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Court Says Inpatients Changed to Observation Have Right to Appeal, Orders New Process

By Nina Youngstrom

A federal court on March 24 ordered CMS to let Medicare patients "challenge decisions by hospitals" to change their status from inpatients to observation, dating back to 2009. Patients who were admitted as inpatients but later got the Medicare Outpatient Observation Notice (MOON) must have "a meaningful opportunity to appeal," according to the decision from the U.S. District Court for the District of Connecticut.[1] However, the new appeal rights won't apply to patients placed in observation at the outset.

The decision, which came down in a class-action lawsuit filed by Medicare patients placed in observation, appears to apply nationally, said attorney Judy Waltz, with Foley & Lardner in San Francisco. CMS apparently would be required to have quality improvement organizations (QIOs) hear this new breed of appeal, because they already decide beneficiary appeals of hospital discharge decisions. Judge Michael Shea was particularly concerned that Medicare beneficiaries whose status changed from inpatient to observation lose coverage for skilled nursing facility (SNF) admissions, although higher cost-sharing for observation also was a factor in his thinking.

Because of its potential for upheaval, CMS surely will appeal the court's ruling, Waltz said.

The decision puts more pressure on hospitals and admitting physicians to get their patient-status determinations right on the front end, said attorney Jessica Gustafson, with The Health Law Partners in Farmington Hills, Michigan. "This should involve increased education to admitting physicians."

Because of the court ruling, CMS must "develop regulations and sub-regulatory guidance, modify or enter into new contracts and create beneficiary notices," Gustafson said. But "these tasks should not be unduly onerous, as processes are already in place that are substantially similar to what the court has ordered here." Waltz said, however, that QIOs can't take on the additional workload "without a massive ramp-up."

Court: Patients 'Stripped' of 'Property Interest'

The decision stemmed from a lawsuit filed against HHS in 2011 by seven Medicare beneficiaries who alleged they had been "deprived of Medicare Part A coverage by being improperly classified as outpatients," which they said violated the Medicare Act, Administrative Procedure Act, and the Due Process Clause. Eventually this was certified as a class-action lawsuit with a lot of legal skirmishing, a trip to the U.S. Court of Appeals for the Second Circuit, failed motions for summary judgment and a 2019 trial. It has culminated in this decision, with the judge siding with Medicare beneficiaries under certain circumstances.

"I find that some class members, specifically those who were initially admitted as inpatients by a physician but whose status during their stay was changed to observation, have demonstrated that the Secretary is violating their due process rights," the judge ruled. "These class members must be afforded some means to challenge the decision that effectively stripped them of their property interest in Part A benefits."

In a nutshell, to find a due-process violation, there must be a constitutionally protected property interest plus

state action, Waltz explained. In this case, the judge ruled that the protected interest is what hospitals took away —inpatient admission and Medicare coverage under Part A—when they converted patients to observation status. "Then what was interesting is the court finds state action based on the enforcement framework," she said. The government has various Medicare auditors (e.g., Medicare administrative contractors, QIOs and the HHS Office of Inspector General), "and ultimately it ends up with hospital utilization managers trying to ensure compliance [with the two-midnight rule], and the judge finds the government's regulatory and enforcement framework, even with the final actions taken by the hospitals, is enough to find state action," she said.

Patient Status Is 'an Artificial Distinction'

Waltz noted that the legal conclusions in the decision reflected some creative analysis likely to encourage the government to appeal, which underscores her frustration with the inpatient-observation industrial complex. "Patient status as inpatient or observation is an artificial distinction" that has no effect on patient care and exists solely for payment purposes, she said. The determination of patient status is made by physicians who have no financial skin in the game and by hospital utilization review committees that try to get it right. "It's a lot of flurry for no improvement in patient care, with the result that beneficiaries often pay more under observation and may be denied skilled nursing care coverage that requires a hospital stay," she said.

The judge ordered CMS to "provide a meaningful opportunity to appeal" to the members of the class-action lawsuit whose due-process rights were violated, and modified the definition of the members of the class to "all Medicare beneficiaries who, on or after January 1, 2009: (1) have been or will have been formally admitted as a hospital inpatient, (2) have been or will have been subsequently reclassified as an outpatient receiving "observation services"; (3) have received or will have received an initial determination or Medicare Outpatient Observation Notice (MOON) indicating that the observation services are not covered under Medicare Part A; and (4) either (a) were not enrolled in Part B coverage at the time of their hospitalization; or (b) stayed at the hospital for three or more consecutive days but were designated as inpatients for fewer than three days, unless more than 30 days [have] passed after the hospital stay without the beneficiary's having been admitted to a skilled nursing facility."

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1 Christina Alexander v. Alex M. Azar, No. 3:11-cv-1703, memorandum, March 24, 2020, https://bit.ly/2ydmMiM.