

PUBLICATION

Uncertainty Continues for Two-Midnight Rule's Payment Reduction [Ober|Kaler]

October 14, 2015

In *Shands Jacksonville v. Burwell*, No. CV 14-1477, 2015 WL 5579653, (D.D.C. Sept. 21, 2015), the United States District Court for the District of Columbia gave the Secretary of the Department of Health and Human Services (HHS) the opportunity to further explain and justify the need for the 2% payment reduction in the FFY 2014 standardized payments. This payment reduction portion of the “two-midnight rule” was challenged by the plaintiffs. Despite finding that the Secretary had the authority to make the 2% payment reduction, the court held that the Secretary’s rulemaking process was deficient.

Proposed in [May 2013 \[PDF\]](#) and finalized in [August 2013 \[PDF\]](#), the two-midnight rule allows Medicare contractors to assume that inpatient hospital admissions for patients expected to stay in the hospital for at least two midnights are appropriate. The Secretary stated that the two-midnight rule was designed to address hospitals’ concerns about the financial risk associated with admitting beneficiaries as inpatients that may ultimately be denied by Medicare contractors. To combat that risk, hospitals had been treating beneficiaries as long-term outpatients instead of admitting them. HHS used the two-midnight rule to clarify how to review inpatient hospital admissions for payment and when beneficiaries should be admitted as hospital inpatients. HHS anticipated that implementation of the two-midnight rule would result in more inpatient stays which would increase the cost to the Medicare program. To offset that cost increase, the Secretary proposed to reduce compensation for inpatient services by 2%. Many hospitals disagreed with the predicted increased costs and need for a payment reduction.

The plaintiffs challenged the Secretary’s authority to make an across-the-board payment reduction for inpatient services. The court examined the Secretary’s authority under the general statutory provision to create exceptions and adjustments and found it to be ambiguous. The court then found that the Secretary’s interpretation of her authority under the exceptions and adjustments provision was reasonable.

In addition, the plaintiffs contended that the Secretary violated the Administrative Procedure Act insofar as the hospitals were deprived of a meaningful opportunity to comment because the notice of proposed rulemaking left out information regarding HHS actuaries’ assumptions behind and methodology for setting the 2% payment reduction. For example, in determining the number of encounters that would likely shift from outpatient to inpatient status, the actuaries only reviewed outpatient claims for observation or a major procedure, and in estimating the number of encounters that would likely shift from inpatient to outpatient status, the actuaries only reviewed claims containing a surgical MS-DRG and not medical MS-DRGs. These assumptions and methodologies may have affected the number of encounters that HHS factored into the 2% payment reduction.

In its decision, the court emphasized that for the purposes of notice and comment rulemaking, agencies must identify and make available the studies, data, models, and methodologies on which their reasoning rests. Here, the court found that the Secretary failed to disclose key aspects of HHS’s methodology and critical assumptions used by HHS’s actuaries until after the comment period had ended. The court agreed with the plaintiffs and concluded that by omitting the important information, HHS had deprived the public and the plaintiffs of a meaningful opportunity to comment and thereby violated the APA.

Ultimately, the court remanded the matter to the Secretary to develop and publish additional justifications for the payment reduction. The court ordered the parties to confer and propose a timetable for repromulgation of the proposed rule with additional opportunity to comment.

Ober|Kaler's Comments

The court clearly found for the hospitals in determining that the Secretary's rule could not stand when she did not provide the data to support her assumptions and methodologies. However, the dispute as to whether the Secretary can justify her rule remains to be seen. Hospitals should continue to preserve this issue by including it as a protested amount on their filed cost reports.