No. 19-1203

In The
Supreme Court of the United States

CHILDREN'S HOSPITAL
ASSOCIATION OF TEXAS, et al.,

Petitioners,

v.

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

Respondents.

On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The District Of Columbia Circuit

REPLY BRIEF FOR THE PETITIONERS

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CORPORATE DISCLOSURE STATEMENT

The corporate disclosure statement included in the petition for a writ of certiorari remains accurate.

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REPLY BRIEF FOR THE PETITIONERS

The important issues in this case deserve review. As the amicus briefs explain, the decision below will cause extreme financial harm to children's hospitals, including petitioners, and other hospitals that serve high levels of Medicaid-eligible patients. Congress specifically required supplemental payments for these hospitals. The statute even singles out "children's hospitals" in particular. 42 U.S.C. 1396r-4(a)(2)(D). Yet under CMS's flawed new regime, petitioners receive no supplemental payments. That happens because CMS has conflated two statutory concepts—costs and payments—that the statute's plain language keeps separate. See *Tenn. Hosp. Ass'n* v. *Azar*, 908 F.3d 1029, 1047-1048 (6th Cir. 2018) (Kethledge, J., concurring in the judgment).

Apart from distorting Congress's instructions, the decision below raises foundational questions of administrative law: whether agencies may change interpretations of a statute without recognizing that they are doing so (and hence without accounting for reliance interests) and whether courts may defer to an agency without first conducting their own non-deferential interpretation of the statute.

Respondents advance two main arguments against review. They argue that no court of appeals has found the 2017 rule invalid, and they defend that outcome on the merits. Br. in Opp. 11. But regardless of what other courts of appeals have held about the 2017 rule, there is no denying that the D.C. Circuit's

analysis conflicts with the approaches taken by courts in other agency disputes.

That includes this Court, which has repeatedly—and recently—rejected the arguments respondents advance here and prevailed with below. Agencies may not make policy changes premised on legal errors or lack of attention to those who relied on the prior policy. See, *e.g.*, *Dep't of Homeland Sec.* v. *Regents of the Univ. of Cal.*, 140 S. Ct. 1891, 1913-1915 (2020). Nor may courts defer to agency interpretations without emptying their traditional statutory-interpretation toolkit. See, *e.g.*, *Kisor* v. *Wilkie*, 139 S. Ct. 2400, 2415 (2019). And of course several members of this Court, and others throughout the judiciary, question the whole complicated edifice of *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

This case, which at one level is about a change in Medicaid policy that inflicts serious harm on children's hospitals, is also an appropriate vehicle for this Court to bring order to lower courts' confused and conflicting applications of *Chevron*. It is past time for this Court to do so.

A. The Court Should Review The D.C. Circuit's Deference To An Agency That Erroneously Denied It Was Changing Its Interpretation

Respondents do not deny that the first question raised in the petition is squarely presented. The court

of appeals held that an agency making a regulatory change can satisfy its obligation to engage in reasoned decision-making and command *Chevron* deference while denying that it is making that change. Pet. App. 15a-17a. According to the court of appeals, agencies that wish to change existing policy do not need to explain a change *as a change*. They only need to explain why they think the new policy is the best approach. *Id.* at 16a.

Other courts of appeals hold the opposite. Pet. 20-22. Respondents try to distinguish those cases as involving agencies, supposedly unlike CMS here, that failed to "provide[] a well-reasoned explanation" for their new policies. Br. in Opp. 17. But that purported distinction begs the relevant question: whether it is possible to adequately explain a change while mistakenly claiming it is no change at all. The Third Circuit pinpointed the issue: "[b]ecause the Commission fails to acknowledge that it has changed its policy on fleeting material, it is *unable* to comply with the requirement * * * that an agency supply a reasoned explanation for its departure from prior policy." *CBS Corp.* v. *FCC*, 663 F.3d 122, 151-152 (2011) (emphasis added). Agencies cannot explain what they do not acknowledge.[1]

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[1] Respondents incorrectly assert (at 14) that petitioners do not "seriously dispute" the adequacy of CMS's explanation. Petitioners have consistently disputed the explanation's adequacy, and the particular inadequacy warranting this Court's attention is CMS's failure to acknowledge and explain its change in position. Quoting unrelated excerpts from CMS's rulemaking does

The D.C. Circuit's rejection of that principle deserves review. This Court has already said that an agency wishing to change an existing policy "must at least 'display awareness that it is changing position.'" *Encino Motorcars, LLC* v. *Navarro*, 136 S. Ct. 2117, 2126 (2016) (citation omitted). That requirement is sensible, because explaining why Option A is "better" than Option B is not equivalent to explaining why one should switch to Option A having already chosen Option B. Reasoned decision-making "requires the agency to focus upon *the fact of change* where change is relevant." *FCC* v. *Fox Television Stations, Inc.*, 556 U.S. 502, 550 (2009) (Breyer, J., dissenting) (emphasis added). Otherwise the agency will miss "important aspect[s] of the problem" before it. *Regents*, 140 S. Ct. at 1910 (citation omitted).

In particular, an agency that is "not writing on a blank slate" must consider the effect a policy change would have on those who rely on the existing regime. *Regents*, 140 S. Ct. at 1915 (citation omitted). This Court recently held that it was arbitrary and capricious for the Government to rescind the prior administration's Deferred Action for Childhood Arrivals program without first considering whether the program had created legitimate reliance interests. *Id.* at 1913. The rescission therefore had to be vacated. *Id.* at 1901.

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not make up for that failure. See Pet. App. 16a-17a (highlighting portions of the rulemaking in which CMS failed to acknowledge and explain that it was changing its prior position); Br. in Opp. 12 (same).

There is no basis for a different outcome here. The petition recounted (at 23) CMS's refusal to address the "increased burden" that the 2017 rule places on hospitals like petitioners and refusal to phase in the new policy through the "transition period" commenters requested. 82 Fed. Reg. 16,114, 16,118 (Apr. 3, 2017). For both refusals, CMS cited its erroneous belief that the 2017 rule merely "provid[ed] clarification to existing policy" and did "not reflect a change." *Ibid.* Respondents offer no response to this point. CMS's failure to consider reliance interests is dispositive, particularly after *Regents*.

Respondents ignore *Regents* and instead highlight *Little Sisters of the Poor Saints Peter & Paul Home* v. *Pennsylvania*, 140 S. Ct. 2367, 2384 (2020). They claim (at 15-16) that CMS's failure to acknowledge its change is harmless error at most. Unlike *Regents*, however, *Little Sisters* did not address an inadequately explained agency change. It addressed a notice of proposed rulemaking bearing a purportedly incorrect title. *Little Sisters*, 140 S. Ct. at 2384. The challengers had not "experienced any harm from the title of the document" because the document's contents provided the information the challengers were owed. *Id.* at 2385. Not so here. Because of its erroneous insistence that it was not changing policy, CMS summarily rejected alternative actions that would benefit petitioners immensely. (Even a modest transition period would save petitioners millions of DSH dollars.)

In this way, respondents reassert an argument that failed in *Regents*: that it is "an idle and useless

formality" to measure agency action based on the reasons offered at the time of decision. 140 S. Ct. at 1909 (citation omitted). Yet under *Regents*, it makes no difference whether CMS would have found that "policy concerns outweigh any reliance interests" had it appreciated that the 2017 rule did in fact change existing policy. *Id.* at 1914. "Making that difficult decision was the agency's job," and "the agency failed to do it." *Ibid.* For these reasons, if the Court does not decide to resolve the conflicts and *Chevron*-related problems petitioners identify, it should at a minimum vacate the decision below and remand for reconsideration in light of *Regents*.

Respondents also advance two case-specific reasons they should not have had to acknowledge their change in policy: (1) at the time of the rulemaking, acknowledging the change would have contradicted their litigating position in the ongoing challenges to CMS's website FAQs, and (2) CMS supposedly "left no doubt about what its policy had been in the past." Br. in Opp. 14.

Neither reason is valid. The agency was *wrong* about what its policy had been in the past. And commenters encouraged CMS to wait until the resolution of the FAQ litigation to avoid the first issue. 82 Fed. Reg. at 16,118. Yet the agency insisted it was "not necessary to wait for the outcome of the pending litigation" because—why else?—the 2017 rule was not a change but "a clarification of the existing policy." *Ibid.* Here, too, a central premise of the rulemaking was CMS's erroneous belief that the 2017 rule was

consistent with prior policy—an error that CMS only belatedly recognized when it withdrew the FAQs after losing every case that challenged them.

Contrary to respondents' objection (at 15), insisting that CMS base its decision on an accurate description of the 2017 rule's effect is not an "attempt[] to bootstrap" anything. Petitioners merely seek to hold CMS to its reasoned-decision-making obligation under *Encino Motorcars*, *Regents*, and other cases given CMS's desire to change its 2008 policy. CMS breached that obligation, and it is no excuse that CMS changed a policy it did not think it had.

This case is an ideal vehicle for addressing this important question. There is no dispute that the agency changed its position while denying that it was doing so. Five courts of appeals, including the court below, have recognized that the policy of the 2017 rule is a different policy than the 2008 regulation, and the brief in opposition does not contest that conclusion. The question could not arise more cleanly.

B. The Court Should Review The D.C. Circuit's Distortion Of Statutory-Construction And Deference Principles In Misconstruing The Medicaid Act

Respondents emphasize that no court of appeals has found the 2017 rule substantively unlawful. But they do not deny that courts of appeals take inconsistent approaches to *Chevron*, including on several points that drove the decision below.

The first such point is whether an express delegation of rulemaking authority obviates the need for *Chevron* step-one scrutiny when the parties dispute the scope of the delegation. Respondents appear to concede that the First and Ninth Circuits have previously rejected pleas for *Chevron* deference at step one despite an express delegation, while in the D.C. Circuit an express delegation is an automatic ticket to a highly deferential step two. Compare Pet. 24-26, with Br. in Opp. 19 & n.4. Yet respondents contend that this Court recently refused to review the D.C. Circuit's approach and that there is enough common ground between the parties that the circuit disagreement is irrelevant.

Both contentions are inaccurate. The petition cited by respondents did not present a question about skipping step one; it challenged the D.C. Circuit's alleged practice of expanding agency authority at step two. See Pet. at i, *Am. Bankers Ass'n* v. *Nat'l Credit Union Admin.*, No. 19-1115, 2020 WL 3492665 (June 29, 2020). And the Government insisted that the "case [did] not present that question" because the court of appeals did not afford the agency any "extra deference." Br. in Opp. at 13-14, *Am. Bankers Ass'n*, *supra* (No. 19-1115). The Government also stressed that the petitioner did not "urge that *Chevron* be overruled." *Id.* at 13. Respondents cannot make those claims here. Moreover, respondents' repeated assertion (at 18, 19 n.4) that petitioners "do not dispute" that the 2017 rule is an exercise of CMS's delegated authority is false. That is the exact interpretive

disagreement that divides the parties. See *Tenn. Hosp. Ass'n*, 908 F.3d at 1049 (Kethledge, J., concurring in the judgment).[2]

The second point of divergence among courts is over how rigorously to apply canons of interpretation. See Pet. 26-30; Southwestern Legal Foundation Amicus Br. 2-3, 5-13. In the context of *Auer* deference, this Court recently cited *Chevron* and explained that "before concluding that a rule is genuinely ambiguous, a court must exhaust all the 'traditional tools' of construction" because "only when that legal toolkit is empty and the interpretive question still has no single right answer can a judge conclude that it is 'more [one] of policy than of law.'" *Kisor*, 139 S. Ct. at 2415. One would expect that "[i]f a reviewing court employs all of the traditional tools of construction, the court will almost always reach a conclusion about the best interpretation," eliminating any need to defer. *Id.* at 2448 (Kavanaugh, J., concurring in the judgment). But

[2] Petitioners do not agree with respondents' repeated claim that the statute delegates CMS authority to determine "costs incurred." That claim overlooks many of the words in the relevant statutory provision. For instance, the word "incurred" is part of a larger adjective phrase ("incurred during the year") denoting the relevant timeframe for measuring costs, which precedes a second adjective phrase ("of furnishing hospital services") denoting the types of costs to be measured. 42 U.S.C. 1396r-4(g)(1)(A); see also 42 U.S.C. 1396r-4(g)(2)(A) (cross-referencing "the costs of furnishing hospital services described in paragraph (1)(A) during the year"). Artificially carving up the statutory language to suggest the relevant term is "costs incurred" is merely an attempt to morph CMS's authority over costs into authority over payments.

statistics show *Chevron* does not produce that result. Pet. 33.

Respondents try to ignore this issue by defending the specific interpretation below. But they leave basic questions unanswered. For example, how can the 2017 rule be squared with the statute if it results in "zero" dollars of supplemental DSH funding for hospitals, including petitioners, that are deemed eligible to receive "an increase in the rate or amount of payment" from Medicaid? Br. in Opp. 23; Pet. 29-30 (quoting 42 U.S.C. 1396r-4(a)(1)(B)). Respondents never address this problem, nor did the court below. This statutory language mandating an increased DSH payment shows that respondents are the ones who have "a policy disagreement with Congress," and their cited legislative history does not prove otherwise. Br. in Opp. 23-24.[3]

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[3] Petitioners disagree with respondents' arguments against applying the *expressio unius* canon, the canon of meaningful variation, and the canon against superfluity, but will not address these disagreements here. See Pet. 26-29. One point of clarification, however, is important given respondents' arguments about the second sentence of Section 1396r-4(g)(1)(A). In direct conflict with their position below, respondents now argue (at 21) as follows: "If petitioners were correct that the reference to Medicaid and uninsured-patient payments in the [first] sentence [of Section 1396r-4(g)(1)(A)] must be read to exclude deduction of payments from all other sources, the direction in [the second] sentence would be superfluous." In the court of appeals, petitioners explained why that is wrong: the second sentence directs that indigent patients not be treated as having "third party coverage" (which would remove them from the uninsured component of the DSH formula) merely because of state or local governments' indigent-care payments on their behalf. Pet. C.A. Br. 50. In reply, respondents *agreed* that the second sentence "clarifies the

Although petitioners maintain that rigorous adherence to this Court's *Chevron* precedents would mandate reversal, the frequency with which lower courts avoid such rigor suggests it may be time to rethink *Chevron*. Instead of offering reasons to preserve *Chevron*, respondents merely note (at 24) two recent cases in which this Court declined to reconsider the doctrine.

Each of those cases was "an exceedingly poor vehicle to address the continuing vitality of *Chevron*." Gov't Br. in Opp. at 16, *United Parcel Serv., Inc.* v. *Postal Regulatory Comm'n*, 139 S. Ct. 2614 (2019) (No. 18-853). In the first, which arose in a rate-setting context that had been marked by judicial deference even before *Chevron*, the Government argued that the "[p]etitioner's real disagreement [was] not with the [agency's] reading of the statute, but instead with the agency's highly technical determination [about] petitioner's submission." *Id.* at 24-25. The second case was "a particularly unsuitable vehicle" because the Government had "consistently maintained that *Chevron* [was] not applicable"; it makes no sense to reconsider *Chevron* "in a case in which no party urges [its] application." Br. in Opp. at 13-14, *Guedes* v. *Bureau of Alcohol, Tobacco, Firearms & Explosives*, 140 S. Ct. 789 (2020) (No. 19-296); see also *Guedes*, 140 S. Ct. at 791

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category of patients that may be deemed uninsured" (but argued that "determining uninsured status" is not the second sentence's sole purpose). Gov't C.A. Reply 12-13. Because the second sentence has this undisputed purpose, respondents' new superfluity argument is meritless by their own account.

(Gorsuch, J., respecting denial of certiorari) ("I agree with my colleagues that the interlocutory petition before us does not merit review.").

This case presents no such complications. The parties' substantive dispute is a dispute over statutory interpretation, not technical expertise. And while no court of appeals majority has adopted petitioners' reading, the interpretive questions have been thoroughly vetted in the lower courts, with one appellate judge and several district court judges finding the statute unambiguously in petitioners' favor, one appellate judge finding the statute unambiguously in respondents' favor, and the balance finding the statute triggering *Chevron* somewhere in between. Further percolation about this statute's meaning is unlikely and would not advance the ball.

Nor is the express delegation in the statute any reason to avoid reconsidering *Chevron*. See Br. in Opp. 24. As respondents concede (at 19), the D.C. Circuit's straight-to-step-two approach derives from its understanding of *Chevron*. If anything, the express delegation makes this case a better vehicle by supplying a better opportunity to show how statutory interpretation would work in a world without *Chevron*.

CONCLUSION

For these reasons and those stated in the petition for a writ of certiorari, the petition should be granted.

Respectfully submitted,

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