ET AL., *supra* note 21.

309. See, e.g., Greg Anrig, *Federalism and Its Discontents*, DEMOCRACY: A JOURNAL OF IDEAS, Winter 2010, at 46, available at <http://www.democracyjournal.org/article.php?ID=6729>; James Surowiecki, *Fifty Ways to Kill Recovery*, NEW YORKER, July 27, 2009, [http://www.newyorker.com/talk/financial/2009/07/27/090727ta\\_talk\\_surowiecki](http://www.newyorker.com/talk/financial/2009/07/27/090727ta_talk_surowiecki).

310. Waivers have been granted to individual states to experiment with new methods of program financing and administration. E.g., Abigail R. Moncrieff, *Federalization Snowballs: The Need for National Action in Medical Malpractice Reform*, 109 COLUM. L. REV. 844, 879 n.102 (2009) (“The Medicaid Program, for example, includes a waiver provision that allows the states to deviate from federal substantive requirements of the Medicaid Act in order to try alternative approaches to public health insurance.” (citing 42 U.S.C. § 1315 (2000))); see also Erik Eckholm, *Florida Shifts Child-Welfare System's Focus to Saving Families*, N.Y. TIMES, July 25, 2009, at A12 (describing federal waiver allowing Florida to alter financing and programmatic focus of its child welfare program).

financial power with the ability of states to know and serve the needs of their citizenry. The idealistic view of government existing to maximize social welfare can be realized if the realities in which the ideals are pursued are adequately contemplated. The reforms and additional inquiries this Article suggests are both possible and necessary to begin restoring the integrity and promise of fiscal federalism principles in federal grant-in-aid programs.