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When Can the Government Issue a Retroactive Medicare Reimbursement Rule? A Preview of Bowen v. Georgetown University Hospital

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When Can the Government Issue a Retroactive Medicare Reimbursement Rule?

by Robert Schwartz

Otis R. Bowen
v.
Georgetown University Hospital
(Docket No. 87-1097)

Argument Date: October 11, 1988

ISSUES

The only issue before the Court is whether the Secretary of Health and Human Services can issue a regulation with entirely retroactive effect governing Medicare reimbursement for healthcare providers. The Court must decide whether such a retroactive rule is permitted by the Administrative Procedures Act (the "APA"), which defines a rule as "an agency statement of either general or particular applicability and *future* effect," or by the Medicare statute, which authorizes the Secretary to issue regulations to provide for the reimbursement of the "reasonable costs" of hospitals providing Medicare services.

If the Court uses this case to determine whether retroactive rulemaking is permitted under the APA generally, the decision will have substantial impact on virtually every federal administrative agency. If the Court finesses the APA issue by relying only upon the Medicare statute, it will have a very narrow impact, affecting only some hospitals' reimbursement for Medicare services rendered during parts of 1981 and 1982.

FACTS

Ever since the Medicare statute was first enacted in 1965 it has provided that Medicare providers be reimbursed for the reasonable costs they incur in providing services to qualified Medicare recipients. These costs are determined by the Secretary of Health and Human Services. Originally these reasonable costs were determined retrospectively by looking at the actual costs incurred by each of the institutions that provided Medicare services. In 1972 Congress authorized the Secretary to provide some prospective cost limits in the hope that these absolute ceilings on reimbursable costs, published before the hospitals provided the services and sought reimbursement, would encourage hospitals to be more efficient. Beginning in 1974 the Secretary did issue annual regulations providing for prospective cost limits on the routine operating costs (like room and meal services) of hospitals serving Medicare patients. Over the next five years the Secretary used various systems to determine the actual prospective cost limits, but each year the limits were regionally adjusted for geographical factors that made healthcare more expensive to provide in some areas than in others.

In 1979 the Secretary divided the routine operating costs that were to be prospectively limited into two different kinds of costs: wage costs and all other costs. For each relevant geographical area, the national wage cost limit was adjusted by an index of local wage costs. This index, provided by the Bureau of Labor Statistics, was figured by dividing the average monthly hospital wage in the relevant geographical area by the national average monthly hospital wage. Thus, a Medicare provider in an area that had wage costs that were 10 percent higher than the national average would have a wage cost index (and thus a wage cost reimbursement ceiling) that was 10 percent higher than the national average; a provider in an area with lower than average wage costs would have a lower wage cost ceiling, and, consequently, lower Medicare reimbursement for wage costs.

The 1980 regulation followed the 1979 form, but in 1981 the Secretary changed the formula for figuring the regional wage cost indexes by excluding federal hospitals from the calculations. Thus, the 1981 indexes depended only upon wages paid by private, state, and local hospitals. The Secretary determined that the regional indexes would be more accurate with the federal exclusion because the federal hospitals used national pay scales and thus did not reflect local labor costs. Because the federal hospital wage costs tended to be higher than the wage costs of other hospitals, the 1981 change in the formula worked to the disadvantage of Medicare providers in areas with substantial federal health facilities. Local Medicare providers in cities with federal hospitals thought that the change was economically unjustified because the non-federal hospitals had to compete with those federal healthcare providers for employees, and thus the wages they paid were largely determined by those paid by the federal institutions.

Although the Secretary had issued all of the cost limit regulations from 1974 through 1980 in accord with the public participation provisions of the APA, the Secretary dispensed with those procedures in issuing the 1981 regulations, arguing that the "minor technical changes" instituted by excluding federal facilities from the 1981 indexes provided "good cause" for avoiding the notice and comment process that previously had been followed. The adversely

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affected hospitals immediately challenged the regulation in the United States District Court in the District of Columbia, and in 1983 the district court declared the 1981 regulation to be invalid on the grounds that there had not been adequate "good cause" for the Secretary to waive the notice and comment provisions of the APA. The district court left the enforcement of its declaration of invalidity to the administrative process established under the Medicare act, and the Medicare providers were ultimately reimbursed based on a wage index that included federal hospitals.

Not about to knuckle under to the district court's finding of invalidity of the rule, in 1984 the Secretary instituted a formal rulemaking procedure under the APA to adopt the previously invalidated 1981 regulation for retroactive application. Because the method of Medicare reimbursement had substantially changed in 1982 and again in 1983, the effect of the 1984 regulation was to be entirely retroactive—it was to apply only to reimbursement reporting periods that began between July 1, 1981 and September 30, 1982, the period that would have been covered by the original 1981 regulation. After notice and the comment period required by the APA, the Secretary "curatively" adopted the original 1981 regulation, and sought to recover the "overpayments" that had been made to the hospitals after the original promulgation of the 1981 regulation had been declared invalid.

After pursuing their administrative remedies the hospitals again sought relief in the United States District Court for the District of Columbia. This time the district court applied a balancing test to determine if the 1984 regulation, which was procedurally properly promulgated, could be applied retroactively to the 1981 cost reporting period. The district court decided that the ill effect of the retroactive application of the regulation outweighed the inequitable effect of failing to apply it retroactively, and thus the district court once again found the regulation invalid. The Court of Appeals for the District of Columbia Circuit affirmed the district court, but with different reasoning. Instead of applying a balancing test, the court of appeals determined that the APA governed the promulgation of the rule in question, and that the language of the APA required that rules have only future, not retroactive, effect (821 F.2d 750, 1987). The Supreme Court granted the Secretary's petition for *certiorari.*

BACKGROUND AND SIGNIFICANCE

Technically, very little depends on the actual decision in this case; the validity of the rule will determine the appropriate reimbursement of many Medicare providers for cost reporting periods that began during a fifteen month period in 1981 and 1982. However, the Court is called upon to address the propriety of retroactive rulemaking under two statutes—the APA and the Medicare Act. If the Court decides the circumstances under which the APA permits retroactive rulemaking, the opinion will be extremely significant because it will affect virtually every federal agency. On the other hand, if the Court decides that the Medicare Act either specifically permits or specifically prohibits this kind of retroactive rulemaking, it will not be required to address the applicability of the APA to retroactive rulemaking of other agencies, and the opinion will be of much narrower interest.

If the Court determines whether agencies can issue retroactive rules under the APA, it can reach any one of three conclusions. The first, which forms the basis of the hospitals' position, is that retroactive rulemaking is not permitted by the APA. This argument is based on the language of the APA (which limits a "rule" to a statement of "future effect"), and on the long history of common law suspicion of retroactive government action. Indeed, this suspicion was one of the primary reasons for the public participation and "future effect" requirements for rulemakig under the APA.

Alternatively, the Court could adopt the Secretary's position that the "future effect" provision of the APA requires only that a rule be enforced in the future, not that the rule be applied only to events or transactions that occur after its promulgation. This interpretation of the APA would specifically permit the kind of "curative" rulemaking done by the Secretary here. As the court of appeals pointed out in this case, however, under this interpretation "agencies would be free to violate the rulemaking requirements of the APA with impunity if, upon invalidation of a rule, they were free to 'reissue' the rule on a retroactive basis." The Secretary counters that his interpretation of "future effect" is especially appropriate where an agency is merely curing a procedural defect in the earlier promulgation of a rule. He suggests that the primary policy reason to limit retroactive lawmaking is to avoid the unfair surprise application of law to someone who cannot now alter past practice to account for the law's consequences. Where there has been a timely but procedurally defective attempt to issue a regulation, the Secretary argues, those affected by it cannot claim that they were without notice of the government's intentions.

The Court could take a middle ground in determining the validity of a retroactive rule under the APA. The Court could apply a balancing test to determine if rules could be given retroactive affect. Forty years ago the Court was called upon to determine what retroactive effect could be given to new governing principles applied by an administrative agency in the course of adjudicating a particular case. The Court there said that retroactive application of the principle would be appropriate only when the "mischief of producing a result which is contrary to a statutory design or to legal and equitable principles...is greater than the ill effect of the retroactive application of a new standard." The application of this balancing test to formal rulemaking under the APA could yield a decision favoring either side in this case; it would be a matter of analysis of the facts.

Finally, the Court could avoid any APA analysis by deciding the case on the basis on the Medicare Act. The hospitals claim that the section of the Medicare Act which authorizes the Secretary to set up cost ceilings "*to be recognized* as reasonable..." requires the Secretary to act prospectively. If the Court adopts this reading of the Medicare statute, the APA arguments become irrelevant.

On the other hand, the Secretary depends upon another part of the Medicare statute which expressly authorizes the Secretary to promulgate "regulations ... for the making of suitable corrective adjustments where, for a provider of services ..., the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive." This provision, he argues, provides for retroactive application of cost limits, and thus trumps any prohibition on retroactive rulemaking that would be imposed by the APA. The hospitals argue that this statutory provision applies only to adjudications involving inadequate or excessive reimbursements of particular hospitals in particular cases. If the Court adopts the Secretary's reading of this portion of the Medicare Act, the APA arguments are similarly irrelevant.

ARGUMENTS

For Otis R. Bowen, Secretary of Health and Human Services *(Counsel, Thomas W. Merrill, Deputy Solicitor General, Department of Justice, Washington, DC 20530; telephone (202) 633-2217)*

1. Neither the APA nor the Medicare Act bars the Secretary from promulgating a retroactive cost limit rule under the general rulemaking authority of the Medicare Act.
2. The Medicare Act specifically authorizes the Secretary's promulgation of a retroactive cost limit rule to prevent excessive reimbursement.

For Georgetown University Hospital *(Counsel of Record, Ronald N. Sutter, 1015 Eighteenth Street, NW, Ninth Floor, Washington, DC 20036; telephone (202) 466-6550)*

1. The Medicare Act precludes the Secretary from issuing a retroactive cost limit rule.
2. The APA generally bars the Secretary from issuing a rule which has a "primary" retroactive effect.
3. The Secretary's "curative rulemaking" defense is unsupported by law and an affront to the integrity of the administrative process.
4. If a balancing test is applicable, the ill effects of the Secretary's retroactive rule far exceed any possible statutory interest underlying the rule.

AMICUS ARGUMENTS

In Support of Georgetown University Hospital

The Sisters of Mercy Health Corporation and the Michigan Hospital Association filed an amicus brief pointing out that they are currently litigating exactly the same issue before the Sixth Circuit Court of Appeals. In that case the district court upheld the validity of the 1984 retroactive regulation.

The Ohio Power Company filed an amicus brief because it has recently asked the Supreme Court to review a court of appeals decision which, it claims, improperly permits retroactive rulemaking under the APA in a context unrelated to the Medicare statute. This amicus is concerned with the effect of retroactive rulemaking by the Environmental Protection Agency, and the brief argues that the ancient and important common law limitations on retroactive rulemaking can be overcome only by explicit statutory authorization permitting an agency to adopt rules affecting past transactions or events.

The American Hospital Association filed an amicus brief supporting Georgetown University Hospital's interpretation of the APA and the Medicare statute.