Federal Court Permanently Enjoins CMS' Policy Reducing the Hospital-Specific Medicaid Disproportionate Share Hospital Limit

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On March 2, 2017, the United States District Court for the District of New Hampshire issued an order (the Order) for a permanent injunction against CMS barring it from enforcing certain "policy clarifications" with respect to the calculation of the hospital-specific disproportionate share hospital (DSH) limit (42 U.S.C. § 1396r-4(g)). As a result of this order, CMS is permanently enjoined from enforcing these "policy clarifications," which States had used to reduce the DSH payments for many hospitals. We anticipate the full scope of this injunction to play out in states around the country.

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As background, Congress established a hospital-specific DSH equal to "the costs incurred during the year of furnishing hospital services (as determined by the Secretary and net of payments under this subchapter, other than under this section, and by uninsured patients) by the hospital to individuals who either are eligible for medical assistance under the State plan or have no health insurance (or other source of third party coverage) for services provided during the year."[1] In January 2010, CMS posted on its website answers to "frequently asked questions" regarding the audit and reporting requirements that the agency had promulgated in 2008.[2] In response to two of the frequently asked questions, "FAQ 33" and "FAQ 34," CMS directed States to subtract payments received from private insurance (FAQ 33) and Medicare (FAQ 34) for dually eligible Medicaid patients from the costs incurred by a hospital when calculating the hospital-specific DSH limit for that hospital.

These "policy clarifications," never formalized in any rulemaking, appear to be in direct contradiction with the statute's provision that costs would be applied net of payments under Title XIX and by uninsured patients. Despite these questions, States began applying these "policy clarifications" in reducing the DSH payments received by hospitals.

Multiple States, hospitals, and other stakeholders immediately expressed concern about the policy set forth in the DSH FAQs.[3] Both the New Hampshire District Court and the United States District Court for the District of Columbia had enjoined CMS from enforcing, applying, or implementing the policies referenced in FAQs 33 and/or 34.[4]

In this case, the plaintiffs had petitioned CMS requesting repeal of FAQs 33 and 34. CMS denied the petition, asserting that the "longstanding, consistent policy. . . . reflects a valid interpretation of the

statute governing the calculation of uncompensated care costs for purposes of the DSH hospital-specific limit . . . and the associated regulations." CMS distinguished the previously-issued injunction in the *Texas Children's Hospital* case but limited its effect to hospitals in Texas only.

The plaintiffs filed a lawsuit based on three Administrative Procedure Act ("APA") theories: (1) the promulgation and enforcement of the FAQs was in excess of the defendants' statutory authority; (2) the issuance of the FAQs was arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law, and without observance of procedure required by law based on the failure to formally adopt these policies as regulations; and (3) the application of the FAQs constituted an effective amendment to the Medicaid State Plan without meeting the notice-and-comment requirements for such amendments pursuant to 42 U.S.C. § 1396a(a)(13)(A) and 42 C.F.R. § 447.205. The Order addressed cross motions for summary judgments by both parties.

After determining that the plaintiffs had standing to raise this challenge, the District Court granted summary judgment to the plaintiffs on the first two theories and granted summary judgment to the defendants on the third theory to defendants:

- Count I: After determining that CMS' action did not warrant deference under either *Chevron*[5] or *Skidmore*[6], the court held that even to the extent the term "as determined by the Secretary" granted CMS the authority to consider Medicare and commercial payments as offsets to costs, "[a]t most, the statute might have delegated to the Secretary the ability to determine by regulation that additional payments should be considered."[7]
- Count II: The court determined that the FAQs violated the APA by being substantive rules that were not promulgated using notice-and-comment rulemaking under the APA.
- Count III: The court determined that while federal law may impose public notice obligations on a state prior to amending their state plans, such failure does not give rise to liability by CMS or the other defendants.

Based on the above, the district court granted a permanent injunction against the defendants "from enforcing FAQs 33 and 34. Defendants shall follow the policies and procedures in effect before defendants issued FAQs 33 and 34, until and unless these policies and procedures are replaced by an enforceable and properly promulgated regulation."

The full impact of the Order on hospitals in states other than New Hampshire remains to be seen, and such impact will vary depending on:

- Whether CMS requests reconsideration of the Order to limit the relief granted or appeals the Order to the Court of Appeal;
- Whether CMS finalizes the proposed rule that would adopt the policy within the FAQs as regulations;
- Whether other state Medicaid agencies or courts determine that the Order applies broadly to all applications of the FAQs.

Hooper, Lundy & Bookman continues to monitor this and other legal issues relating to Medicaid DSH payments and other Medicaid payment issues. For more information, please contact: The San Francisco Office at 415.875.8503; in Los Angeles, John Hellow at 310.551.8155; in Washington, D.C., Kelly Carroll at 202.580.7712.

[1] 42 U.S.C. § 1396r-4(g)(1)(A) (emphasis added).

[2] *See* "Additional Information on the DSH Reporting and Audit Requirements," https://www.medicaid.gov/medicaid-chip-program-information/by-topics/financing-and-reimbursement/downloads/part-1-additional-info-on-dsh-reporting-and-auditing.pdf ("DSH FAQs").

[3] 81 Fed. Reg. 53891, 53983 (Aug. 15, 2016). CMS had proposed to adopt the policies behind FAQs 33 and 34 in formal rulemaking last year. The rule has yet to be finalized.

[4] *See Texas Children's Hosp. v. Burwell*, 76 F. Supp. 3d 224 (D.D.C. 2014); *see also New Hampshire Hosp. Ass'n v. Burwell*, No. 15-CV-460-LM, 2016 WL 1048023 (D.N.H. Mar. 11, 2016).

[5] *See Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 842–43 (1984).

[6] *See Skidmore v. Swift & Co.*, 323 U.S. 134, 139–40 (1944).

[7] *See also Texas Children's Hosp.*, 76 F. Supp. 3d at 236.

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