KATHRYN DOI, SBN 121979
Email: kdoi@murphyaustin.com
JENNY MAE PHILLIPS, SBN 255458
Email: jphillips@murphyaustin.com
MURPHY AUSTIN ADAMS SCHOENFELD LLP
304 "S" Street (95811-6906)
Post Office Box 1319
Sacramento, California 95812-1319
Telephone: (916) 446-2300
Facsimile: (916) 503-4000

DOUGLAS S. CUMMING, SBN 88580
Email: dsc@dougcummingmedical-law.com
LAW OFFICES OF DOUGLAS S. CUMMING
542 5th Street
Lincoln, CA 95648
Telephone: (916) 434-8719
Facsimile: (916) 645-2997

Attorneys for Plaintiffs
DEVELOPMENTAL SERVICES NETWORK; and UNITED CEREBRAL PALSY OF LOS ANGELES, VENTURA, AND SANTA BARBARA COUNTIES

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

DEVELOPMENTAL SERVICES NETWORK, et al.

Plaintiffs,

v.

DAVID MAXWELL-JOLLY, Director of the Department of Health Care Services, State of California, et al.

Defendants.

Case No. CV10-03284

PLAINTIFFS' MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF MOTION FOR PRELIMINARY INJUNCTION

[Notice of Motion and Motion for Preliminary Injunction; Declarations of Macomber, Mattson, and Cohen and Exhibits thereto; Request for Judicial Notice; and [Proposed] Order Granting Motion for Preliminary Injunction filed concurrently herewith]

DATE: June 7, 2010
TIME: 10:00 a.m.
DEPT: 5- 2nd Floor

ASSIGNED FOR ALL PURPOSES TO HON. CHRISTINA A. SNYDER

TABLE OF CONTENTS

TABLE OF CONTENTS
(continued)

Page

TABLE OF AUTHORITIES

Page

Federal Cases

TABLE OF AUTHORITIES
(continued)

TABLE OF AUTHORITIES
(continued)

Page

Other Authorities

I. INTRODUCTION

Plaintiffs Developmental Services Network ("DSN"), a trade association for intermediate care facilities for the developmentally disabled-habilitative and nursing ("ICF/DD-H" and "ICF/DD-N", respectively), and United Cerebral Palsy of Los Angeles, Ventura and Santa Barbara Counties ("UCP"), one of DSN's members and the owner/operator of 12 ICF/DD-H homes and 9 ICF/DD-N homes (collectively, "plaintiffs"), bring this action to challenge a State of California law adopted in July 2009 that permanently "freezes" Medi-Cal reimbursement rates for ICF/DD-Hs and ICF/DD-Ns at the 2008-09 rates.

Defendants the Department of Health Care Services ("DHCS") and its Director (collectively, "defendants") have implemented this rate freeze and, since August 1, 2009, have paid and continue to pay ICF/DD-Hs and ICF/DD-Ns at the 2008-09 rates despite the results of defendants' own cost study, conducted pursuant to the California Medicaid State Plan, which shows that weighted reimbursement rates paid to ICF/DD-Hs should be 6.03% higher and weighted reimbursement rates paid to ICF/DD-Ns should be 8.87% higher for the 2009-10 fiscal year (which began August 1, 2009).

The legislative history underlying the rate freeze statute shows that the statute was enacted based solely on the budget concerns of the State of California, without any analysis or consideration of the quality of care or equal access considerations required under federal Medicaid law. The Ninth Circuit and this Court have clearly stated in a series of recent decisions that State of California Medi-Cal health care provider rate reductions and freezes enacted in this manner and under comparable circumstances are invalid as preempted by federal Medicaid law pursuant to the Supremacy Clause of the United States Constitution.

In fact, on February 24, 2010, this Court granted a plaintiff's motion for a preliminary injunction in a case challenging different subdivisions of the exact same statute, California Welfare and Institutions Code section 14105.191, finding

that plaintiff in that case had demonstrated a likelihood of success on the merits of its claim under 42 U.S.C. § 1396a(a)(30)(A) ("§ 30(A)") because the State had failed to consider the "quality of care" and "equal access" provisions of § 30(A), or whether reimbursement rates are reasonably related to provider costs, before its implementation. (*California Hospital Association* v. *Maxwell-Jolly* (C.D. Cal) Case No. CV 09-8642 CAS (MANx).)

Plaintiffs submit that a preliminary injunction should likewise be issued in this case on the grounds that they have the same likelihood of success on the merits as the health care providers who have challenged the other reimbursement rate limitations and have made the showing in this motion that they, like the health care providers in the other actions, are likewise suffering irreparable injury as a result of the rate freeze. Plaintiffs further submit that the balance of hardships tips in their favor and that the public interest weighs in favor of granting the preliminary injunction. Accordingly, plaintiffs request that the Court issue a preliminary injunction order preventing defendants from continuing to implement the rate freeze and to direct defendants to pay the members of plaintiff DSN and plaintiff UCP the rate already calculated by defendants for the 2009-10 rate year.

II. BACKGROUND

A. Federal Medicaid Law

In 1965, Congress enacted Title XIX of the Social Security Act, generally referred to as The Medicaid Act, to provide States with funding to furnish medical assistance to individuals "whose income and resources are insufficient to meet the costs of necessary medical services." (42 U.S.C. §§ 1396 *et. seq.*; *Wilder* v. *Va. Hosp. Ass'n* (1990) 496 U.S. 498, 502 [110 S.Ct. 2510, 2513, 110 L.Ed.2d 455].) The Medicaid program authorizes federal financial support to States for medical assistance to low income persons who are aged, blind, disabled, or members of families with dependent children. The program is jointly financed by the federal and State governments and administered by the States. The States, in accordance

with federal law, determine eligibility of particular types of beneficiaries, types and ranges of services, payment levels, and administrative and operative procedures. Payment for services is made directly by States to the individuals or entities that furnish the services. (42 C.F.R. § 430.0.)

A State's participation in Medicaid is voluntary, but a State that chooses to participate must comply with the provisions of the Medicaid Act and its implementing regulations. (*Alaska Dept. of Health and Social Servs.* v. *Centers for Medicare and Medicaid Servs.* (9th Cir. 2005) 424 F.3d 931, 935.) Each State administers its Medicaid program through a single State agency, which is charged with the responsibility of establishing and complying with a State Medicaid Plan that, in turn, must comply with the applicable provisions of federal Medicaid law, including the requirements set forth in 42 U.S.C. § 1396a(a)(1)-(70). (42 U.S.C. § 1396a(a)(5); 42 C.F.R. §§ 430.10 & 431.10.) In California, defendant DHCS is the single State agency charged with administration of the California Medicaid program, which is referred to as "Medi-Cal". (*See* Cal. Welf. & Inst. Code §§ 10720 *et seq.* and 14000 *et seq.*)

In accordance with the requirements of 42 U.S.C. § 1396a(a)(1)-(70), California must provide "methods and procedures" for the payment of care and services that (1) are "consistent with efficiency, economy, and quality of care," and (2) ensure their availability to the Medicaid population to the same "extent as they are available to the general population in the geographic area." (42 U.S.C. § 1396a(a)(30)(A).) These requirements are known, respectively, as the "quality of care" and "equal access" provisions of § 30(A) of the Medicaid Act.

In addition, for certain providers, including ICF/DDs, California must establish rates through a public process that includes publication of the proposed rates and their underlying methodologies, such that providers are "given a reasonable opportunity for review and comment." (42 U.S.C. § 1396a(a)(13)(A) ("§ 13(A)").) In addition, CMS implementing regulations require that public notice

be provided of "any significant proposed change" in the State's setting of payment rates for services, with exceptions not relevant here. (42 C.F.R. § 447.205 ("§ 447.205").)

Finally, the California Medicaid State Plan ("State Plan") requires defendants to recalculate the reimbursement rate for ICF/DD-Hs and ICF/DD-Ns each year based on cost reports and audits. Unless and until the State Plan is approved by the federal Centers for Medicare and Medicaid Services ("CMS"), defendants are required to perform these calculations and implement the resulting reimbursement rates. (*See Exeter Memorial Hospital Ass'n* v. *Belshe* (9th Cir. 1998) 145 F.3d 1106; *Oregon Ass'n of Homes for the Aging, Inc.* v. *State of Oregon* (9th Cir. 1993) 5 F.3d 1239, 1241.) For fiscal year 2009-10, defendants performed the calculations required under the State Plan, but did not implement the resulting reimbursement rates.

B. The Establishment Of Intermediate Care Facilities Under Federal and State Law

Prior to 1971, facilities for the developmentally disabled were financed solely by state, local and private funding. In the Act of December 14, 1971 (Public Law 92-223), Congress enacted legislation that provided federal funding for ICF/DDs (referred to as "intermediate care facilities for the mentally retarded" or "ICF/MRs" in the federal legislation) through the Medi-Cal program.

Under federal law, ICF/MR is defined as follows:

> The term "intermediate care facility for the mentally retarded" means an institution (or distinct part thereof) for the mentally retarded or persons with related conditions if (1) the primary purpose of such institution (or distinct part thereof) is to provide health or rehabilitative services for mentally retarded individuals and the institution meets such standards as may be prescribed by the Secretary;

> (2) the mentally retarded individual with respect to whom a request for payment is made under a plan approved under this subchapter is receiving active treatment under such a program; and
>
> (3) in the case of a public institution, the State or political subdivision responsible for the operation of such institution has agreed that the non-Federal expenditures in any calendar quarter prior to January 1, 1975, with respect to services furnished to patients in such institution (or distinct part thereof) in the State will not, because of payments made under this subchapter, be reduced below the average amount expended for such services in such institution in the four quarters immediately preceding the quarter in which the State in which such institution is located elected to make such services available under its plan approved under this subchapter.

(42 U.S.C. § 1396d(d).)

The State of California Department of Public Health, in turn, issues licenses to intermediate care facilities that fall into one of four categories: (1) intermediate care facility; (2) ICF/DD-Hs; (3) intermediate care facility/developmentally disabled; and (4) ICF/DD-Ns. (Cal. Health & Saf. Code §§ 1250(d), (e), (g) and (h), respectively.) Plaintiffs own and operate or represent ICF/DD-H and ICF/DD-N facilities only.

An ICF/DD-H facility is defined as:

> a facility with a capacity of 4 to 15 beds that provides 24-hour personal care, habilitation, developmental, and supportive health services to 15 or fewer persons with developmental disabilities who have intermittent

> recurring needs for nursing services, but have been certified by a physician and surgeon as not requiring availability of continuous skilled nursing care.

(Cal. Health & Saf. Code § 1250(e).)

An ICF/DD-N facility is defined as:

> a facility with a capacity of 4 to 15 beds that provides 24-hour personal care, developmental services, and nursing supervision for persons with developmental disabilities who have intermittent recurring needs for skilled nursing care but have been certified by a physician and surgeon as not requiring continuous skilled nursing care. The facility shall serve medically fragile persons with developmental disabilities or who demonstrate significant developmental delay that may lead to a developmental disability if not treated.

(Cal. Health & Saf. Code § 1250(h).)

C. The Reimbursement System For Intermediate Care Facilities For The Developmentally Disabled – Habilitative and Nursing

The State Plan establishes the principles of the State of California's reimbursement system for providers of long-term care services to assure compliance with the requirements of Title XIX of the Federal Social Security Act and the Code of Federal Regulations and describes the procedures to be followed by DHCS in determining long-term care reimbursement rates. (*See* intro. to Att. 4.19-D of the State Plan, eff. Aug. 1, 2005, Exh. 11 to Plaintiffs' Request for Judicial Notice ("RJN"), served and filed herewith.)

These procedures provide for the establishment of reimbursement rates. Rates are set for four classes of ICF/DD-Hs and ICF/DD-Ns: 4-6 bed ICF/DD-Hs; 7-15 bed ICF/DD-Hs; 4-6 bed ICF/DD-Ns; and 7-15 bed ICF/DD-Ns. (RJN, Exh.

11 Att. 4.19-D, § I(I)(3)(j) & (k), p.5 (eff. Aug. 1, 2004).)

The State Plan requires defendants to recalculate reimbursement rates for ICFs every year. Prospective rates for each class are developed based on cost reports submitted by the ICFs, as adjusted by random audits of a minimum of 15% of the cost reports. (RJN, Exh. 11 at p. 9-10, Att. 4.19-D, §§ III(A), p.9 & IV(A)(1)(f) & (g), p.10 (eff. Aug. 1, 2004).) Providers have the right to appeal findings which may result in an adjustment to program reimbursement rates. (RJN, Exh. 11, Att. 4.19-D, § III(D), p.9 (eff. Aug. 1, 2002).)

The reimbursement rate per patient day is set at the 65th percentile of projected costs for the class. (RJN, Exh. 11, Att. 4.19-D, § IV(F)(9), p.15 (eff. Aug. 1, 2005).) This is a higher reimbursement rate than other classes of long-term facilities in recognition of the fact that ICFs serve a disproportionate share of low income patients with special needs. (*Id.*) Plaintiffs understand that Medi-Cal pays for services provided to over 99% of the ICF patients in California.

As long as there is a projected net increase in the California Consumer Price Index during the State's fiscal year previous to the new rate year, no prospective rate of reimbursement shall be decreased solely because the class median projected cost is less than the existing rate of reimbursement. (RJN, Exh. 11, Att. 4.19-D, § IV(F)(5), p.14 (eff. Aug. 1, 2002.)

In addition, since 2003, the State has made a supplemental Medi-Cal reimbursement payment on a per diem basis to ICFs over and above the reimbursement rate established through the cost report/audit procedures described above to support the facilities' quality improvement efforts. (Cal. Health & Saf. Code § 1324.10.) These payments are currently set at 8.99% of the reimbursement rate.

Since 2003, ICFs are required to remit to the State a quality assurance fee ("QAF") on the entire gross receipts of the ICFs. (Cal. Health & Saf. Code § 1324.2(a).) The QAF rate is currently 5.5%. The QAF is deposited in the State

General Fund. (*Id.*, § 1324.8.)

D. The Passage Of Assembly Bill 5, Which Freezes ICF Payments At 2008-09 Rates

On July 2, 2009, Assembly Bill 5 ("AB4X_5") was introduced during the 2009-10 Fourth Extraordinary Session to address the California state budget as a placeholder "spot" bill to enact statutory changes relating to the Budget Act of 2009. There was no substance to the bill as introduced on July 2, 2009. (AB4X_5, as introduced July 2, 2009, Exh. 5 to RJN.)

On July 23, 2009, AB4X_5 was amended to amend, appeal and add various sections of the California Financial Code, Health and Safety Code, Insurance Code and Welfare and Institutions Code. The bill as amended was 98 pages in length. (Sen. Amend. to AB4X_5, July 23, 2009, Exh. 6 to RJN.)

One of the changes contained in the amended AB4X_5 was to add subdivision (f)(2) to California Welfare & Institutions Code section 14105.191 ("Section 14105.191(f)(2)"). This amendment reads, in pertinent part, as follows:

> (f)(2) … Medi-Cal reimbursement rates applicable to the following classes of facilities for services rendered during the 2009-10 rate year; and each rate year thereafter, shall not exceed the reimbursement rates that were applicable to those facilities and services in the 2008-09 rate year:
>
> (A) Facilities identified in paragraph (5) of subdivision (d).

(*See* RJN, Exh. 6 at p. 77.)

Paragraph (5) of subdivision (d) identifies, in pertinent part, the following facilities: "Intermediate care facilities for the developmentally disabled licensed pursuant to subdivision (e), (g), or (h) of Section 1250 of the California Health and Safety Code …." As noted above, subdivisions (e) and (h) of Section 1250 of the Health and Safety Code define ICF/DD-Hs and ICF/DD-Ns.

AB4X_5 as amended was passed by the Senate on July 23, the day it was introduced, passed by the Assembly later that same day, and was enrolled and sent to the Governor on July 24. (AB4X_5, Complete Bill History, Exh. 4 to RJN.) The Governor approved the bill and it was chaptered by the Secretary of State on July 28. (AB4X_5, as chaptered July 28, 2009, Exh. 7 to RJN.) The bill was enacted as an urgency statute and became effective immediately. Defendants immediately implemented the rate freeze and have continued to pay the 2008-09 rate. (*See* Decl. of P. Dennis Mattson, Ph.D., ¶ 4; Decl. of Ronald S. Cohen, Ph.D. ¶¶ 8, 9, 10.)

The legislative history of AB4X_5 does not contain any evidence that either the defendants or the California Legislature considered the "quality of care" or "equal access" provisions of § 30(A), or whether reimbursement rates are reasonably related to provider costs, before its implemented the rate freeze imposed by Section 14105.191(f)(2).

Three committee analyses were prepared with respect to AB4X_5. The first bill analysis, dated July 13, 2009, before the bill was amended to add substantive provisions, was two pages long and simply expressed the intent of the Legislature to enact unspecified statutory changes relating to the 2009 Budget Act. (Sen. Rules Com. Analysis of AB4X_5 (2009-10) as introduced, Exh. 8 to RJN.)

The second bill analysis, dated July 23, 2009, states as follows with respect to the rate freeze at issue in this case:

> This bill freezes the reimbursement rate paid to Level B Nursing homes (AB 1629 homes), as well as other long-term care facilities for a savings of about $95 million (General Fund). This proposal was part of the Governor's May Revision.

(Sen. Rules Com. Analysis of AB4X_5 as amended, Exh. 9 to RJN.)

The third bill analysis, apparently dated July 24, 2009, after the bill had already been sent to the Governor's office, states with respect to the freeze:

> This bill freezes the reimbursement rate paid to Level B Nursing Homes (AB 1629 homes), as well as all other long-term care facilities for a savings of about $75 million (GF). This proposal was part of the Governor's May Revision.

(Assem. Budget Com. Analysis of AB4X_5, Exh. 10 to RJN.)

There is no evidence in the legislative history or in the Governor's May Revision that any responsible cost studies as required by § 30(A) were relied upon by the California Legislature, the Governor's office, or defendants prior to the adoption and implementation of Section 14105.191(f)(2)(A). (*See* Governor's 2009-10 May Revision, Exh. 1 to RJN; Legislative Analyst Office's Overview of the Governor's 2009-10 May Revision, Exh. 2 to RJN; Macomber decl., ¶ 11.)

There is also no evidence that a public process was followed, as required by § 13(A) and § 447.205, in connection with the adoption and implementation of Section 14105.191(f)(2)(A). Contrary to the statements in the committee analyses, there was no reference to a freeze of reimbursement rates for long-term care facilities in the Governor's May Revision. (*See* Exh. 1 and Exh. 2.) In addition, although a notice of the proposed rate change was published in the California Notice Register, the publication did not occur until July 31, 2009, after the bill had been adopted and signed into law. (Cal. Reg. Notice Register, No. 31-2, publ. July 31, 2009, Exh. 3 to RJN.)

E. DHCS Calculations Show ICF/DD Reimbursement Rates Should Have Increased Beginning August 1, 2009

Notwithstanding the enactment of Section 14105.191(f)(2), DHCS collected the rate reports and conducted its audit process as required by the State Plan for the rate year beginning August 1, 2009. (Macomber decl., ¶ 19.)

DHCS' calculations for the four classes of small ICF/DDs for the rates effective August 1, 2008 and August 1, 2009 are as follows:

Facility Group	Rate effective 8/1/2008*	Rate effective 8/1/2009*	Percent change in rates
ICF/DD-Habilitative			
4-6 Beds	$185.50	$197.45	6.44%
7-15 Beds	$201.77	$201.95	0.09%
Weighted ICF/DD-H Rate	$186.63	$197.72	6.03%
ICF/DD-Nursing			
4-6 Beds	$211.63	$230.74	9.03%
7-15 Beds	$219.79	$232.28	5.68%
Weighted ICF/DD-N Rate	$212.00	$230.81	8.87%

* Includes supplemental payment for quality improvement efforts. (*See* Macomber decl., Exhs. B and E.)

The rate study conducted by DHCS shows that were the freeze not in place, rates would have been increased on August 1, 2009, by a weighted average of 6.03% for ICF/DD-H providers and by 8.87% for ICF/DD-N providers. Accordingly, all ICF/DD-Hs and all ICF/DD-Ns, including plaintiff UCP and the members of DSN, are being underpaid for every patient for every day they are reimbursed at the 2008-09 rate as a result of the rate freeze.

III. DISCUSSION

A. Plaintiffs' Application Meets The Well-Established Standards For The Granting Of Injunctive Relief In The Same Manner As The Medi-Cal Rate Cut And Freeze Cases That Have Preceded This Action

"A plaintiff seeking a preliminary injunction must establish that he is likely to succeed on the merits, that he is likely to suffer irreparable harm in the absence of preliminary relief, that the balance of equities tips in his favor, and that an injunction is in the public interest." (*Winter* v. *Natural Resources Defense Council*

(2008) -- U.S. --, 129 S.Ct. 365, 374 [172 L.Ed.2d 249]; *Dominguez* v. *Schwarzenegger* (9th Cir. 2010) 596 F.3d 1087, 1092, *pet. for cert. filed* Mar. 24, 2010; *California Pharmacists Ass'n* v. *Maxwell-Jolly* (9th Cir. 2009) 563 F.3d 847, 849.)

Since the Court of Appeals for the Ninth Circuit issued its first opinion in the *Independent Living Center of Southern California, Inc.* v. *Shewry* (9th Cir. 2008) 543 F.3d 1050, *cert. denied* June 22, 2009, this Court and other courts have granted preliminary injunctive relief in seven cases challenging State laws that reduced or froze Medi-Cal reimbursement rates as part of budget trailer bills on the grounds that these laws had been enacted in violation of the "quality of care" and "equal access" provisions of § 30(A) of the Medicaid Act or duty to provide a notice and comment process on the rate change pursuant to §§ 13(A) and 447.205. [1]

As with the plaintiffs who have come before them, the plaintiffs here establish in this application that they are likely to succeed on the merits and are suffering irreparable injury, and that a balancing of the equities and public interest warrant granting of the requested injunctive relief.

B. Plaintiffs Are Likely To Succeed On The Merits Because Defendants Failed To Comply With Federal Medicaid Law Before Freezing The Reimbursement Rates

The Supremacy Clause of the United States Constitution provides:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof … shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or

[1] *See Dominguez* v. *Schwarzenegger* (9th Cir. 2009) 596 F.3d 1087, *pet. for cert. filed* Mar 24, 2010; *California Pharmacists Ass'n* v. *Maxwell-Jolly* (9th Cir. 2009) 563 F.3d 847; *California Pharmacists Ass'n* v. *Maxwell-Jolly* (C.D. Cal. 2010) No. 09-08200; *California Hospital Ass'n* v. *Maxwell-Jolly* (C.D. Cal. 2010), No. 09-8642; *Managed Pharmacy Care* v. *Maxwell-Jolly* (C.D. Cal. 2009) 603 F.Supp.2d 1230, *mtn to amend denied by* (C.D.Cal. 2009) 2009 WL 926987; *Santa Rosa Memorial Hospital* v. *Shewry* (C.D. Cal. 2009), No. 08-05173, *app. pending*; *Mission Hospital Regional Medical Center* v. *Shewry* (3d Dist. 2008) 168 Cal.App.4th 460 [85 Cal.Rptr.3d 639].

Laws of any State to the Contrary notwithstanding.

(U.S. Const., art. VI, cl. 2.)

Plaintiffs' Supremacy Clause claim is predicated upon federal conflict preemption. "Under general principles of federal preemption, state law is preempted only to the extent that it actually conflicts with federal law." (*California Pharmacists Assn.* v. *Maxwell-Jolly* (C.D. Cal. 2009) 630 F. Supp. 2d 1154, 1158 *and* 630 F. Supp. 2d 1144, 1149, *both citing Pacific Gas & Elec. Co.* v. *State Energy Comm'n* (1983) 461 U.S. 190, 204.) "Conflict preemption arises "when compliance with both federal and state regulations is a physical impossibility, or where state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." (*Independent Living Center of Southern Calfiornia, Inc.* v. *Maxwell-Jolly* (9th Cir. 2009) 572 F.3d 644, 653, *quoting PG&E, supra*, 461 U.S. at 204.)

Conflict preemption in which compliance with both federal and state law was impossible simply occurs when the State law would allow a different result than the applicable federal law. For example, conflict preemption was found to exist in *McDermott* v. *Wisconsin* (1913) 228 U.S. 115 [115 S.Ct. 431, 57 L.Ed.754].), in which "a state law made it criminal to offer for sale syrup that was not labeled in compliance with the state law, even though the syrup offered for sale did meet federal labeling requirements." (*Pharmaceutical Research and Manufacturers of America* v. *District of Columbia* (2005) 406 F. Supp. 2d 56, 65 n.8, *citing McDermott, supra*, 228 U.S. 124-27.)

Under so-called "obstruction" preemption, "an aberrant or hostile state rule is preempted to the extent it actually interferes with the 'methods by which the federal statute was designed to reach [its] goal.'" (*Independent Living Center, supra*, 572 F.3d at 653, *citing Ting* v. *AT&T* (9th Cir. 2003) 319 F.3d 1126, 1137 [alteration in original], *quoting Int'l Paper Co.* v. *Oullette* (1987) 479 U.S. 481, 494. [107 S.Ct. 805, 813, 93 L.Ed.2d 883].) "Thus, obstruction preemption focuses on both the

objective of the federal law and the method chosen by Congress to effectuate that objective, taking into account the law's text, application, history and interpretation." (*Independent Living Center, supra*, 572 F.3d at 653, *quoting Ting, supra*, 319 F.3d at 1137.)

1. Plaintiffs are likely to succeed on the merits of the argument that the rate freeze is preempted by § 30(A) under the Supremacy Clause because it is impossible for defendants to comply with federal and State law and the State law obstructs the purpose underlying federal Medicaid law

As noted above, federal Medicaid law requires California to provide "methods and procedures" for the payment of care and services that (1) are "consistent with efficiency, economy, and quality of care," and (2) ensure their availability to the Medicaid population to the same "extent as they are available to the general population in the geographic area." (42 U.S.C. § 1396a(a)(30)(A).)

In *Orthopaedic Hospital* v. *Belshe* (9th Cir. 1997), 103 F.3d 1491, 1496, the Ninth Circuit identified the purpose of § 30(A) as demonstrating that "Congress intended payments to be flexible within a range; payments should be no higher than what is required to provide efficient and economical care, but still high enough to provide for quality care and to ensure access to services." (*Id.* at 1497; *see also Independent Living Center, supra,* 572 F.3d at 653.) The Ninth Circuit interpreted § 30(A) to require defendants to set reimbursement rates that "bear a reasonable relationship to efficient and economical hospitals' costs of providing quality services, unless the Department shows some justification for rates that substantially deviate from such costs." (*Id.*, *see also Independent Living Center, supra,* 572 F.3d at 651-52.) To meet this statutory requirement, the Ninth Circuit held that the State "must rely on responsible cost studies, its own or others', that provide reliable data as a basis for its rate setting." (*Orthopaedic Hospital*, *supra*, 103 F.3d at 1496.)

As outlined above, there is no evidence in the Governor's May Revision or the legislative history of the bill that any responsible cost studies were relied upon

by the State as a basis for its determination that rates for ICF/DD-Hs and ICF/DD-Ns should be frozen.

It is impossible for defendants to comply with both the federal law, which requires that rate setting be based on reliable data from responsible cost studies to ensure that the quality of care and equal access standards are met, which in the case do not exist, on the one hand, and the State law, which imposes a rate freeze based solely on the need of the State to address its budget issues and without reliance on responsible cost studies or a finding on the quality of care and equal access issues. Defendants have opted to comply with State law, when under the Supremacy Clause, they are required to comply instead with the federal Medicaid law.

In addition, the State law at issue here is preempted because it actually interferes with the methods by which the federal Medicaid statute was designed to reach its goal of ensuring that State rate setting is consistent with quality of care and equal access standards.

Under § 30(A), payment must be "consistent with efficiency, economy, and qualify of care" and "sufficient to enlist enough providers so that care and services are available under the plan." In the case of ICF/DD-Hs and ICF/DD-Ns, rates are set at 65% of projected costs for the class. Plaintiffs understand that Medi-Cal pays for services provided over 99% of the ICF/DD-H and ICF/DD-N patients in California. If rates are frozen at the 2008-09 levels, particularly when defendants have already calculated that the weighted ICF/DD-H and ICF/DD-N rates should be increased by 6.03% and 8.87%, respectively more than 35% of these facilities will be paid less than costs. Particularly hard hit will be the 4-6 bed ICF/DD-N facilities, which are currently being underpaid by 9.03%, according to defendants' calculations. No studies were relied upon to determine how the rate freeze would affect these facilities' ability to continue to provide quality care or even stay open.

Accordingly, plaintiffs have a strong likelihood of success on their conflict preemption argument with respect to § 30(A).

2. Plaintiffs are likely to succeed on the merits of the argument that the rate freeze is preempted by §§ 13(A) and 477.205 under the Supremacy Clause because there was no meaningful notice or opportunity to be heard

As noted above, federal Medicaid law requires California to establish rates for ICF/DD-Hs and ICF/DD-Ns through a public process that includes publication of the proposed rates and their underlying methodologies, such that "providers, beneficiaries and their representatives, and other concerned State residents are given a reasonable opportunity for review and comment on the proposed rates, methodologies, and justifications." (§ 13(A).) In addition, CMS implementing regulations require that public notice be provided of "any significant proposed change" in the State's "methods and standards for setting payment rates for services, with exceptions not relevant here. (§ 447.205.)

The ICF/DD rate freeze was written into AB4X_5 on the same day the bill was passed by both the Senate and Assembly, it was signed by the Governor five days later, and notice to the public via publication in the California Notice Register was not given until three days after the Governor had signed the bill into law and the day before the freeze was implemented by defendants.

Contrary to the statements made in the legislative committee analyses, there was no mention of a possible freeze in the May Revision. There were no public hearings before the Legislature before or after it amended the bill to include the freeze. The publication in the Notice Register occurred the day before the defendants implemented the freeze. Under this scenario, there was no reasonable, meaningful opportunity for providers, beneficiaries or members of the public to review and comment on this significant proposed change to reimbursement rates before it became law.

Plaintiffs submit that the analysis and conclusion adopted by the California Court of Appeals in *Mission Hospital Regional Medical Center* v. *Shewry* (3d Dist. 2008) 168 Cal.App.4th 460 [85 Cal.Rptr.3d 639] is instructive here. The facts of the

Mission Hospital case are strikingly similar to those at issue here. In 2004, the California Legislature, as part of adopting a State budget after the Constitutional budget deadline had expired, proposed and enacted over only a three-day period a freeze on the rates the State would use to reimburse certain hospitals that provided services to Medicaid beneficiaries during the upcoming 2004-04 fiscal year. The court noted that the California State Legislature has the power to adopt or waive its own rules when it considers new state law and that the due process principles of notice and opportunity for a hearing do not apply to legislative action as a matter of State constitutional law. However, the court found that the case before it did not concern these principles.

> Rather, this case concerns the extent to which a federal statute constrains state legislative action; more particularly, a federal statute's imposition of notice and comment procedures to acts by a state legislature when the state voluntarily agrees to participate in the federal program. This is a matter of federalism, not administrative law.

(*Id.* at 485) The court further noted that,

> [B]y agreeing to participate in the Medicaid program, the state subjected itself under the supremacy clause to comply with all federal Medicaid laws. Under those laws, the state would retain flexibility and discretion as allowed by those laws to develop methods and procedures, but those methods and procedures would have to satisfy the requirements of the federal law."

(*Id.* at 486.) The court concluded that "the truncated process" utilized in enacting the budget trailer bill at issue in *Mission Hospital* "did not satisfy the object and purpose" of § 13(A). Plaintiffs submit that the same is true here, and that,

accordingly, plaintiffs are likely to succeed on the merits of their challenge to the rate freeze under § 13(A).

3. Plaintiffs are likely to succeed on the merits of the argument that the rate freeze is preempted under the Supremacy Clause because the implementation of the freeze is inconsistent with the current provisions of the California State Medicaid Plan

The State Plan is a comprehensive written statement submitted by the State describing the nature and scope of its Medicaid program and giving assurance that it will be administered in conformity with federal Medicaid law. (42 C.F.R. § 430.10.) The plan must specify comprehensively the methods and standards used by the agency to set payment rates in a manner consistent with federal Medicaid law. (42 C.F.R. § 447.252(b).) With respect to rates paid, "The Medicaid agency must pay for … long term care services using rates determined in accordance with methods and standards specified in an approved State Plan." (42 C.F.R. § 447.253(i).) "Long-term care facility services" include ICF/MRs. (42 C.F.R. § 447.251.)

As described above, the State Plan requires defendants to recalculate the reimbursement rate for ICF/DD-Hs and ICF/DD-Ns each year based on cost reports and audits. (*See* Exh. 11 of RJN.)

Federal Medicaid law requires that whenever a State Medicaid agency makes a change in its methods and standards for ICFs, the agency must make a finding that the rates "are reasonable and adequate to meet the costs that must be incurred by efficiently and economically operated providers to provide services in conformity with applicable State and Federal laws, regulations, and quality and safety standards." (42 C.F.R. § 447.253(b)(1)(i).) The State Medicaid agency must also demonstrate that it has complied with the public notice requirements in § 447.205 when it is proposing significant changes to its methods or standards for setting payment rates for ICF/DD-Hs and ICF/DD-Ns. (42 C.F.R. § 447.253(i).)

///

Defendants have submitted a request for a State Plan Amendment that would implement the ICF/DD-H and ICF/DD-N rate freeze, but that this State Plan Amendment has apparently not been approved. (*See* Macomber decl., ¶¶ 12, 15-18.) The Ninth Circuit has held that the State Medicaid Director cannot implement State Plan amendments until federal approval has been granted. (*Exeter Memorial Hospital Ass'n*, *supra*, 145 F.3d 1106 (California was required to obtain approval from the federal government before implementing amendments to Medi-Cal.); *Oregon Ass'n of Homes for the Aging, Inc.* v. *State of Oregon* (9th Cir. 1993) 5 F.3d 1239, 1241 (A law that effects a change in payment methods or standards without federal approval is invalid.).)

ICF/DD-Hs and ICF/DD-Ns submitted their cost reports in accordance with the currently effective State Plan methodology and defendants conducted audits and applied the currently effective State Plan methodology to calculate rates for the 2009-10 fiscal year, which are higher than the rates for the 2008-09 fiscal year. (Macomber decl., ¶¶ 14, 19.) Until the State Plan is changed, defendants are required to perform these calculations and implement the resulting reimbursement rates. Thus, plaintiffs have a high likelihood of success on the merits of their preemption argument on the grounds that defendants' current implementation of the rate freeze is inconsistent with and preempted by federal Medicaid law and the existing State Plan. (It should also be noted that even if the State Plan were changed, to the extent that the new provisions conflict with federal law, they could not be legally implemented by DHCS; that issue is not currently before the Court.)

C. Plaintiffs Are Suffering And Will Continue To Suffer Irreparable Injury As A Result Of The Rate Freeze

In *Independent Living Center* v. *Shewry* (9th Cir. 2008) 543 F.3d 1050, 1058, the Ninth Circuit held that health care providers have standing to being an action for injunctive relief under the Supremacy Clause if they will be directly injured by loss of gross income as the result of a reduction in Medi-Cal reimbursement rates.

In *California Pharmacists Ass'n*, *supra*, 563 F.3d 847, 851-52, the Ninth Circuit found that monetary harm in the form of lost revenue before the merits of a challenge to a reduction in Medi-Cal reimbursement rates constitutes harm that is also irreparable because the Eleventh Amendment sovereign immunity of DHCS (a branch of the State of California government) bars providers from recovering damages in federal court. The Ninth Circuit observed that, although damages may become available to health care providers in State court, persuasive authority suggests that federal courts may consider only what *federal* remedies are available. (*Id.* at 852 n.2, *citing United States* v. *New York* (2d Cir. 1983) 708 F.2d 92, 93-94 (per curiam).)

Using the defendants' own calculations, each ICF/DD-H and ICF/DD-N has been underpaid for every day of service provided to every patient since August 1, 2009. Thus, the 49 company members of plaintiff DSN, including plaintiff UCP, which collectively own and operate approximately 250 ICF/DD-H and ICF/DD-N facilities, are likewise being irreparably harmed by the imposition of the AB4X_5 rate freeze on the reimbursement rates for ICF/DD-Hs and ICF/DD-Ns because they cannot recover the unlawfully withheld amounts of the 2009-10 reimbursement rates from defendants in federal court. (Mattson Decl., ¶ 4.)

Unless enjoined, this underpayment will continue for years until a final decision on the merits. As just one example of the hardship, plaintiff UCP's six-bed ICF/DD-N, Newport House in Chatsworth, California, has been underpaid $21,097 for the six-month period August 1, 2009 to January 31, 2010, based on the difference between the 2008-09 rate it was paid and the 2009-10 "unfrozen" rate calculated by DHCS. (Cohen decl., ¶ 9.) Moreover, UCP, which owns and operates 12 ICF/DD-H facilities and 9 ICF/DD-N facilities, has been underpaid $301,946 for all of its facilities for the same six-month period. (Cohen decl., ¶ 10.) Since all ICF/DD-Hs and ICF/DD-Ns would have been paid at a higher rate beginning August 1, 2009, if DHCS had implemented the "unfrozen" rates as

required by federal law, all members of DSN are being monetarily injured every day that they are paid at the 2008-09 levels. (Macomber decl., ¶ 20; Mattson decl., ¶ 5.)

D. The Balance Of Hardships Tips In Plaintiffs' Favor And The Granting Of An Injunction Is In The Public Interest

The only official reason for the enactment of AB4X_5 is to address the State of California budget situation. When it was introduced as a placeholder spot bill, the bill explained that "This act addresses the fiscal emergency declared by the Governor by proclamation on July 1, 2009, pursuant to subdivision (f) of Section 10 of Article IV of the California Constitution." (*See* Exh. 5 of RJN.) The committee reports give as the only reason for the bill that it "contains necessary changes to enact modifications to the 2009 Budget Act." (*See* Exh. 8 at p. 1; Exh. 9 at p. 1 of RJN.) The only reason given for the freeze on rates for long-term care is to save money. (*See* Exh. 9 at p. 2, Exh. 10 at p. 2 of RJN.)

The Ninth Circuit has recently and repeatedly recognized that "state Medicaid rate reductions may not be based solely on state budgetary concerns. (*Independent Living Center*, *supra*, 572 F.3d 655.) In *Dominguez, supra*, 596 F.3d 1087, 1098, the court noted, "[W]e have repeatedly recognized that individuals' interests in sufficient access to health care trump the State's interest in balancing its budget." The record here supports the conclusion that the State's sole reason for imposing the cuts was California's fiscal emergency. (*Independent Living Center, supra*, 572 F.3d at 655.) As in the *Independent Living Center* case, the legislation was passed in an emergency session called to address the fiscal emergency declared by the government. (*Id.*) In *Independent Living Center*, the Ninth Circuit concluded, "the State's decision to reduce Medi-Cal reimbursement rates based solely on state budgetary concerns violated federal law." Likewise, the State's decision in this case to freeze Medi-Cal reimbursement rates, which was effectively a reduction, based solely on state budgetary concerns, violated federal law.

Since the State's fiscal emergency is not a hardship that warrants Medi-Cal reimbursement rate reductions or freezes, and plaintiffs have demonstrated that DSN's members and UCP are suffering daily harm by being reimbursed at the "frozen" rate, the balance of hardships tips in plaintiffs' favor, and the public interest is clearly in favor of the issuance of an injunction. As the Ninth Circuit found in the *California Pharmacists* case,

> [I]t is clear that it would not be equitable or in the public's interest to allow the state to continue to violate the requirements of federal law, especially when there are no adequate remedies available to compensate the Hospital Plaintiffs for the irreparable harm that would be caused by the continuing violation. In such circumstances, the interest of preserving the Supremacy Clause is paramount.

(*California Pharmacists, supra*, 563 F.3d at 852-53.)

The frozen rates impose a great hardship to the owners and operators of ICF/DD-Hs and ICF/DD-Ns daily. Per the DHCS's own calculations, depending on the type of facility, these owners and operators should be paid up to 9.03% more per patient per day to assist with the cost of caring for this medically needy population. For the facilities serving a particularly fragile population, such as the UCP's Newport House, where residents need 24-hour nursing care, specialized feeding through a g-tube (feeding tube), physical and occupational therapy, and other highly specialized services, costs are higher than the costs of providing care to able-bodied developmentally disabled individuals. (Cohen decl., ¶ 5.) For a facility like the Newport House, even the unfrozen 2009-10 rates are significantly below the facility's audited costs ($303.07 costs per day vs. $211.63 at the 2008-09 rates and $230.74 at the unfrozen 2009-10 rates). (Cohen decl., ¶ 8.) Moreover, in contrast, the State Developmental Centers, operated by the California Department of Developmental Services, receive approximately $500.00 per patient per day for

providing comparable services. (Macomber decl., ¶¶ 3, 21.)

Declarants Ronald S. Cohen, Ph.D., P. Dennis Mattson, Ph.D., and Gary Macomber have each been in the ICF/DD industry for over 20 years. (*See* Cohen decl., ¶¶ 2, 3; Mattson decl., ¶¶ 2, 3; Macomber decl., ¶¶ 2, 3.) They believe that if the frozen rates continue to be paid, it is only a matter of time before ICF/DD-Hs and ICF/DD-Ns begin to go out of business, which will result in a loss of access to care for the highly needy population served by ICFs as well as a diminution in the quality of care furnished by those ICFs remaining in the program trying to stay afloat while being reimbursed at a level below their costs of operation. (Cohen decl., ¶ 11; Mattson decl., ¶ 5; Macomber decl., ¶ 22.) As the cost of gas, food, salaries, and other supplies continue to grow, the gap between costs and the frozen reimbursement rates will continue to grow, as well. (Cohen decl., ¶ 11.) As private facilities close, the burden will grow on the State Developmental Centers, which are limited in capacity and are reimbursed at a higher rate than private facilities, ultimately costing the State more than continuing to pay private facilities at the federally-mandated unfrozen rates.

E. A Preliminary Injunction Has Already Issued Enjoining Defendants From Implementing The Section 14105.191(f) Rate Freeze With Respect To Other Providers

On November 24, 2009, the California Hospital Association filed a lawsuit against defendant Maxwell-Jolly, challenging, among other provisions, the Section 14105.191(f) rate freeze as applied to nursing facilities that are part of hospitals and pediatric subacute care units that are part of hospitals. (*California Hospital Association* v. *Maxwell-Jolly* (C.D. Cal.) Case No. CV 09-8642 CAS ("the *CHA* action").)

In the *CHA* action, the plaintiff alleged that the Section 14105.191(f) rate freeze violated § 30(A) and was therefore invalid under the Supremacy Clause of because neither the Director nor the California Legislature considered the "quality of care" and "equal access" provisions of § 30(A), or whether reimbursement rates

were reasonably related to provider costs, before its implementation. On February 24, 2010, this Court granted the *CHA* plaintiff's motion for a preliminary injunction, on the grounds, in part, that the plaintiff had demonstrated a likelihood of success on the merits of its § 30(A) claim and had sufficiently demonstrated that there was a likelihood that CHA's member hospitals would suffer monetary losses as a result of the AB4X_5 rate freeze.

Since the likelihood of success on the merits, showing of irreparable injury, the balance of hardships, and the public interest are essentially the same here, a preliminary injunction is also warranted.

IV. CONCLUSION

For the foregoing reasons, plaintiffs request that the Court preliminarily enjoin defendants from continuing to implement the rate freeze to the reimbursement rates payable to ICF/DD-Hs and ICF/DD-Ns and issue a mandatory injunction requiring defendants to reimburse ICF/DD-Hs and ICF/DD-Ns at the 2009-10 unfrozen rates already calculated by defendants.

Dated: May 10, 2010

Murphy Austin Adams Schoenfeld LLP

By: _____
KATHRYN DOI
JENNY MAE PHILLIPS

Dated: May 10, 2010

Law Offices of Douglas S. Cumming

By: _____
DOUGLAS S. CUMMING

Attorneys for Plaintiffs DEVELOPMENTAL SERVICES NETWORK; UNITED CEREBRAL PALSY OF LOS ANGELES; and HOME OF GUIDING HANDS

KATHRYN DOI, SBN 121979
Email: kdoi@murphyaustin.com
JENNY MAE PHILLIPS, SBN 255458
Email: jphillips@murphyaustin.com
MURPHY AUSTIN ADAMS SCHOENFELD LLP
304 "S" Street (95811-6906)
Post Office Box 1319
Sacramento, California 95812-1319
Telephone: (916) 446-2300
Facsimile: (916) 503-4000

DOUGLAS S. CUMMING, SBN 88580
Email: dsc@dougcummingmedical-law.com
LAW OFFICES OF DOUGLAS S. CUMMING
542 5th Street
Lincoln, CA 95648
Telephone: (916) 434-8719
Facsimile: (916) 645-2997

Attorneys for Plaintiffs
DEVELOPMENTAL SERVICES NETWORK; and
UNITED CEREBRAL PALSY/SPASTIC CHILDREN'S FOUNDATION OF LOS ANGELES AND VENTURA COUNTIES

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

DEVELOPMENTAL SERVICES NETWORK, et al., Plaintiffs, v. DAVID MAXWELL-JOLLY, et al., Defendants.	Case No. CV10-03284 **[PROPOSED] ORDER FOR PRELIMINARY INJUNCTION** **DATE: June 7, 2010** **TIME: 10:00 a.m.** **DEPT: 5 – 2nd Floor** ASSIGNED FOR ALL PURPOSES TO HON. CHRISTINA A. SNYDER

On June 7, 2010, in Courtroom 5 of the above referenced court, located at 312 N. Spring Street, Los Angeles, California, plaintiff Developmental Services Network ("DSN"), on behalf of its members, and plaintiff United Cerebral Palsy/Spastic Children's Foundation of Los Angeles and Ventura Counties ("UCP") moved the Court for a preliminary injunction requiring defendants David

Maxwell-Jolly, Director of the California Department of Health Care Services ("Director") and the California Department of Health Care Services ("DHCS"), their agents, employees, and all persons acting in concert with them discontinue implementation of California Welfare & Institutions Code section 14105.191(f)(2)(A) as to the members of DSN and as to UCP and to immediately reimburse the members of DSN and UCP at the rates calculated by the DHCS to be effective August 1, 2009, for the 2009-10 fiscal year.

On reading the complaint on file, the supporting memorandum of points and authorities, the supporting declarations, and other documents listed in support of this notice, and it appearing to the satisfaction of the Court that this is a proper case for granting a preliminary injunction, and that unless a preliminary injunction is granted, irreparable injury will result to the members of DSN and UCP before this matter can be heard on the trial of the merits.

IT IS HEREBY ORDERED AS FOLLOWS:

Defendants Director and the DHCS, their employees, agents, and others acting in concert with them be, and hereby are, required to immediately discontinue implementation of California Welfare & Institutions Code section 14105.191(f)(2)(A) as to the members of DSN and as to UCP and to immediately reimburse the members of DSN and UCP at the rates calculated by the DHCS to be effective August 1, 2009, for the 2009-10 fiscal year.

LET THE ABOVE ORDER ISSUE.

DATED: _____

BY: _____
HON. CHRISTINA A. SNYDER
JUDGE OF THE U.S. DISTRICT COURT