PUBLICATION

Second Circuit Affirms that Medicare Beneficiaries Who Are Reclassified by Hospitals from Inpatient to Observation Status Are Entitled Due Process

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On January 25, 2022, the U.S. Court of Appeals for the Second Circuit issued an important opinion in *Barrows v. Becerra* that will have a significant impact on hospitals, skilled nursing facilities and, potentially, other Medicare providers. The Second Circuit affirmed a ruling from the United States District Court for the District of Connecticut that the U.S. Secretary of Health and Human Services (HHS) violated the due process rights of a certified nationwide class of Medicare patients that were reclassified from "inpatient" to "observation" by a hospital's utilization review committee (URC) without being provided an administrative review process to challenge that determination.

Although hospitals (and other Medicare providers and suppliers) are not typically considered to be governmental actors, the Second Circuit affirmed the district court's conclusion that the Centers for Medicare and Medicaid Services (CMS) requirements surrounding hospital URCs made those determinations "state action" and thus subject to due process requirements under the Fifth Amendment of the U.S. Constitution.

The classification from "inpatient" to "observation" can have significant financial repercussions to the Medicare beneficiary. Hospital inpatient services are generally covered under Medicare Part A. Outpatient or observation services are generally covered under Medicare Part B. Medicare beneficiaries pay monthly premiums for Part B coverage and also are subject to copayment obligations under Part B that may be higher than the inpatient deductible under Part A. The Second Circuit's opinion marks the latest development in litigation that has lasted 11 years to date. The case stems from hospital URC' decisions to reclassify patients who were admitted as "inpatients" to "outpatient" receiving "observation services." In addition to CMS requiring every Medicare-participating hospital to establish a URC, CMS's regulations require URCs to include at least two physician members. If the URC determines that a patient should not have been admitted for inpatient services, URCs have the authority and obligation to reclassify an admission from inpatient to outpatient (observation).

CMS has also provided significant (and not always consistent) guidance to hospitals on how the determination should be made as to whether a patient should be classified as an inpatient or outpatient. Before 2013, CMS directed hospital physicians to consider a patient's history and to determine whether a patient would be expected to need inpatient care for at least 24 hours. In 2013, CMS promulgated a new regulation, which allowed payment under Medicare Part A when a physician reasonably expected a patient to require medically necessary hospital care that would span two midnights after the patient arrives at the hospital. This rule is often referred to as the "Two Midnight Rule." If a patient is not expected to require hospital care for two midnights or more, then the hospital is expected to bill for outpatient observation services under Medicare Part B.

In addition to the URC requirements and CMS's guidance on patient classification, CMS exerts other influence over hospitals. As detailed in the appellate opinion, CMS applies significant pressure on URCs to reclassify patients who do not meet criteria for inpatient services. This pressure comes in the form of audits and post-payment reviews. Because Medicare typically reimburses hospitals more for Part A inpatient claims than for Part B outpatient claims, this classification determination can often be the subject of recoupments and other investigations.

The Second Circuit noted that a hospital has a formal administrative right to challenge Medicare's ' determination that a Part A inpatient claim should not have been billed. On the other hand, a patient who is determined by a URC to require reclassification from inpatient to observation before the hospital submits a claim to Medicare does not have any corresponding appeal rights.

The threshold question presented in *Barrows* was whether CMS's oversight and control over hospital URC's reclassification determinations transform those URCs into state action and thus subject to constitutional due process. The Second Circuit affirmed the district court's decision, which also included a permanent injunction, requiring the HHS Secretary to create some sort of due process if a Medicare beneficiary disagrees with a hospital URC's reclassification determination.

This decision may also favorably impact skilled nursing facilities. Generally, a Medicare beneficiary must have a three-day inpatient stay at a hospital in order for Medicare to pay for a subsequent stay in a skilled nursing facility. This three-day requirement is currently waived during the COVID-19 public health emergency. Once the three-day-stay requirement returns, this decision may positively impact skilled nursing facilities by discouraging hospitals from reclassifying patients from inpatient to observation.

Although the district court decision was issued in 2020, the Second Circuit had granted a temporary stay to allow the HHS Secretary to appeal. In the Second Circuit's opinion, the Court affirmed the district court and denied the HHS Secretary's motion for stay as moot.

At this stage, HHS has not signaled what due process hospital URCs will have to provide a Medicare beneficiary who disagrees with a reclassification determination. There are also open questions about how to handle potential claims for various members of the class. The class includes Medicare beneficiaries who have been hospitalized since January 1, 2009, had their status changed from inpatient to hospital, received a notice from the hospital or Medicare, and either have Part A-coverage only or had Part A and B and were (or still could be) admitted to a skilled nursing facility within 30 days of hospital discharge.

The HHS Secretary has until late April 2022 to file a petition for writ of certiorari in the U.S. Supreme Court. At the time of this publication, HHS has not indicated whether it intends to appeal.

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