DIVISION ONE
FILED: 1/29/2013
RUTH A. WILLINGHAM, CLERK
BY: mjt

IN THE COURT OF APPEALS
STATE OF ARIZONA
DIVISION ONE

SAMARITAN HEALTH SYSTEM, an Arizona corporation dba Desert Samaritan Hospital, Good Samaritan Medical Center, Havasu Samaritan Regional Hospital, Maryvale Samaritan Hospital, Thunderbird Samaritan Hospital, and Page Hospital; ARROWHEAD HOSPITAL, an Arizona corporation; MEDICAL ENVIRONMENTS, INC., a California corporation dba Bullhead Community Hospital; CARONDELET HEALTH SERVICES, INC., an Arizona corporation dba Carondelet St. Joseph's Hospital and Carondelet St. Mary's Hospital; CASA GRANDE REGIONAL MEDICAL CENTER, an Arizona corporation; CHANDLER REGIONAL HOSPITAL, an Arizona corporation; MESA GENERAL HOSPITAL, an Arizona corporation dba Community Hospital Medical Center; SUN HEALTH CORPORATION, an Arizona corporation dba Del E. Webb Memorial Hospital and Walter O. Boswell Memorial Hospital; FLAGSTAFF MEDICAL CENTER, INC., an Arizona corporation; HEALTHWEST REGIONAL MEDICAL CENTER, an Arizona corporation; HOLY CROSS HOSPITAL AND HEALTH CENTER, INC., an Arizona corporation; JOHN C. LINCOLN HOSPITAL AND HEALTH CORPORATION, an Arizona corporation; KINGMAN HOSPITAL, INC., an Arizona corporation dba	No. 1 CA-CV 12-0031 DEPARTMENT D **MEMORANDUM DECISION** (Not for Publication - Rule 28, Arizona Rules of Civil Appellate Procedure)

Kingman Regional Medical Center; MARCUS J. LAWRENCE MEDICAL CENTER, an Arizona corporation; MESA GENERAL HOSPITAL MEDICAL CENTER, INC., an Arizona corporation; LUTHERAN HEALTH NETWORK, an Arizona corporation dba Mesa Lutheran Hospital and Valley Lutheran Hospital; PARADISE VALLEY HOSPITAL, an Arizona corporation; PHOENIX BAPTIST HOSPITAL, an Arizona corporation; PHOENIX CHILDREN'S HOSPITAL, an Arizona corporation; PHOENIX MEMORIAL HOSPITAL, an Arizona corporation; SCOTTSDALE MEMORIAL HOSPITAL, an Arizona corporation; MERCY HEALTHCARE ARIZONA, an Arizona corporation dba St. Joseph's Hospital and Medical Center; SIERRA VISTA COMMUNITY HOSPITAL, an Arizona corporation; TUCSON MEDICAL CENTER, an Arizona corporation; UNIVERSITY MEDICAL CENTER CORPORATION, an Arizona corporation; YAVAPAI REGIONAL MEDICAL CENTER, an Arizona corporation; and YUMA REGIONAL MEDICAL CENTER, an Arizona Corporation,

Plaintiffs/Appellees,

v.

ARIZONA HEALTH CARE COST CONTAINMENT SYSTEM ADMINISTRATION, an Agency of the State of Arizona; and TOM BETLACH (successor to Anthony Rodgers), in his capacity as Director,

Defendants/Appellants.

Appeal from the Superior Court in Maricopa County

Cause No. LC 2009-000282-001

The Honorable Crane McClennen, Judge

REVERSED; REMANDED

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J O H N S E N, Judge

¶1 The Arizona Health Care Cost Containment System Administration ("AHCCCS") appeals from the superior court's determination that AHCCCS abused its discretion when it modified certain rates it paid hospitals for services for AHCCCS patients during the late 1990s. We conclude AHCCCS did not abuse its discretion in adopting the rates and reverse the judgment in favor of Samaritan Health Systems and other hospitals (collectively, "Samaritan") and remand for entry of judgment in favor of AHCCCS.

FACTS AND PROCEDURAL HISTORY

¶2 AHCCCS administers Arizona's Medicaid program through a federal-state partnership pursuant to Title XIX of the Social

Security Act. *See* 42 U.S.C. §§ 1396a *et seq.* (West 2013).[1] At issue here is one aspect of the methodology AHCCCS developed in 1993 to reimburse hospitals for treating Medicaid patients between 1994 and 1999. This is the second time this case has come before this court in litigation spanning 17 years.

¶3 The methodology at issue reimbursed hospitals through two mechanisms. The first mechanism, applicable to most patient cases, was a tiered per diem rate under which AHCCCS paid hospitals a fixed amount for each day a patient in a particular class was hospitalized. The classes, called tiers, distinguished patients based on their condition and care, such as a maternity, surgery or intensive care. *Samaritan Health Sys. v. Ariz. Health Care Cost Containment Sys. Admin.*, 198 Ariz. 533, 535, ¶ 3, 11 P.3d 1072, 1074 (App. 2000). The per diem rates were determined prospectively based on the statewide average cost of treating the various tiers of patients.

¶4 The hospitals requested, and AHCCCS agreed, to provide an alternate reimbursement mechanism for a small class of patients whose treatment was extraordinarily more expensive than others. This mechanism applied to "exceptionally high cost" claims, termed "outliers." AHCCCS reimbursed hospitals for outlier claims by paying them a fixed percentage of the total

[1] Absent material relevant revisions after the relevant date, we cite a statute's current version.

costs hospitals incurred in treating these particular cases. *Id.* at ¶ 5. The percentage was "based on the statewide ratio of total hospital costs to total charges." *Id.*

¶5 Under a formula used by AHCCCS, a hospital claim was put into the "outlier" tier when

> the cost per day, excluding capital and medical education, is in excess of the greater of:
>
> a. The weighted average operating cost per day within a tier plus or minus three standard deviations, or
>
> b. The overall weighted average operating cost per day plus or minus two standard deviations across all tiers.

Ariz. Admin. Code ("A.A.C.") R9-22-101.84. As devised by AHCCCS, this formula was intended to put about one percent of all cases into the outlier tier. Because outliers were not paid at the per diem rates, AHCCCS did not include the outliers' costs in calculating the per diem rates; to do so would have disproportionately raised the per diem rate. *Samaritan*, 198 Ariz. at 535, ¶ 6, 11 P.3d at 1074. The per diem rates therefore were based on the statewide average cost to hospitals of treating all non-outlier claims in a particular tier. *Id.*

¶6 The present dispute stems from AHCCCS's annual revisions of the outlier threshold between 1994 and 1998. When the methodology was developed in 1993, there was no statutory provision that explicitly provided for an outlier component to

the reimbursement scheme. The original enabling statute for the implementation of the system, Arizona Revised Statutes ("A.R.S.") section 36-2903.01(J) (1993), only provided for per diem payments and periodic revisions to the per diem payments. At the time, the enabling statute in pertinent part provided:

> 1. For inpatient hospital stays, the administration *shall* use a *prospective tiered per diem methodology* . . . [including a] stop loss-stop gain or similar mechanism . . . [that ensures] that the tiered per diem rates assigned to a hospital do not represent less than ninety per cent of its 1990 base year costs or more than one hundred ten per cent of its 1990 base year costs, adjusted by an audit factor, during the period of March 1, 1993 through September 30, 1994. The tiered per diem rates set for hospitals shall represent no less than eighty-seven and one-half per cent or more than one hundred twelve and one-half per cent of its 1990 base year costs, adjusted by an audit factor, from October 1, 1994 through September 30, 1995 and no less than eighty-five per cent or more than one hundred fifteen per cent of its 1990 base year costs, adjusted by an audit factor, from October 1, 1995 through September 30, 1996. . . . An adjustment in the stop loss-stop gain percentage may be made to ensure that total payments do not increase as a result of this provision.
>
> 2. For rates effective on October 1, 1994, and *annually* thereafter, the administration *shall* adjust tiered per diem payments for inpatient hospital care by the data resources incorporated market basket index for prospective payment system hospitals and *shall* also adjust payments to reflect changes in length of stay.

> 3. Subsequent to October 1, 1993, the administration *shall* recalculate the per diem payments every *two to four years*, as determined by the administration, using an updated data base of hospital claims and encounters.

A.R.S. § 36-2903.01(J) (1993) (emphasis added).

¶7 Under the statute, AHCCCS was obligated to adjust the per diem rates annually to take into account inflation and changes in the length of hospitalizations, and every two to four years was required to more broadly recalculate the per diem payments it would make to hospitals based on costs actually incurred. When AHCCCS first annually updated the per diem rates pursuant to A.R.S. § 36-2903.01(J)(2) in 1994, however, it became clear that the number of claims beyond the outlier threshold had become significantly greater than one percent of total claims. To maintain the number of outliers at about one percent of total claims, AHCCCS increased its outlier threshold annually from 1994 to 1998 by recalculating the threshold "based on information it received from hospitals statewide and according to the 'standard deviation' formula." AHCCCS codified this practice in 1997 by amending the Arizona Administrative Code to provide that:

> Update. Administration shall update the outlier cost thresholds and outlier charge thresholds for each hospital. The outlier cost thresholds are updated annually by recalculating the standard deviations based

> on the claims and encounters used for the length-of-stay adjustment . . . .

A.A.C. R9-12-711(A)(5)(b).

¶8 When AHCCCS raised the outlier thresholds annually between 1994 and 1998, it did not also recalculate the per diem rates applicable to non-outlier claims. The result was that claims that fell just below the newly adjusted outlier threshold were paid at a per diem rate calculated based on other lower-cost claims. Samaritan contends that AHCCCS's manner of adjusting the outlier thresholds caused AHCCCS to underpay hospitals $96,000,000 over the four years in dispute. The disagreement over AHCCCS's increases in the outlier thresholds did not cease until the statute was modified in 1999 to freeze the thresholds in effect on October 1, 1999 and permit AHCCCS to adjust those thresholds annually only based on inflation. A.R.S. § 36-2903.01(J) (1999).

¶9 Samaritan successfully challenged the four annual outlier threshold modifications in superior court, but this court reversed, holding Samaritan had failed to exhaust its administrative remedies. *Samaritan*, 198 Ariz. at 534, ¶ 1, 11 P.3d at 1073. Samaritan then filed an administrative claim, arguing AHCCCS abused its discretion and acted arbitrarily and capriciously in raising the outlier thresholds. After a three-day evidentiary hearing, an administrative law judge ("ALJ")

determined that AHCCCS "did not act outside of its legal authority and did not abuse its discretion by increasing the outlier thresholds in the manner that they were increased each year from 1994 through 1998." The ALJ premised his decision on his finding that the

> evidence shows that in considering how to exercise its discretion regarding outlier rates, [AHCCCS] considered the definition of outlier in the State Plan and its intention to keep outliers at one percent of all claims. Further, AHCCCS was aware that it could not recalculate the per diem rates each year, so that was not an option. Also, because of the specific wording of the statute, [AHCCCS] had authority to adjust for inflation only the "tiered per diem" rates and not any other rates. Finally, [AHCCCS] determined that length-of-stay adjustments for outlier rates would be covered by annually updating the outlier thresholds because the database used for the outlier updates contained length-of-stay data. Thus, the evidence shows a reasoned choice by AHCCCS that cannot be characterized as arbitrary or capricious.

¶10 After the Director of AHCCCS adopted the ALJ's decision in its entirety, Samaritan filed a complaint in superior court, and the court concluded AHCCCS abused its discretion in modifying the outlier thresholds because "[t]o the extent the legislature mandated that AHCCCS payment must relate to the hospitals' costs for treating those patients, the revised system would no longer satisfy the legislative mandate." The court reasoned that because AHCCCS did not have the statutory

authority to recalculate the per diem rates annually pursuant to A.R.S. § 36-2903.01(J)(3) (1993), AHCCCS "should have left the threshold where it was so that the per diem accurately reflected the average cost for those cases below the threshold." We have jurisdiction over AHCCCS's timely appeal pursuant to A.R.S. §§ 12-120.21(A)(1) (West 2013) and -2101(A)(1) (West 2013).

DISCUSSION

A. Legal Principles.

¶11 Pursuant to A.R.S. § 12-910(E) (West 2013), in reviewing an agency's action, a "court shall affirm the agency action unless after reviewing the administrative record and supplementing evidence presented at the evidentiary hearing the court concludes that the action is not supported by substantial evidence, is contrary to law, is arbitrary and capricious or is an abuse of discretion." On appeal from a superior court's review of an administrative decision, "we consider whether the agency action was supported by the law and substantial evidence and whether it was arbitrary, capricious or an abuse of discretion." *Sharpe v. Ariz. Health Care Cost Containment Sys.*, 220 Ariz. 488, 492, ¶ 9, 207 P.3d 741, 745 (App. 2009) (quotation omitted). We therefore focus on the AHCCCS Director's decision, which adopted the ALJ decision in its entirety, rather than the superior court's decision. *Id.* While we give great weight to an agency's interpretation of a statute

or regulation it implements, "we review an agency's application and interpretation of the law *de novo*," and therefore are "free to draw our own legal conclusions in determining if the [agency] properly interpreted the law." *Id.* at 492, 494, ¶¶ 9, 18, 207 P.3d at 745, 747 (quotation omitted).

¶12 An agency acts arbitrarily and capriciously when it does not examine "the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made." *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (quotation omitted). In the context of a federal agency regulation, a rule is arbitrary and capricious if "the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise." *Id.* Under this analysis, the question is whether the agency has taken an action "without consideration and in disregard for facts and circumstances; where there is room for two opinions, the action is not arbitrary or capricious if exercised honestly and upon due consideration, even though it may be believed that an

erroneous conclusion has been reached." *Petras v. Ariz. State Liquor Bd.*, 129 Ariz. 449, 452, 631 P.2d 1107, 1110 (App. 1981).

B. Given the Purpose of the Reimbursement Methodology and Governing Statutes, AHCCCS Did Not Abuse Its Discretion in Raising Outlier Thresholds.

¶13 Samaritan argues AHCCCS's modifications of the outlier thresholds during the four years in question were arbitrary and capricious because they "violate[d] the rules of arithmetic and undermine[d] the concept of a cost-based system." Samaritan argues that because the reimbursement system is based on costs, AHCCCS's decision to raise the outlier thresholds without recalculating the per diem rates "contradicts the essence of a cost-based system by forcing real costs to disappear from the system." It continues: "Under the *Motor Vehicle Manufacturers'* standard, AHCCCS relied on 'irrelevant factors' and failed to think through 'important aspect[s] of the problem' by making its 'definition' of outliers the sole policy consideration. AHCCCS lost sight of other 'factors' that were 'relevant' to its decision – namely, the rules of arithmetic in the context of a cost-based system."

¶14 We cannot accept Samaritan's argument, however, because it rests on a fundamental mischaracterization of the purpose of the cost-based reimbursement system. While it is true that AHCCCS's decision to raise the outlier thresholds lowered the amount it paid hospitals under that payment

mechanism, Samaritan points to nothing in the history or structure of the law requiring that hospitals must be reimbursed 100 percent of their costs for treating Medicaid patients. To the contrary, the history of the 1993 methodology and the language of the statute indicate that the per diem methodology was not intended to reimburse hospitals for all of the costs they incur in treating those patients. At the relevant time, § 36-2903.01(J)(1) (1993) provided that the initial rates "shall be based upon hospital claims and encounter data" for 1991-92. While requiring a payment mechanism "based upon" hospitals' costs, the statute did not specify that AHCCCS reimburse hospitals for all of their costs.

¶15 The 1993 cost-based methodology was a replacement for another payment method known as Adjusted Billed Charges ("ABC"), which reimbursed hospitals a percentage of their total *charges* (as distinct from their *costs*) for treating a Medicaid patient. The legislation that mandated the ABC system provided that its purpose was to keep reimbursement constant with 1984 levels. Thus, whenever a hospital would increase its charged rates, AHCCCS would adjust a hospital-specific "factor" downward by the amount of the increase so that the result would be payment at the 1984 level.

¶16 In reality, neither AHCCCS nor Samaritan was happy with how ABC worked. As a practical matter, the methodology did

not hold reimbursements constant at 1984 levels because hospitals' billed charges were rising faster than AHCCCS could adjust the rates it applied to the hospitals' charges. And hospitals were concerned at what they saw as the prospect of a continually widening gap between charges and reimbursement.

¶17 Two 1988 studies recommended replacing the *charge*-based system with the 1993 *cost*-based system; the cost-based system was designed as a prospective payment system that would set fixed rates for services into the future, thus encouraging efficiencies. Nothing in the legislative history or the statute, however, suggested that the cost-based per diem methodology would result in AHCCCS reimbursing hospitals for 100 percent of their costs in treating a Medicaid patient. An expert for AHCCCS who was involved in developing the 1993 methodology, in fact, testified before the ALJ that the new system was never intended to reimburse hospitals their costs for every service they provided.

¶18 The text of A.R.S. § 36-2903.01(J)(1) further reflects the notion that hospitals were not to be reimbursed for all of their costs. The statute implemented a stop-loss/stop-gain provision for the three years following the implementation of the new system that delimited AHCCCS's payments to each hospital. For example, from 1993 to 1994, AHCCCS could not reimburse any hospital less than 90 percent or more than 110

percent of its 1990 costs. A.R.S. § 36-2903.01(J)(1). Similarly, for the periods from 1994 to 1995 and 1995 to 1996, AHCCCS's payments were mandated to be between 87.5 percent and 112.5 percent and 85 percent and 115 percent of a hospital's 1990 costs, respectively. *Id.*

¶19 On appeal, Samaritan dismisses the stop-loss/stop-gain mechanism as a "temporary backstop for hospitals with above-average operating costs" because after 1996, hospitals were to be reimbursed according to the statewide per diem average. While this is literally true, Samaritan's argument ignores the statutory provision requiring AHCCCS to recalculate the statewide average "every two to four years, as determined by the administration." A.R.S. § 36-2903.01(J)(3). Thus, in enacting the statute, the legislature recognized that to the extent that costs rose, it would be two to four years before the per diem rates would be recalculated in response.

¶20 Further confirmation that the AHCCCS payment mechanism was not intended to guarantee that hospitals would be reimbursed for all of their costs is the explicit requirement in the Code of Federal Regulations that a state's Medicaid payments do not in the aggregate exceed what would have been paid under Medicare principles of reimbursement. The Medicare principle, in turn, requires reimbursement of only the lesser of reasonable costs or charges. 42 C.F.R. § 447.272 (West 2013).

¶21 Nevertheless, Samaritan contends that notwithstanding that the Arizona statute did not obligate AHCCCS to specially treat an outlier tier of the most expensive patient cases, once AHCCCS did implement the outlier component, it could not unilaterally raise the outlier threshold in a manner that resulted in shortfalls in per diem reimbursements. Samaritan argues the agency's decision to maintain the class of outliers as the most expensive one percent of cases was arbitrary and capricious.

¶22 This argument fails to recognize the purpose of the outlier component and the role it played in the wider statutory scheme. The outlier was one aspect of an otherwise complex, interconnected reimbursement system intended in part to contain hospital costs. The legislature's intent to contain costs can be seen within the statutory scheme. For example, A.R.S. § 36-2903(B)(4) (West 2013) notes that the administrator of the system has a responsibility to develop "a complete system of accounts and controls for the system including provisions designed to ensure that covered health and medical services provided through the system are not used unnecessarily or unreasonably . . . . The administrator shall periodically assess the cost effectiveness and health implications of alternate approaches to the provision of covered health and medical services through the system in order to reduce

unnecessary or unreasonable utilization." Further, AHCCCS's expert testified the outlier component of the reimbursement mechanism was only one of several variables, some favoring AHCCCS and others favoring the hospitals, that made up the entire reimbursement scheme.

¶23 Given that a purpose of the program is to limit the costs of care, we cannot conclude AHCCCS acted arbitrarily by deciding it would reimburse only the most expensive one percent of cases at the outlier rate.

C. Samaritan's Contention that AHCCCS Should Have Adjusted the Outlier Threshold for Inflation Does Not Comport With the Methodology's Goal of Containing Costs.

¶24 Samaritan does not argue AHCCCS should have recalculated the per diem each year; it recognizes that A.R.S. § 36-2903.01(J)(3) did not authorize AHCCCS to recalculate the per diem rates annually. It contends, however, that rather than reset the outlier threshold annually to include only about the most expensive one percent of cases, AHCCCS should have adjusted the outlier cost threshold year to year based on inflation. So, for example, if costs rose five percent, Samaritan would have had AHCCCS raise the outlier threshold by five percent. This would mean the outlier threshold would have moved in tandem with the annual adjustment of per diem payments under A.R.S. § 36-2903.01(J)(2) to take into account inflation.

¶25 While AHCCCS rationally might have adjusted the outlier threshold as Samaritan suggests, we cannot conclude it acted arbitrarily by determining instead to maintain the outlier threshold at about the upper one percent of the patient cases. Following guidance from the United States Supreme Court, Arizona courts long have held that an agency does not act arbitrarily and capriciously merely because there is a difference of opinion as to what the agency should have done, as long as a "decision was reached after due consideration and upon a rational basis." *Griffith Energy, L.L.C. v. Ariz. Dep't of Revenue*, 210 Ariz. 132, 136, ¶ 19, 108 P.3d 282, 286 (App. 2005).

¶26 *Griffith* illustrates the flaws in Samaritan's argument. A taxpayer in that case challenged the methodology by which the state Department of Revenue ("ADOR") valued depreciating personal property at electric generation plants. *Id.* at 133, ¶ 1, 108 P.3d at 283. A state statute allowed ADOR to adopt a valuation table for depreciation, and the agency chose a table that depreciated the value of the property over 25 years. *Id.* at ¶ 4. The taxpayer asserted ADOR should have adopted a 15-year depreciation table instead. *Id.* at ¶ 5. Rejecting the taxpayer's argument, this court pointed out that given the legislature's grant of authority to ADOR to adopt such a table, the taxpayer's disagreement with the table ADOR adopted did not demonstrate an abuse of discretion. *Id.* at 136-37, ¶¶

19, 24, 108 P.3d at 286-87. We noted, "If ADOR exercised its discretion honestly and upon due consideration, and its decision was supported by substantial evidence, the tax court was required to uphold ADOR's adoption of the Table even if the court disagreed with ADOR's decision." *Id.* at 135, ¶ 16, 108 P.3d at 285. The court recounted that

> ADOR presented evidence that it selected a twenty-five-year depreciation life after gathering information from a variety of sources. Among other things, ADOR obtained information from new merchant and incumbent providers of electric generation services in Arizona, including Taxpayer, reviewed a depreciation study prepared on behalf of Pinnacle West Energy Corporation, and surveyed all other states to determine that they assigned life spans to electric generation plants ranging between twenty and thirty years. ADOR also hired independent experts to research and report on the life of a combined cycle plant. . . . Based on all this evidence, ADOR adopted a twenty-five-year life span for electric generation personal property . . . .

Id. at 136, ¶ 20, 108 P.3d at 286. Similarly, here, AHCCCS raised its outlier thresholds between 1994 and 1998 after considering a number of factors, including the state Medicaid plan's definition of outliers, A.R.S. § 36-2903.01(J), and the goal of containing costs. Accordingly, the agency's actions cannot be characterized as unsupported by substantial evidence or without due consideration.

¶27 Impliedly acknowledging the validity of AHCCCS's decision to adjust the outlier thresholds in some fashion, Samaritan argues that AHCCCS simply should have raised the threshold to account for inflation, rather than recalculating the threshold to maintain the number of outlier cases at about one percent. Samaritan argues AHCCCS acted arbitrarily and capriciously because its decision to maintain the threshold at one percent shortchanged Samaritan by $96 million.

¶28 But as AHCCCS points out, that calculation by Samaritan is based on unsupported assumptions about the reimbursement system. Samaritan calculated its "loss" by assuming every case it contends should be treated as an outlier actually would be reimbursed as an outlier. As AHCCCS's expert made clear, however, regardless of where the threshold is set, not every claim identified as an outlier is reimbursed as such. In fact, identifying a claim as an outlier is only one step in the overall scheme of how a hospital is reimbursed for such a claim. AHCCCS's expert testified that Samaritan's calculation did "not take into consideration other payments by third parties and quick pay, slow pay, and some of the other adjustments that are made to final reimbursement." As a result, Samaritan's assertion about the harm it suffered because of AHCCCS's decision to maintain the outlier threshold at about one percent of patient cases is overstated.

¶29 Second, Samaritan's current assertions are not premised on any of the flaws it identified in the proceedings before the ALJ. In those proceedings, Samaritan's expert submitted two reports, one in 1995 and another in 2002, each of which criticized the AHCCCS methodology for failing to recalculate the per diem rates to take into account costly patient cases that fell below the newly adjusted outlier thresholds. As noted, however, Samaritan now recognizes that AHCCCS by law could not have recalculated per diem rates annually. Accordingly, Samaritan's analysis of loss of $96 million was untied to its criticisms of the reimbursement system.

D. Samaritan's Reliance on *Judulang v. Holder* Is Inapposite.

¶30 Samaritan relies on *Judulang v. Holder*, 132 S. Ct. 476 (2011), as support for its contention that AHCCCS acted arbitrarily and capriciously in raising the outlier thresholds. In that case, the Supreme Court struck down as arbitrary and capricious the practice of the Board of Immigration Appeals ("BIA") of granting discretionary relief to aliens in deportation proceedings less frequently than in exclusion proceedings under an approach known as the "comparable-grounds" rule. *Id.* at 479. The Supreme Court determined that while the BIA may have had a legitimate reason for providing discretionary relief less frequently in deportation proceedings than in

exclusion proceedings, its adoption of the "comparable-grounds" approach was an abuse of discretion because it did not award discretionary relief in a "rational way." *Id.* at 485. Samaritan analogizes *Judulang* to the present case, arguing that AHCCCS's alteration of the outlier thresholds was not rational, meaning it was arbitrary and capricious.

¶31 Samaritan misunderstands the import of *Judulang* to the present case. The Court premised its *Judulang* decision on the purpose of the federal immigration laws. The Court explained that the "comparable-grounds" approach had "no connection to the goals of the deportation process or the rational operation of the immigration laws." *Id.* at 487. The approach did "not rest on any factors relevant to whether an alien (or any group of aliens) should be deported." *Id.*

¶32 Contrary to the premise of Samaritan's argument, it is not the central purpose of the AHCCCS reimbursement scheme to ensure that hospitals are reimbursed for all of their costs. The decision by AHCCCS that Samaritan challenges was consistent with the goals of the reimbursement system.

E. Samaritan May Not Now Raise Its Due-Process Argument.

¶33 Samaritan argues its due-process rights were violated by the AHCCCS grievance process, in which it contends the AHCCCS Director is both the "defendant" and the "judge." *See* A.R.S. § 41-1092.08(B), (F) (West 2013) (grievance system); *Pavlik v.*

Chinle Unified Sch. Dist. No. 24, 195 Ariz. 148, 152, ¶ 12, 985 P.2d 633, 637 (App. 1999) (due-process). Such an argument, however, must be raised first in the administrative proceeding. *See Phoenix Children's Hospital v. Ariz. Health Care Cost Containment Sys. Admin.*, 195 Ariz. 277, 282, ¶ 18, 987 P.2d 763, 768 (App. 1999) ("Allowing parties to build a factual record is one of the policies underlying the requirement that parties first seek a remedy from the agency before seeking judicial review."). Because Samaritan failed to raise this contention in the administrative proceeding, we will not address it.

CONCLUSION

¶34 For the reasons set forth above, we reverse the judgment in favor of Samaritan and remand for entry of judgment in favor of AHCCCS. Contingent on compliance with Arizona Rule of Civil Appellate Procedure 21, AHCCCS may recover its costs of appeal.

/s/

DIANE M. JOHNSEN, Judge

CONCURRING:

/s/

ANDREW W. GOULD, Acting Presiding Judge

/s/

DONN KESSLER, Judge