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CMS Acts on Medicaid State-Directed Payments

The Centers for Medicare and Medicaid Services (CMS) issued new guidance on H.R.1-imposed state-directed payment (SDP) limitations.

THE 80 MILLION

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tl;dr

- The Centers for Medicare and Medicaid Services (CMS) released preliminary guidance on H.R.1-imposed state-directed payment (SDP) limitations this month and signaled a more restrictive approach to interpreting the law.
- Some states also received CMS approvals of their SDP preprints and are likely breathing a sigh of relief that their SDPs are likely to be grandfathered under the law.

- Still, many unanswered questions remain. CMS has promised that formal guidance is in the works, which will expand on its preliminary direction.

The 80 Million Impact

The Centers for Medicare and Medicaid Services (CMS) released preliminary guidance on the implementation of state-directed payment (SDP) limits under H.R.1 (P.L. 119-21) on Sept. 9. The agency also approved a number of new state SDP preprints last week.

As explained in [previous 80 Million blogs](#), H.R.1 limits the total payment rate of any new SDPs to 100% of Medicare rates for expansion states and 110% of Medicare rates for non-expansion states, but temporarily “grandfathers” certain SDPs with higher payment levels. Beginning in 2028, states must reduce these grandfathered SDPs by 10 percentage points per year until the total payment rate equals 100% of Medicare for expansion states and 110% for non-expansion states. These limitations, together with new restrictions on state use of provider taxes in expansion states, are estimated to result in substantial Medicaid funding cuts to states these cuts impact all states but have disproportionate effect on Medicaid expansion states.

In its new guidance, CMS clarified the definition and payment limits for grandfathered SDPs. Notably, CMS sets a more stringent limit on grandfathered SDPs by basing the cap on an *aggregate* dollar cap included in the approved preprint rather than setting a per-service cap. CMS characterizes the guidance as preliminary and notes that it intends to engage in formal rulemaking on SDPs soon, and its formal rulemaking may impose payment limits on additional services not subject to the SDP limits in H.R.1.

Here are the specifics of the key grandfathering issues addressed in the guidance:

- **Applicable rating period criteria.** H.R.1 grandfathers certain SDPs with rating periods occurring within 180 days of H.R.1’s enactment (July 4, 2025). CMS interprets the provision as applying to preprints with a rating period that includes any days from Jan. 5, 2025 through July 3, 2025 (i.e., the 180 days before H.R.1’s enactment) or July 5, 2025

through Dec. 31, 2025 (i.e., the 180 days after H.R.1's enactment). In practice, CMS notes that SDPs with rating periods of state fiscal year (SFY) 2025, calendar year (CY) 2025, or SFY 2026 could qualify for grandfathering if they also meet other relevant criteria, but those for SFY 2024 or CY 2024 would not.

- **Definition of "complete" and "good faith" effort.** H.R.1 requires that in addition to meeting the rating period criteria described above, SDPs must also meet one of the following criteria to qualify for grandfathering:
 - SDPs (other than for rural hospitals) for which written prior approval was made by CMS before May 1, 2025;
 - SDPs (other than for rural hospitals) for which a good faith effort to receive CMS approval was made before May 1, 2025;
 - SDPs for rural hospitals for which written prior approval was made by CMS before July 4, 2025;
 - SDPs for rural hospitals for which a good faith effort to receive CMS approval was made before July 4, 2025; and,
 - SDPs for which a completed preprint was submitted to CMS prior to July 4, 2025.

The guidance, based on a definition previously released through a 2023 Informational Bulletin, interprets "completed" to mean both the preprint form and, if necessary, addendum tables completed in full, "and all information must be provided only in the fillable sections of the preprint and the addendum tables." The definition suggests that CMS could deny preprints submitted to CMS prior to July 4, 2025, if even a minor question on the 21-page preprint form was left unanswered. The guidance also specifies that states must submit a completed preprint to CMS to demonstrate a "good faith effort," meaning there is no difference between the two terms.

- **Payment limits for grandfathered SDPs.** The guidance specifies that the aggregate dollar amount in the approved preprint is the payment limit for grandfathered SDPs. This interpretation departs from the underlying structure of SDPs, which are based on the utilization of services and made on a per-service basis. Historically, aggregate payment amounts included in SDP preprints were treated as estimates that would be revised based on actual utilization during the rating

period. Capping the preprint based on the aggregate dollar amount means — even before the SDP reductions begin in 2028 — payment levels cannot increase for changes in utilization, nor can they account for the impact of inflation.

The guidance does not address important questions related to H.R.1's SDP grandfathering requirements, which CMS notes will be included in subsequent rulemaking. Key questions that remain for CMS to address include:

- How the 10 percentage point reductions will be calculated beginning in 2028;
- Whether states can increase the per-service payment amount in the approved grandfathered preprint, as long as the state does not exceed the aggregate payment amount in the preprint;
- Whether states can adjust the class of providers eligible for a grandfathered preprint, either actively (e.g., adding a provider not included in the approved preprint) or passively (e.g., as a result of provider mergers or closures), as long as payments do not exceed the aggregate cap; and
- Whether — for grandfathered preprints — states need to continue submitting preprints to CMS annually, as is the current requirement.

CMS wrapped up the week by approving several state SDP preprints for New York, Illinois, and Washington D.C., among others, and issuing preliminary determinations that the preprints qualify for grandfathering under the law. All three are expansion states that will be hit hard by both the eligibility and financing restrictions in the law and had been waiting for CMS approval of their SDPs for more than 9 months.

The Bottom Line

As CMS prepares formal rulemaking related to H.R.1's SDP limits, the guidance suggests that CMS is inclined to limit the value of grandfathered SDPs based on more stringent interpretations of the law's SDP provisions. Interpreting the grandfathered SDP limit as the total aggregate payment rather than per-service payment means an effective cut to SDPs even before the statutory reductions phase in, because grandfathered SDPs cannot adjust for utilization or inflation. CMS' indication that it may limit SDPs for additional service categories not subject to the H.R.1 requirements, plus its narrow definition of

what constitutes a “completed” preprint for purposes of grandfathering, also suggests a more restrictive stance on SDP. Many crucial, open questions beyond these remain and may be answered in similarly restrictive ways. Nevertheless, with recent pre-print approvals, at least some states are breathing a sigh of relief that their SDPs have made it under the grandfathering wire.



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