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Hospital DSH payments negatively impacted by D.C. Circuit's reinstatement of 2017 CMS rule on dual eligibility

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The D.C. Circuit Court of Appeals reinstated a 2017 rule[1] promulgated by the Secretary of United States Department of Health and Human Services (the Secretary), the effect of which is that hospitals must now subtract payments received from private insurers and other third parties in determining their "costs incurred" for the purpose of calculating their net financial shortfall under the Medicaid Act (the Medicaid Shortfall).[2] The 2017 Rule results in many hospitals experiencing a significant reduction in Disproportionate Share Hospital (DSH) reimbursement payments which Congress authorizes in order to offset costs incurred by hospitals that serve a disproportionate share of low-income patients. Children's hospitals are particularly negatively impacted by the 2017 Rule.

In its opinion, the D.C. Circuit reversed the district court, thoroughly rejecting the plaintiff hospital's arguments that the 2017 Rule exceeds the Secretary's authority under the Medicaid Act, or that it is arbitrary and capricious under the Administrative Procedures Act. First, the court held that, under the analytical framework established in *Chevron,*[3] the statute is not ambiguous because it contains an express delegation of authority to the Secretary to determine "costs incurred."[4] Next,

[1] *See* "Medicaid Program; Disproportionate Share Hospital Payments — Treatment of Third-Party Payers in Calculating Uncompensated Care Costs," 82 *Fed. Reg.* 16,114 16,122 (Apr. 3, 2017) ("the 2017 Rule").

[2] The Secretary previously attempted to enact the policies now codified in the 2017 Rule by posting FAQs on its website in 2010, without notice and comment required by the Administrative Procedures Act. Nixon Peabody successfully blocked the Secretary's attempt to end-run the APA on behalf of NP's New Hampshire hospital clients. *See N.H. Hosp. Ass'n v. Azar*, 887 F.3d 62, 75 (1st Cir. 2018). The First Circuit ruled that the 2010 FAQs were procedurally invalid, but declined to rule on the validity of the substantive policies contained in the FAQs (now codified in the 2017 Rule). *Id.*; *see also Children's Health Care v. Ctrs. for Medicare & Medicaid Servs.*, 900 F.3d 1022, 1025 (8th Cir. 2018); *Children's Hosp. of the King's Daughters, Inc. v. Azar*, 896 F.3d 615, 621 (4th Cir. 2018). Our prior alert on this subject is available here.

[3] *See Chevron U.S.A. Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 843-44 (1984).

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

the court found that the 2017 Rule is reasonable, dispensing with all four of the plaintiff hospital's arguments to the contrary. The plaintiff hospital's primary argument adopted by the district court was that the statute exclusively specifies which payments can be considered in calculating "costs incurred," and therefore the 2017 Rule cannot add additional payments to consider. Rejecting this argument, the court stated that "[a]lthough the statute establishes that payments by Medicaid and the uninsured *must* be considered, it nowhere states that those are the only payments that *may* be considered."[5]

The court also disagreed with the plaintiff hospital's argument that the 2017 Rule is arbitrary and capricious in reasoning. Specifically, the court was unpersuaded by the fact that, according to the administrative record, "CMS reduces DSH payments to the plaintiff hospitals when it considers private insurance payments, notwithstanding [that] 'they have among the highest Medicaid inpatient utilization rates in their respective states and the highest net financial shortfalls in serving Medicaid patients.'"[6] The court found that "the statute does not consider a hospital's actual costs; it considers only those costs that Medicaid pays for."[7] In other words, while ancillary programs and services that hospitals provide to patients "may be laudable," they are not to be considered for purposes of determining DSH payments.[8]

Implications

Hospitals that receive DSH payments will now have to net out payments received from Medicare and third-party payors from their Medicaid Shortfall calculation. Depending on the applicable state plan specifics, this netting out may reduce the actual DSH reimbursement. Further, because the 2017 Rule has been reinstated, audits completed during the time that the 2017 Rule was invalid and on appeal could be reopened to account for the third-party payment requirement. Hospitals should analyze how this change will impact issued and anticipated reimbursements. Overpayments could result in future set-offs.

For more information on the content of this alert, or how this change in the Medicaid Shortfall calculation may impact DSH payments under the operative state plan, please contact your Nixon Peabody attorney or:

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[5] *See Children's Hosp. of Texas v. Azar*, No. 17-cv-00844, p. 7 (D.C. Cir. Aug. 13, 2019) (emphasis in original).

[6] *Id.* at 15 (citing Plaintiffs' Br. 65).

[7] *Id.*

[8] *Id.* (quoting 82 *Fed. Reg.* at 16,118).