PUBLICATION

Hospitals Plagued by HHS's 2012 Medicare DSH Calculation Obtain Relief from the D.C. Circuit

August 25, 2017

Hospitals affected by HHS's 2014 decision to include Medicare Part C enrollees as part of the Medicare fraction of the disproportionate share calculation obtained relief late last month when that position was voided by the U.S. Court of Appeals for the District of Columbia in *Allina Health Services v. Price*. More specifically, the Court of Appeals for the D.C. Circuit reversed the district court's decision and concluded that HHS violated the notice-and-comment rulemaking requirements of the Medicare statute by retroactively changing the reimbursement adjustment formula for fiscal year 2012 forward. The decision should be on one's reading list. Of potentially great significance, the Court of Appeals rejected the government's argument that the Medicare Act incorporates the APA's exceptions to the notice-and-comment rulemaking requirements.

Background

The Medicare statute authorizes reimbursement adjustments to increase payments to hospitals that treat a disproportionately high number of low-income patients, known as the "disproportionate share hospital adjustment" (DSH). DSH payments are calculated by adding two fractions to approximate the proportion of low-income patients treated during the fiscal year. Hospitals' fiscal intermediaries are required to use the HHS fraction in making the final DSH reimbursement adjustment for every hospital.

Each year, HHS publishes one such fraction, called the Medicare fraction, for every hospital nationwide. The fraction is based, in part, on the number of patient days that year for each patient entitled to benefits under Part A of Medicare. Importantly, the historically wealthier Part C (which features managed care or Medicare Advantage) enrollees were not included in the fraction. In 2004, however, HHS attempted to change course and proposed a rule that would bring Part C beneficiaries into the Part A patient day "Medicare" calculation, thereby resulting in lower DSH reimbursement to most hospitals. In an earlier decision, however, the D.C. Circuit vacated the 2004 final rule, finding that it was not a "logical outgrowth" of the proposed rule and therefore was improperly issued without opportunity for notice and comment from the public.

Years later, in June 2014, HHS published Medicare fractions to be used to calculate the 2012 DSH adjustment. Those fractions for all hospitals once again included Part C days in the Medicare fraction of the DSH calculation. Not surprisingly, hospitals again challenged this position.

Upon review, the United States District Court granted HHS's motion for summary judgment, concluding that the decision to include Part C patient days was an "interpretive rule" under the APA, and thus publication of the fiscal year 2012 Medicare fractions was exempt from the APA's notice-and-comment provisions. The district court further ruled that the Medicare statute incorporated the APA's exception from notice-and-comment rulemaking for interpretive rules.

The D.C. Circuit has now reversed that lower court decision, concluding that HHS unlawfully failed to provide for notice-and-comment.

The Court's Ruling

The Court of Appeals began with an explanation of the Medicare statute language which provides, in part, that "No rule, requirement, or other statement of policy . . . that establishes or changes a substantive legal standard governing . . . the payment for services . . . shall take effect unless it is promulgated" by the Secretary of HHS in such manner as provides for public notice and comment.

The Court of Appeals concluded that the inclusion of Part C days was, if not a "rule" or policy statement, at the very least, a "requirement" because fiscal intermediaries are *commanded* to use the HHS fraction in calculating the DSH adjustment, and thus are *required* to use the Part C days in HHS's new interpretation.

Further, the Court of Appeals ruled, the inclusion of Part C days constituted a "change" in HHS standards because, prior to 2004, the standard practice was to exclude Part C days. The decision by Judge Kavanaugh noted that the attempted rule change in 2004 was vacated, so the "baseline" from 2004 to 2013 remained that Part C days were excluded. As a result, the application of Part C days in 2012 did, in fact, represent a "change" from prior practice.

Importantly, the Court of Appeals found that the inclusion of Part C days in the Medicare fraction established a "substantive legal standard" because it created, defined or regulated the rights, duties or powers of the parties. That is, the fiscal intermediaries must apply the Medicare fraction, which includes the Part C patient days, and such inclusion necessarily defines the scope of the hospital's right to payment for treating low-income patients. Relatedly, the court concluded that the inclusion of Part C days also governs "payment for services," as evidenced by the resultant decrease in payments to hospitals.

For these reasons, the court concluded that there was a change in a requirement affecting substantive legal standards for the payment of services, fitting squarely within the Medicare statute's requirement that HHS engage in notice-and-comment rulemaking.

HHS relied heavily on its argument that the inclusion of Part C patients in the fraction was an interpretive rule change, which it claimed was exempt from notice-and-comment rulemaking by virtue of the Medicare statute's adoption of certain APA provisions. Namely, the APA carves out an exception for interpretive rules, obviating the need for notice-and-comment procedures.

However, the Court of Appeals quickly disposed of this argument, determining that the Medicare statute does not incorporate the interpretive rule exception found in the APA, but rather expressly requires notice-and-comment rulemaking for *any* rule, requirement or statement of policy, without any reference to interpretive rules. Indeed, the APA makes explicit reference to the interpretive rule exception – a point Congress could have, but chose not to, include in drafting the Medicare statute. That is, where Congress carved out interpretive rulemaking from the APA, but omitted the carve-out language in the Medicare statute, Congress did not intend for the Medicare statue to mirror the exception for interpretive rules. The D.C. Circuit recognized that its decision regarding the interpretive rule exception diverges from opinions from the First, Sixth and Tenth Circuits, but nonetheless disagreed with those courts.

As a final point, Judge Kavanaugh also made a finding that renders moot the question of whether the Medicare statute incorporated the APA's interpretive rule exception. Namely, he ruled that a separate part of the Medicare statute also requires notice-and-comment rulemaking for any regulatory change that includes a provision that is not a "logical outgrowth" of a previously published notice of proposed rulemaking or interim final rule. Because the 2004 rule on Part C days was vacated, the court found that the application of the Part C days to 2012 was not a logical outgrowth of that earlier thwarted rulemaking, and thus required notice-and-comment rulemaking anew. As the court stated: "HHS could not circumvent this requirement by claiming that it was acting by way of adjudication rather than rulemaking."

Baker Donelson Comments

The *Allina* decision has potentially far-reaching ramifications on CMS and its frequent practice of making policy changes without adhering to notice-and-comment procedures. Consequently, one can expect the government to give serious consideration to seeking further review, either before the full circuit court or the Supreme Court.