

Hospital Groups File Lawsuits Challenging “Two-Midnight” Rule

On April 14, 2014, the American Hospital Association (AHA), along with several state hospital associations and large healthcare systems, filed two lawsuits in the federal district court of Washington, D.C., against the U.S. Department of Health and Human Services (HHS), seeking to enjoin enforcement of the “two-midnight” rule finalized in August 2013.¹ The first lawsuit seeks to overturn the 0.2% rate cut to hospitals imposed by the Centers for Medicare & Medicaid Services (CMS) to pay for the cost of the *Recovery Audit Contractor* (RAC) reviews. The second lawsuit seeks to throw out three distinct parts of the CMS Final Rule entitled, “*Medicare Program; Hospital Inpatient Prospective Payment Systems for Acute Care Hospitals and the Long-Term Care Hospital Prospective Payment System and Fiscal Year 2014 Rates; Quality Reporting Requirements for Specific Providers; Hospital Conditions of Participation; Payment Policies Related to Patient Status*”:

- (1) The “two-midnight” rule;²
- (2) The one-year filing limit on a hospital’s revised claims after RAC denial;³ and,
- (3) The requirement of written physician orders for each inpatient stay at a hospital.⁴

Four health systems and four state hospital groups joined the AHA in its lawsuit against resigning HHS Secretary Kathleen Sebelius, including: (1) The Hospital & Healthsystem Association of Pennsylvania; (2) New Jersey Hospital Association; (3) Healthcare Association of New York State; (4) Greater New York Hospital Association; (5) Banner Health; (6) Einstein Healthcare Network (7) Wake Forest University Medical Center; and, (8) Mount Sinai Hospital.⁵ The parties requested that the rules both be declared invalid and that the hospitals listed in the complaint receive reimbursement for the medical care at issue in the cases.⁶

The two lawsuits focus on the rules and regulations concerning “inpatient” status, in contrast to “outpatient” status, and how those determinations are reported, reviewed, and reimbursed under the “two-midnight” rule.⁷ Generally, hospital care for inpatient services is reimbursed under Medicare Part A, while hospital care for outpatient services is reimbursed under Medicare Part B.⁸ Designating a patient as “inpatient” or “outpatient” affects both the processes to provide medical care for that patient and the rate of reimbursement to the hospital for that care, as Part A reimbursement rates for hospital care are higher than

Part B reimbursement rates for doctor care.⁹ Furthermore, outpatient care reimbursement under Medicare Part B often does not cover operating costs for patients under observation status.¹⁰ As illustrated above, a simple classification can have a significant impact on the overall Medicare reimbursement to hospitals and their providers for healthcare delivery services.

As noted in a previous Health Capital Topics article, under the “two-midnight” rule, a hospital patient qualifies as an “inpatient” when two requirements are met¹¹:

- (1) The patient must be “*formally admitted following a physician order for hospital inpatient admission*,”¹² and,
- (2) The formal admission order must state that the admission designation as “inpatient” is “*reasonable and necessary based on how long beneficiaries have spent, or are reasonably expected to spend, in the hospital as inpatients*.”¹³

Importantly, RAC reviews presume that the “*reasonable and necessary*” prong is satisfied when the patient “*require(s) more than 1 Medicare utilization day*,” which CMS defines as patient visits “*crossing two ‘midnights’*.”¹⁴ The rule additionally states that patient visits to a hospital *not* spanning two midnights may nevertheless be classified as “inpatient” if “*there is clear physician documentation in the medical record*” that supports the admitting physician’s expectation that the patient required care over a period crossing two midnights.¹⁵ “Inpatient” classifications remain subject to external review by an RAC, and the RAC uses the “two-midnight” rule, as well as CMS standards governing activities such as proper coding,¹⁶ to judge whether a hospital properly submitted a Medicare claim for reimbursement under Part A.

The first lawsuit against HHS seeks to invalidate the “two-midnight” rule’s provision decreasing hospital reimbursement rates under Medicare Part A by 0.2%. Each claim submitted under Medicare Part A is subject to this rate cut,¹⁷ which applies to both base discharge reimbursements under Part A, as well as reimbursements for capital expenses under Part A.¹⁸ The rule stated that the cut will offset what CMS estimates to be an additional \$220 million in expenditures under Medicare Part A due to the “two-midnight” rule.¹⁹ However, the Plaintiffs assert that this \$220 million will actually be borne by hospitals, not CMS.²⁰ They argue that “*medical cases are more likely to shift from inpatient to outpatient*” overall, resulting in

lower Part A expenditures by CMS without changing the care provided by the hospitals.²¹ Bolstering the Plaintiff's argument, Moody's Investors Service has projected that the 0.2% rate cut may result in costs to hospitals of up to \$4,000 per review.²²

According to the second lawsuit, the "two-midnight" rule will "burden hospitals with arbitrary standards and documentation requests and deprive hospitals of Medicare reimbursement to which they are entitled."²³ Importantly, the Plaintiffs assert that the rule undermines the ability of physicians and hospitals to use the necessary discretion to make appropriate medical judgments. The Plaintiffs claim that RACs "regularly overrule physicians' expert judgments" on whether a patient should be considered "inpatient" or "outpatient" based on a strict interpretation of the "two-midnight" rule.²⁴ The Plaintiffs assert that CMS adopted the "two-midnight" rule without considering that an "inpatient" designation focuses also on the "level of care" necessary for a particular patient, not solely a patient's length-of-stay at a hospital.²⁵

Additionally, the Plaintiffs argue that the procedures for RAC review and denial effectively prevent hospitals from receiving any reimbursement from Medicare because most RAC denials of Part A claims occurred after the one-year filing deadline on Medicare reimbursement claims.²⁶ Although hospitals and providers can file revised claims under Medicare Part B, they allege that their revised submissions are considered "new claims" under Medicare.²⁷ These new claims must be submitted within one year of a patient's discharge; however, RAC review typically occurs past this one-year limit, effectively preventing hospitals and providers from receiving any reimbursement under Medicare.²⁸

The lawsuits request the court discard the "two-midnight" rule and its accompanying regulations, but the fate of both lawsuits is uncertain. Some attorneys within the healthcare industry claim that any invalidation of the rule will motivate Congress to address the issue, which may potentially lead to deeper, more permanent cuts in Medicare funding.²⁹ Moreover, the two lawsuits may result in a legal settlement that rewrites the "two-midnight" rule, but only reimburse the named Plaintiffs for damages.³⁰ CMS appears to be open to broader changes to its "two-midnight" rule. CMS Deputy Administrator Sean Cavanaugh testified on May 20, 2014, in front of the U.S. House Health Subcommittee regarding the rule, stating that CMS "welcome(s) input on these and other issues relat(ing) to a potential alternative payment methodology" for inpatient hospital stays not satisfying the "two-midnight" rule.³¹

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2 "The American Hospital Association et al., v. Kathleen Sebelius: Complaint" United States District Court for the District of Columbia, Case No. 1:14-cv-00609-RBW (April 14, 2014), p. 4.

3 *Ibid.*, p. 4-5.

4 *Ibid.*, p. 5.

5 "The American Hospital Association et al., v. Kathleen Sebelius: Complaint," United States District Court for the District of

Columbia, Case No. 1:14-cv-00607-RBW (April 14, 2014), p. 2; US District Court for the District of Columbia, Case No. 1:14-cv-00609-RBW, April 14, 2014, p. 2.

6 US District Court for the District of Columbia, Case No. 1:14-cv-00607-RBW, April 14, 2014, p. 26; US District Court for the District of Columbia, Case No. 1:14-cv-00609-RBW, April 14, 2014, p. 29.

7 US District Court for the District of Columbia, Case No. 1:14-cv-00607-RBW, April 14, 2014, p. 2; US District Court for the District of Columbia, Case No. 1:14-cv-00609-RBW, April 14, 2014, p. 2.

8 "Medicare: A Primer" By The Henry K. Kaiser Family Foundation, 2010 Edition, Menlo Park, CA: 2010, Accessed at <http://kaiserfamilyfoundation.files.wordpress.com/2013/01/7615-03.pdf> (Accessed 5/20/14).

9 "Two Kinds of Hospital Patients: Admitted, and Not" by Paula Span, The New York Times, October 29, 2013, <http://newoldage.blogs.nytimes.com/2013/10/29/two-kinds-of-hospital-patients-admitted-and-not/?action=click&module=Search®ion=searchResults&mabReward=relbias%3Ar&url=http%3A%2F%2Fquery.nytimes.com%2Fsearch%2Fsite%2Fsearch%2F%3Faction%3Dclick%26region%3DMasthead%26pgtype%3DHomepage%26module%3DSearchSubmit%26contentCollection%3DHomepage%26t%3Dqry801%23%2Ftwo+midnight+rule> (Accessed 5/20/14).

10 "Hospitalized but Not Admitted: Characteristics of Patients With 'Observation Status' at an Academic Medical Center" By Ann M. Sheehy et al., JAMA Internal Medicine, Vol. 173, No. 21 (November 25, 2013), p. 1997.

11 "Opposition to the 'Two-Midnight' Rule Heating Up" HC Topics Vol. 7, Issue 1, January 2014.

12 "Medicare Program; Hospital Inpatient Prospective Payment Systems for Acute Care Hospitals and the Long-Term Care Hospital Prospective Payment System and Fiscal Year 2014 Rates; Quality Reporting Requirements for Specific Providers; Hospital Conditions of Participation; Payment Policies Related to Patient Status" 78 Fed. Reg. 50746 (August 19, 2013).

13 *Ibid.*

14 *Ibid.*

15 *Ibid.*

16 "Statement of Work for the Recovery Audit Program," Centers for Medicare & Medicaid Services, Washington, DC: 2011, p. 8-9. 78 Fed. Reg. 50746, August 19, 2013.

17 *Ibid.*; "Acute Care Hospital Inpatient Prospective Payment System: Payment System Fact Sheet Series" By Centers for Medicare & Medicaid Services, Washington, DC: April 2013, p. 5. 78 Fed. Reg. 50746, August 19, 2013.

18 US District Court for the District of Columbia, Case No. 1:14-cv-00607-RBW, April 14, 2014, p. 18.

19 *Ibid.*, p. 25.

20 "Sector Comment: Two-Midnight Rule Will Reduce Revenue for Most Hospitals" By Daniel Steingart, CFA, Moody's Investors Service, Report Number 165866, San Francisco, CA, March 12, 2014, p. 2.

21 US District Court for the District of Columbia, Case No. 1:14-cv-00609-RBW, April 14, 2014, p. 2.

22 *Ibid.*, p. 10.

23 *Ibid.*, p. 16.

24 *Ibid.*

25 *Ibid.*

26 *Ibid.*, p. 11.

27 "AHA Lawsuit Over 'Two-Midnight' Rule Called Uphill Battle" By Joe Carlson, Modern Healthcare, April 15, 2014, <http://www.modernhealthcare.com/article/20140415/NEWS/304159962/aha-lawsuit-over-two-midnight-rule-called-uphill-battle> (Accessed 5/9/14).

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29 "CMS Considers Alternatives to Two-Midnight Rule" By Joe Carlson, Modern Healthcare, May 20, 2014, <http://www.modernhealthcare.com/article/20140520/NEWS/305209965/cms-considering-alternatives-to-two-midnight-rule> (Accessed May 20, 2014).



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