No. 17-1408

In the Supreme Court of the United States

BRECKINRIDGE HEALTH, INC., ET AL., PETITIONERS

v.

ALEX M. AZAR, II, SECRETARY OF HEALTH AND HUMAN SERVICES

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Petitioners are hospitals that requested reimbursement under Medicare, as "cost[s] actually incurred," 42 U.S.C. 1395x(v)(1)(A), of payments they made under a state tax on healthcare providers. The question presented is whether the Department of Health and Human Services reasonably determined that petitioners should be reimbursed for the amount of the tax assessed against them, less the amount of payments that petitioners received from a state trust funded by that tax.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-13a) is reported at 869 F.3d 422. The order of the district court (Pet. App. 14a-29a) is reported at 193 F. Supp. 3d 788.

JURISDICTION

The judgment of the court of appeals was entered on August 23, 2017. A petition for rehearing was denied on November 8, 2017 (Pet. App. 49a). On January 22, 2018, Justice Kagan extended the time within which to file a petition for a writ of certiorari to and including April 7, 2018, and the petition was filed on April 9, 2018 (a Monday). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Medicare is a federally funded health insurance program for the elderly and disabled. Medicare reimburses certain hospitals based on their "reasonable costs." 42 U.S.C. 1395f(*l*)(1); see 42 U.S.C. 1395i-4; see; see also 42 C.F.R. 413.70(a). Reasonable costs are defined by statute to include "cost[s] *actually incurred*, excluding therefrom any part of incurred cost found to be unnecessary in the efficient delivery of needed health services." 42 U.S.C. 1395x(v)(1)(A) (emphasis added). The same provision assigns to the Secretary of Health and Human Services responsibility to develop "the method or methods to be used, and the items to be included, in determining such costs." *Ibid.*

The Secretary has long interpreted those statutory provisions as requiring a net-cost approach. See, *e.g.*, *Abraham Lincoln Mem'l Hosp.* v. *Sebelius*, 698 F.3d 536, 551-552 (7th Cir. 2012) (*Abraham Lincoln*); *Abbott-Northwestern Hosp., Inc.* v. *Schweiker*, 698 F.2d 336, 339 (8th Cir. 1983). Under such an approach, providers must reduce their claimed costs to account for related money they have received. See, *e.g.*, 42 C.F.R. 413.98(c) (providing that discounts, allowances, or rebates received after expenses were incurred are applied to reduce reimbursement for "comparable purchases or expenses"); U.S. Dep't of Health & Human Servs., Ctrs. for Medicare & Medicaid Servs., *Provider Reimbursement Manual* § 2302.5 (PRM) (requiring that claimed costs be offset by recoveries on losses or income from "sales of scrap or incidental services"); *id.* § 809 (requiring that claimed costs for vendors be reduced by amounts of vendors' lease payments).

For indirect costs, such as overhead expenses, Medicare reimburses hospitals only for the portion of their

costs that are attributable to Medicare patients. See generally 42 C.F.R. 413.5. Under some circumstances, hospitals may claim state tax payments as indirect Medicare costs. See PRM § 2122.1. In 2010, the Secretary promulgated a final rule (2010 Rule) explaining that, as with other expenses, hospitals may only claim tax costs to the extent that those costs were "actually incurred." See 75 Fed. Reg. 50,042, 50,362 (Aug. 16, 2010); see *id.* at 50,362-50,364.

2. Medicaid is a joint federal-state program that helps fund medical care for individuals with limited income. Under the Medicaid program, state plans are required to provide an upward rate adjustment for hospitals that serve a "disproportionate number of low-income patients with special needs." 42 U.S.C. 1396a(a)(13)(A)(iv). "The purpose of this adjustment is to give relief to those hospitals that have few privately insured patients to counteract the losses incurred from a large volume of uninsured patients." Pet. App. 5a-6a.

Kentucky funds these upward adjustments, known as disproportionate-share hospital (DSH) payments, through a redistributive scheme. Kentucky imposes a 2.5% tax on providers' gross revenues for certain services. Ky. Rev. Stat. Ann. § 142.303(1) (LexisNexis 2010). All proceeds from these provider taxes, known as "KP-Tax" assessment payments, are deposited into the State's Medical Assistance Revolving Trust (MART) fund, where they are supplemented with federal and state matching funds. *Id.* § 205.640(2) and (3)(a) (LexisNexis 2013). The contents of the MART fund are then distributed back to hospitals, as DSH payments, based on each hospital's relative share in caring for indigent patients. *Id.* § 205.640(3)(a) and (d); see Pet. App. 3a. Collecting a provider tax from hospitals

and then redistributing the money back to hospitals in this manner effectively allows the States to collect additional federal matching funds for the State's Medicaid program. See *Abraham Lincoln*, 698 F.3d at 544.

3. a. Petitioners are Kentucky hospitals that sought reimbursement from Medicare, as "reasonable cost[s]" under the program, for the entire amounts of their KP-Tax payments into the MART fund. Pet. App. 3a. The Medicare Administrative Contractor denied full reimbursement, instead "offsetting the KP-Tax cost by the amount of Medicaid DSH payments [petitioners] received." *Ibid.* Petitioners appealed to the Provider Reimbursement Review Board (Board), see 42 U.S.C. 1395*oo*(a), which agreed that the offset was warranted. Pet. App. 3a. The Board explained that, for purposes of Medicare reimbursement, a Kentucky hospital's "actually incurred" cost was its *net* liability to the MART fund. *Id.* at 39a-40a, 46a. The Administrator of the Centers for Medicare & Medicaid Services issued a final decision declining to modify the Board's decision. *Id.* at 4a.

b. Petitioners sought judicial review, and the district court affirmed the Board's decision. Pet. App. 14a-29a. The court noted that "when [a hospital] receive[s] a Kentucky Medicaid DSH distribution, it is necessarily receiving back from the MART Fund some or all of the money that it paid into the MART Fund when it paid the KP-Tax assessment." *Id.* at 23a (citation omitted). The court therefore "agreed with the [Board] that the net economic impact of [petitioners'] receipt of the DSH payment in relation to the cost associated with the KP-Tax assessment indicated that the DSH payments served to reduce [petitioners'] expenses such that they constituted a refund." *Id.* at 4a. The court also rejected petitioners' argument that the offset was impermissible

because it conflicted with the 2010 Rule, which, petitioners claimed, "requires a payment to be made specifically for the purpose of reimbursing a tax in order for the claimed reimbursement to be offset by the payment." *Ibid.* The court concluded that the 2010 Rule merely "requires evidence that the Medicaid DSH payment and the provider tax are related in some manner prior to offsetting the Medicaid DSH payment from the provider tax under the Medicare Act," a requirement that "is consistent with the Secretary's decision in the present case." *Id.* at 28a; see *id.* at 27a-28a.

c. The court of appeals affirmed, concluding that the agency's "decision to uphold the offset was not arbitrary, capricious, or manifestly contrary to the legislative scheme." Pet. App. 7a; see *id.* at 1a-13a.

At the outset, the court of appeals explained that the core issue in this case is the same as the one addressed by the Seventh Circuit in *Abraham Lincoln*, *supra*. Pet. App. 7a. There, the Seventh Circuit affirmed the agency's conclusion that an Illinois tax assessment paid by state hospitals "was a reasonable cost eligible for Medicare reimbursement, but was subject to an offset by payments the hospitals received from the state Medicaid fund." *Ibid.* (citing *Abraham Lincoln*, 698 F.3d at 540). Based on a "totality of the circumstances" approach, the Seventh Circuit had concluded that "the real net economic impact" of the scheme was such that the fund payments offset the costs of the tax. *Id.* at 8a-9a (citing *Abraham Lincoln*, 698 F.3d at 551-552).

The court of appeals in this case noted that "[t]he fundamental elements of the Illinois and Kentucky schemes are the same: under both systems, a tax is paid into a fund, that tax is commingled with other sources, and Medicaid payments derived from that fund are

made to hospitals." Pet. App. 9a. Viewing the Kentucky scheme based on the "totality of the circumstances," the court explained, "when a provider receives a payment from that fund, the payment serves at least as a partial refund of the tax." *Ibid.* The court acknowledged that some "differences" do exist between the Illinois scheme at issue in *Abraham Lincoln* and the Kentucky scheme at issue here. *Ibid.* But those differences, the court concluded, "do not make the net economic effect of [petitioners'] DSH payments out of a fund consisting of their KP-tax payment any less of a refund." *Id.* at 10a.

Finally, the court of appeals rejected petitioners' argument that the offset was inconsistent with the 2010 Rule. Pet. App. 12a-13a. That rule, the court explained, "clarifies that for a tax to be reduced by a separate payment, the payment need only be 'associated with the tax.'" *Id.* at 13a (citing 75 Fed. Reg. at 50,363). The court concluded that petitioners had "set forth no meaningful argument that the DSH payments, derived from a fund consisting of the KP-Tax, is not 'associated with' that tax." *Ibid.*

d. Petitioners filed a petition seeking rehearing and rehearing en banc. Pet App. 49a. The petition was denied, with no judge requesting a vote. *Ibid.*

ARGUMENT

Petitioners renew their argument (Pet. 26-35) that the court of appeals erred in concluding that the amounts they have paid into the MART fund under Kentucky's provider tax may reasonably be offset by payments received back from the State out of that fund for purposes of determining the amount of reimbursement a hospital receives under Medicare. The decision below is correct and is consistent with decisions of other courts of appeals upholding the agency's application of

a "net cost" approach to structurally similar state tax payment programs.

Petitioners separately argue (Pet. 22-26) that the courts of appeals are divided "regarding the deference owed to agency decisions that include embedded issues of state law." The court of appeals here did not defer to the agency regarding any state-law issue, nor did it consider whether such deference would have been appropriate. Further review is not warranted.

1. Medicare authorizes reimbursement for "reasonable cost[s] * * * actually incurred," and it gives the Secretary authority to develop "the method or methods to be used, and the items to be included, in determining such costs." 42 U.S.C. 1395x(v)(1)(A). Under that authority, the Secretary has promulgated regulations requiring a net-cost approach, under which "refunds of previous expense payments are" treated as "reductions of the related expense." 42 C.F.R. 413.98(a); see PRM § 800 (same); see also 42 C.F.R. 413.98(b)(3) (defining "Refunds" as "amounts paid back or a credit allowed on account of an overcollection"). As explained in the 2010 Rule, the same net-cost approach applies when reimbursement is sought for "taxes assessed against a provider." 75 Fed. Reg. at 50,362; see *id.* at 50,362-50,364. The amount of reimbursement for any taxes paid by a provider, therefore, must be "reduced by payments the provider received that are associated with the assessed tax." *Id.* at 50,363 (emphasis omitted).

a. The Board correctly determined that, under a net-cost approach, petitioners' reimbursement for the KP-Tax assessments they paid into the MART fund should be offset by the DSH payments they received from the fund. DSH payments are "derived from" the same fund into which the tax payments are deposited,

Pet. App. 9a, and under state law, such payments "shall be used to fund the disproportionate share program." Ky. Rev. Stat. Ann. § 205.640(3)(a) (LexisNexis 2013). The DSH payments are thus plainly "associated with the assessed tax." 75 Fed. Reg. at 50,363. The "net economic effect" of the scheme, moreover, is "that when a provider receives a payment from that fund, the payment serves at least as a partial refund of the tax." Pet. App. 9a-10a. The court of appeals was therefore correct that the agency's "offset decision was not arbitrary, capricious, or manifestly contrary to the Medicare statute." *Id.* at 10a; see 5 U.S.C. 706(2)(A).

Petitioners nevertheless argue (Pet. 27-28) that "the disproportionate-share hospital payments have no substantive relation to the provider taxes at all," because it is "impossible to definitively trace any portion of the disproportionate-share payment a hospital received to the MART fund, much less to the taxes it had originally paid." Yet petitioners offer no basis in the statute for their suggestion that tax assessments may be offset by refund payments only if those payments may be "definitively trace[d]" back to the assessments. Nor is it consistent with the regulations, which provide that such payments are properly treated as "reductions of [a] *related expense*." 42 C.F.R. 413.98(a) (emphasis added). For similar reasons, there is no merit to petitioners' suggestion (Pet. 28) that a hospital's DSH payments are unrelated to its KP-Tax assessments because the amount of the tax it pays is fixed (at 2.5% of gross revenues), while DSH payments "are calculated on the basis of the proportion of state-wide indigent care each hospital provided during the previous year." As the Board explained, because *all* KP-Tax assessments are deposited into the MART fund, and the DSH payments are made

from the MART fund, "the provider tax and the Medicaid DSH payment are inextricably linked," Pet. App. 43a, even if particular hospitals receive more or less from the fund depending on the amount of indigent care they provide in a given year.

Petitioners further argue (Pet. 29-32) that the decision below is inconsistent with statutory and regulatory requirements. In particular, they contend that if hospitals are denied full reimbursement for the amount of the KP-Tax assessments, those hospitals will be forced to assume some of the costs of providing Medicare services, in contravention to the "principle that 'the necessary costs of efficiently delivering covered services to [patients covered by Medicare] will not be borne by individuals not so covered.'" Pet. 29-30 (quoting 42 U.S.C. 1395x(v)(1)(A)) (brackets in original). Yet that argument assumes, contrary to the foregoing, that the payments do not constitute refunds for the tax assessments. That assumption is incorrect for the reasons stated. See Pet. App. 9a ("[W]hen a provider receives a payment from that fund, the payment serves at least as a partial refund of the tax."). Nor are petitioners correct in arguing (Pet. 31) that DSH payments cannot qualify as "refunds" under the applicable regulations because they are not tied to "overcollection[s]," 42 C.F.R. 413.98(b)(3), or "overpayments," PRM § 802.31. That argument, which petitioners did not make below, gives the regulations an unduly narrow reading. Because the DSH payments have the effect of "mak[ing] the provider whole or partly whole for the tax expenses," 75 Fed. Reg. at 50,363, they are properly considered repayment for at least part of the provider tax assessed against them.

Finally, petitioners reiterate their argument that the decision below is inconsistent with the 2010 Rule, which, they claim, permits offset only where "payments that are associated with the assessed tax are made to providers *specifically* to make the provider whole or partly whole for the tax expenses." Pet. 31 (quoting 75 Fed. Reg. at 50,363) (some emphasis omitted). As the court of appeals explained, when the relevant portion of the 2010 Rule is read in context, it makes clear "that for a tax to be reduced by a separate payment, the payment need only be 'associated with the tax.'" Pet. App. 13a (citing 75 Fed. Reg. at 50,363). Petitioners have "set forth no meaningful argument that the DSH payments, derived from a fund consisting of the KP-Tax, is not 'associated with' that tax." *Ibid.*

b. Petitioners do not contend that any other court of appeals has overturned a decision by the agency requiring that provider payments be used to offset reimbursement for state tax assessments under a program similar to Kentucky's. To the contrary, the decision below is consistent with decisions of other courts of appeals that have upheld the application of offsets where state provider taxes were collected from hospitals and the proceeds (supplemented by federal matching funds) were redistributed back to the same hospitals in the form of Medicaid payments. See *Dana-Farber Cancer Inst.* v. *Hargan*, 878 F.3d 336 (D.C. Cir. 2017); *Abraham Lincoln Mem'l Hosp.* v. *Sebelius*, 698 F.3d 536 (7th Cir. 2012); see also *Kindred Hosps. E., LLC* v. *Sebelius*, 694 F.3d 924 (8th Cir. 2012) (addressing a private pooling arrangement with a similar net effect). Petitioners argue (Pet. 32) that those decisions "involved fundamentally different state statutory schemes." But as the court below explained, despite some differences, the

"fundamental elements" of the schemes "are the same: * * * a tax is paid into a fund, that tax is commingled with other sources, and Medicaid payments derived from that fund are made to hospitals." Pet. App. 9a. When viewed under a "totality of the circumstances," therefore, the "net economic effect" of each of the schemes is similar. *Id.* at 9a-10a. In any event, even if petitioners were correct that those other States' schemes were meaningfully different, that would not suggest that this Court's review of the decision below would be warranted.

2. Petitioners contend (Pet. 22) that this Court's intervention is necessary "to resolve a conflict among the circuits regarding the deference owed to agency decisions that include embedded issues of state law." Any such conflict is not implicated by this case, however. The court of appeals did not defer to the agency's interpretation of state law, nor did it consider whether such deference would have been warranted.

In the district court, petitioners argued that the Board's decision did not merit deference because it was inconsistent with the Medicare statute and regulations and therefore was "plainly erroneous," D. Ct. Doc. No. 33, at 5 (Jan. 19, 2016), and also because it was "inconsistent" with the 2010 Rule, *id.* at 7; see *id.* at 5-10. Petitioners did not argue that the Board had incorrectly resolved any "embedded" issue of state law. Pet. 22. Nor did petitioners raise that argument on appeal. Petitioners argued instead that the district court had "improperly deferred to the Secretary's plainly erroneous interpretation of the Medicare cost statute and refund regulation," Pet. C.A. Br. 18 (capitalization altered); see *id.* at 18-21, and petitioners again argued that the Board's offset determination was inconsistent with the

2010 Rule, *id.* at 25-29. Petitioners first raised the issue of deference to interpretations of state law in their petition for rehearing, see Pet. for Reh'g 7-9, but their petition was denied, with no judge requesting a vote, Pet. App. 49a.

Although petitioners did not raise the issue before the court of appeals until the rehearing stage, petitioners now assert that the court "declined * * * to engage in de novo review of the Kentucky statutes, and instead merely held that the agency's view that the disproportionate-share hospital payments were a refund of the tax payments 'seem[ed] plausible.'" Pet. 22 (quoting Pet. App. 9a) (brackets in original). Petitioners' assertion is based on a single sentence in the decision below, which reads in full: "It seems plausible then, that when a provider receives a payment from [the MART] fund, the payment serves at least as a partial refund of the tax." Pet. App. 9a. The sentence thus refers to the plausibility of the Board's conclusion that a DSH payment "serves at least as a partial refund" of a hospital's KP-Tax assessment. That conclusion is an application of the federal statutory requirement that only costs "actually incurred" be reimbursed, 42 U.S.C. 1395x(v)(1)(A), and the regulatory requirement that "refunds of previous expense payments" should be treated as "reductions of [a] related expense," 42 C.F.R. 413.98(a); see PRM § 800 (same). Although an understanding about the general operation of state law informed that conclusion, the court did not resolve any dispute about the *meaning* of state law. Rather, the court merely relied on the fact that "Kentucky law states that 'provider tax revenues and state and federal matching funds shall be used to fund the disproportionate share program.'" Pet. App. 9a (quoting Ky. Rev.

Stat. Ann. § 205.640(3)(a) (LexisNexis 2013)) (emphasis omitted). Petitioners do not—and could not—dispute that fact, even if they do not agree with the conclusion that the court drew from it as a matter of federal law.

Because the decision below did not rely on deference in resolving any dispute about the meaning of state law, it is fundamentally unlike the decisions cited by petitioners (Pet. 23-24), in which such state-law interpretive disputes affected the case's outcome. See, *e.g.*, *Singh* v. *Ashcroft*, 386 F.3d 1228, 1233 (9th Cir. 2004) (holding that conviction under Oregon's anti-harassment law is not a crime of violence for immigration purposes, based on "[t]he necessary elements of the Oregon crime of harassment, as defined by the statute and case law"); *Cellwave Tel. Servs. L.P.* v. *FCC*, 30 F.3d 1533, 1535 (D.C. Cir. 1994) (declining to defer to agency decision that was based on partnership law "as [the FCC] read Delaware law"); *Board of Governors of the Univ.* v. *United States Dep't of Labor*, 917 F.2d 812, 816 (4th Cir. 1990) (declining to defer to agency's "construction of a state statute" regarding whether State's university system was one state agency rather than several separate agencies), cert. denied, 500 U.S. 916 (1991).

3. Finally, although petitioners contend that "the question presented is of critical importance," Pet. 14 (capitalization altered), petitioners offer no sound reason that review should be granted in absence of a circuit conflict. Petitioners argue at length (Pet. 15-21) that Kentucky hospitals are struggling because they are under-compensated in providing care for low-income patients. But *Medicare* provides reimbursement only for the direct costs of providing care to Medicare patients and for the portion of hospitals' overhead operat-

ing costs attributable to those patients; it is not intended to make up for other shortfalls in hospitals' funding.

Petitioners' argument appears to be that they should receive additional Medicare payments because they have uncompensated costs in caring for low-income, *non*-Medicare patients. The court of appeals, while describing itself as "sympathetic" to petitioners' claims that they "have incurred costs of providing indigent care that have not fully been reimbursed," explained the flaw of petitioners' logic: Petitioners seek reimbursement under Medicare based on "the net economic effect of DSH payment[s] on *all* of the costs incurred, not simply on the KP-tax cost incurred. Under this logic, hospitals would have to be reimbursed [by Medicare] fully for every cost they paid up until the point that they are fully compensated for indigent care." Pet. App. 10a n.2. That approach "would render null the refund provisions in all cases where a hospital is not completely compensated for this care," and has no basis in the Medicare statute or regulations. *Ibid.*

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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