

Post-Chevron Spotlight: Disproportionate Share Hospital Payments Restored as Texas Hospitals Prevail in Challenge to HHS Exclusion Rule

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In a victory for Texas health care providers, in *Baylor All Saints Medical Center dba Baylor Scott & White All Saints Medical Center?Fort Worth et al. v. Xavier Becerra*, case number 4:24?cv?00432, the United States District Court for the Northern District of Texas (“District Court”) has [vacated](#) a regulation promulgated by the U.S. Department of Health and Human Services (“HHS”) that excluded certain patient days funded by Uncompensated Care Cost (“UCC”) pools from the Medicaid Fraction used to calculate Disproportionate Share Hospital (“DSH”) adjustments. The case underscores the ongoing legal scrutiny of HHS’s (and other agencies’) regulatory authority in a post-*Chevron* world.

Background on the Exclusion Rule

In 1986, Congress amended the Medicaid program to establish national qualifying criteria for DSH payments to address financial challenges faced by hospitals that treated a higher number of low-income patients. Now, in the *Baylor* case, Texas health care providers have challenged the calculation of the “Medicaid Fraction,” which measures the ratio of patient days attributable to Medicaid-eligible patients. In 2005, Congress allowed for the inclusion of patient days under certain HHS-approved demonstration projects in this calculation. However, in August 2023, HHS introduced the “Exclusion Rule,” which prevented the inclusion of patient days funded by UCC pools under the Texas Medicaid program in the Medicaid Fraction, reducing DSH payments to hospitals serving low-income patients.

In response, a group of Texas-based hospitals (“the Hospitals”) challenged the Exclusion Rule, arguing that it directly conflicted with the clear language of the Medicare Statute and binding Fifth Circuit precedent.

Administrative Process and Subsequent District Court Review

Initially, the Hospitals sought relief in the Provider Reimbursement Review Board (“PRRB”).

However, the PRRB dismissed the Hospitals' challenge on jurisdictional grounds without addressing the substantive legal issues. The Hospitals then sought judicial review in the District Court, seeking declaratory and injunctive relief.

The District Court first determined, as a threshold matter, that it had jurisdiction over the Hospitals' challenge to the Exclusion Rule, rejecting an argument from HHS that the Hospitals had failed to exhaust their administrative remedies. Specifically, the District Court held that the PRRB's jurisdictional dismissal of the Hospitals' claims was improper as the PRRB did not fulfill its obligation to gather the necessary information to determine jurisdiction. The District Court further held that sending the case back to the PRRB would be futile as the PRRB lacked the constitutional authority to adjudicate the legal question at hand—whether the Exclusion Rule violated the Medicare Statute.

After rejecting the jurisdictional challenges, the District Court agreed with the Hospitals on the merits, ruling that the Exclusion Rule was inconsistent with the plain text of the Medicare statute under the Administrative Procedures Act. Applying Fifth Circuit precedent, the District Court determined that the Exclusion Rule directly contradicted the plain text of Medicare Statute, which requires the inclusion of days for patients eligible for Medicaid, as well as those treated as such under a demonstration project authorized by HHS, in the Medicaid Fraction used to calculate DSH payment adjustments. The District Court highlighted that the Fifth Circuit had already rejected similar arguments by HHS, clarifying that the Exclusion Rule improperly excluded patient days that should have been counted.[1]

Notably, while the Court granted declaratory relief, it also determined that a permanent injunction was not warranted, as the Hospitals failed to demonstrate irreparable harm—a necessary requirement for such relief. Rather, the District Court found vacatur to be the appropriate remedy as a less drastic measure to address the unlawful overreach of the Exclusion Rule. Thus, by vacating the Exclusion Rule, the decision restores the inclusion of UCC-funded patient days in the Medicaid Fraction, potentially increasing DSH payments for qualifying hospitals.

What's Next? Implications for Health Care Providers and Other Stakeholders Operating in Regulated Industries in a Post-*Chevron* World

The District Court's decision not only reaffirms the importance of statutory adherence in agency rulemaking, but also provides a significant glimpse into the evolving landscape of agency deference in a [post-*Chevron* world](#). Indeed, in the wake of the Supreme Court's [Loper Bright decision](#), the State of Texas has already hosted several cases reckoning with the deference owed to agency rulemaking. For example, on July 3, 2024, the same District Court that issued the *Baylor* opinion also [issued a preliminary injunction](#) staying enforcement of the Federal Trade Commission's proposed final rule banning most noncompete agreements. Shortly after, the [United States Court of Appeals for the Fifth Circuit affirmed](#) the United States District Court for the Eastern District of Texas's decision vacating key portions of regulations issued by the Biden Administration implementing the No Surprises Act.

Part of the reason these types of challenges may have seen such success in Texas is that the plaintiffs filing these challenges were already incorporated there, providing them with a natural forum for litigation. On the other hand, Texas may be evolving into a favored jurisdiction for litigants seeking to curtail agency authority, as the State is seen by some as having a judiciary (both at the district court and appellate levels) that is more receptive to arguments aimed at limiting agency authority. Future alerts will tell...

The foregoing notwithstanding, while the District Court's ruling in the *Baylor* case marks a notable win for health care providers, the legal landscape pertaining to the Exclusion Rule remains dynamic and

uncertain. HHS may appeal the decision or consider revising its regulation to align with the District Court's interpretation. As the boundaries of agency authority continue to be tested, health care providers should stay vigilant and retain skilled counsel to help them adapt to further regulatory changes that could have significant financial implications.

[1] See, e.g., *Forrest Gen. Hosp. v. Azar*, 926 F.3d 221 (5th Cir. 2019) (clarifying that Medicaid Fraction includes hospital days of Medicaid-eligible patients treated under certain HHS-approved demonstration projects).

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