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Challenges to Medicare's Outlier Payment Rules - the Secretary Largely Prevails [Ober|Kaler]

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As we reported in an earlier *Payment Matters article*, the United States Court of Appeals for the District of Columbia Circuit handed hospitals a partial victory on May 19, 2015, in their challenge to Medicare outlier payments for FYs 2004-2006. *District Hospital Partners, LP, v. Burwell*, 786 F.3d 46 (D.C. Cir. 2015).

Specifically, the court agreed with the hospitals that, in calculating the outlier threshold for 2004, the Secretary of Health and Human Services (Secretary) had impermissibly failed to explain how data from 123 turbo-charging hospitals, previously identified in a proposed outlier correction rule, were treated. The court then remanded the case to the Secretary to explain her treatment of the turbo-charging hospitals and explain what additional measures, if any, were taken to account for the distorting effect that the turbo-charging hospitals had on the data set used in the 2004 rulemaking. The court, however, limited its remand order to FY 2004. The court concluded that, by 2005 and 2006, the turbo-charging problem had been addressed and that the Secretary's methodology for those years was reasonable. Thus, as earlier discussed, the hospitals' challenge was only partially favorable.

Now, the United States District Court for the District of Columbia has addressed the methodologies for additional years, concluding that, with the exception of the 2004 year rulemaking, the outlier payment regulations stand. In *Banner*, the court dealt with challenges that multiple hospitals mounted to the Secretary's outlier methodologies, and to her explanation of those methodologies, contained in regulations issued for FYs 1997 through 2007.

The court, for the most part, was unpersuaded by the hospitals' challenges. First, the court ruled that the actions taken by the Secretary reflected a reasonable interpretation of the statute. The court said that Congress had established the framework for the outlier payment scheme but had left the details to be fleshed out by the Secretary, thus implicitly delegating to the Secretary the power to fill those gaps. With respect to years prior to 2004, the court viewed the hospitals' arguments as essentially being that, contrary to statute, the Secretary had made outlier payments to hospitals that had high charges rather than hospitals that had high costs. The court, however, did not agree, ruling that the outlier thresholds established during this period were based on reasonable constructions of the statute. Similarly, for the FYs 2004 and later, the court rejected the hospital's statutory challenge that the rulemaking did not comply with a requirement that the Secretary's outlier thresholds produce outlier payments totaling between 5% and 6% of the projected DRG payments. Further, although the hospitals maintained that the statute required the Secretary to adjust her methodologies to reflect continued declines in the cost-to-charge ratios, the court concluded the Secretary's decision to use actual ratios rather than making adjustments was reasonable and consistent with her statutory mandate.

Having concluded that the Secretary's actions were consistent with the statute, the court then turned to the hospitals' assertion that the regulations were arbitrary and capricious. The court ruled that the choices considered by the Secretary were appropriate and that, with the exception of 2004, the Secretary had adequately explained her decisions. Moreover, the court stated that the fact that the Secretary had ultimately decided to change certain features of the payment scheme did not render the original decisions arbitrary and capricious. As for 2004, the district court noted that, in its *District Hospital Partners* decision, the D.C. Circuit

had concluded that the 2004 rulemaking was inadequate and required further explanation. As to the remaining years' challenges, however, the court simply was unpersuaded. The court found that the Secretary's explanation of what she did was adequate and neither arbitrary nor capricious.

Ober|Kaler's Comments

The United States Court of Appeals for the D.C. Circuit will presumably have the opportunity to review the *Banner* decision and evaluate whether it agrees with the district court's conclusions. Given the D.C. Circuit's prior ruling in *District Hospital Partners*, however, the hospitals will likely face an uphill battle in persuading the court that the Secretary's outlier regulations for years other than 2004 are invalid.