# PUBLICATION

## Partial Victory for Hospitals in Medicare Outlier Challenge [Ober|Kaler]

**May 29, 2015**

**In a decision issued May 19, 2015, the United States Court of Appeals for District of Columbia Circuit handed hospitals a partial victory in their challenge to their Medicare outlier payments for 2004. *District Hospital Partners, LP, d/b/a George Washington University Hospital, et al., v. Burwell*, Case No. 14-5061 (May 19, 2015) [PDF].**

## Background

Under the Medicare DRG system, hospitals are reimbursed a fixed amount per discharge regardless of their actual operating costs. Hospitals, however, inevitably care for patients whose hospitalization is extraordinarily costly. To address this, the statute allows the hospitals to receive outlier payments if their "charges, adjusted to cost, exceed... the sum of the applicable DRG prospective payment rate... plus a fixed dollar amount determined by the Secretary." 42 U.S.C. § 1395ww(d)(5)(A)(ii). The critical elements in this determination are the hospital's cost-to-charge ratio, the fixed loss threshold, and the outlier threshold. *See* 42 C.F.R. § 412.84(i)(2).

Prior to 2004, the outlier payment computation contained a structural weakness. Outlier payments are supposed to be made when the cost of care is extraordinarily high in relation to the average cost of treating comparable conditions or illnesses. Hospitals, however, were able to influence the computation by using the time lag between current charges on submitted bills, on the one hand, and the past cost reports that form the basis for the cost-to-charge ratio, on the other. Thus, if a hospital increased its charges significantly in the period between the filing of a cost report and the time the service was furnished, the cost-to-charge ratio would increase and, at least arguably, overestimate the hospital's costs. Taking advantage of this vulnerability, certain hospitals in the 1990s and early 2000s substantially increased their charges, through a practice known as "turbo-charging," to gain higher outlier payments. In June 2003, however, the Secretary issued an outlier correction rule to address this vulnerability.

## Discussion

At issue in the *District Hospital Partners* case was whether the outlier thresholds for 2004, 2005, and 2006 had been appropriately set by the Secretary. The hospitals argued that the Secretary was obligated to use the best data available in formulating the outlier thresholds for all three years and that she had not done so. The court, however, only partially agreed. The court ruled that the Secretary was not required to use the "best data available" in setting the threshold. The court ruled that while agencies do not have free reign to use inaccurate data, an agency is only required to examine the relevant data and articulate a satisfactory explanation for its action, including a rational connection between the facts found and the choices made. The court concluded that the Secretary's rulemaking satisfied this standard for 2005 and 2006, but failed for 2004.

With respect to the 2004 year, the hospitals had argued that the Secretary, in calculating the outlier threshold, should have addressed data from 123 turbo-charging hospitals identified in the proposed outlier correction rule. The court agreed, concluding that the Secretary had failed to explain in the 2004 IPPS rule how data from the 123 turbo-charging hospitals were treated. The court observed that as part of the 2004 rulemaking the

Secretary had identified 50 hospitals that had been consistently overpaid for outliers and that she had adjusted their data as part of the computation. The Secretary, however, did not explain how the 50 hospitals differed from the 123 hospitals identified previously in the correction rule. The court stated that by identifying only 50 turbo-charging hospitals in the 2004 rule, the Secretary acted in a manner that appeared to be inconsistent with the relevant data and did so without providing a satisfactory explanation of her actions. Accordingly, the court remanded the case to the Secretary for further proceedings, requiring the Secretary to explain why her computation was corrected only for the 50 turbo-charging hospitals rather than from the 123 hospitals identified in the earlier correction notice. The Secretary should also explain, the court said, what additional measures, if any, were taken to account for the distorting effect of the turbo-charging hospitals on the data set for the 2004 rulemaking.

Having addressed the 2004 rulemaking, the court next turned to the 2005 and 2006 rules, and in so doing was less concerned. The court concluded that for both years the Secretary's earlier correction notice had addressed the turbo-charging problem. By relying on data not materially affected by turbo-charging, the Secretary's methodology for those years was reasonable.

## Ober|Kaler's Comments

As even a casual observer knows, courts are inclined to extend a high degree of deference to the Secretary of Health and Human Services in her administration of the Medicare program. Even this deference, however, has its limits. The Secretary must act within the confines of the express statutory language. Furthermore, in her rulemaking, the Secretary must provide satisfactory explanations of her treatment of the relevant data and include a rational explanation of the facts found and the choices made. Absent such an explanation, the Secretary's rule will fail, requiring, at a minimum, that the Secretary do a better job on remand.