HCFA Rulings

Department of Health and Human Services

Health Care Financing Administration

Ruling No. 89-2 Date: October 1989

HCFA Rulings are decisions of the Administrator that serve as precedent final opinions and orders and statements of policy and interpretation. They provide clarification and interpretation of complex or ambiguous statutory or regulatory provisions relating to Medicare, Medicaid, Utilization and Quality Control Peer Review, and related matters.

HCFA Rulings are binding on all HCFA components, the Provider Reimbursement Review Board and Administrative Law Judges who hear Medicare appeals. These decisions promote consistency in interpretation of policy and adjudication of disputes.

This Ruling establishes that HCFA's application of the absolute limit provided in 42 CFR 417.532(a)(3) on reasonable cost reimbursement to health maintenance organizations and competitive medical plans is inconsistent with recent court of appeals decisions, which have addressed absolute cost limits in other Medicare contexts.

HCFAR 89-2-1

MEDICARE PROGRAM

Health Maintenance Organizations and Competitive Medical Plans

Notice of Intent to Settle HMO and CMP Cost Reports for Periods Beginning on or after January 1, 1986, Without Application of Absolute Cost Limits.

HCFAR 89-2

PURPOSE: This Ruling provides notice of the Health Care Financing Administration's (HCFA's) determination that application of the absolute limit provided in 42 C.F.R. 417.532(a)(3) on reasonable cost reimbursement to health maintenance organizations (HMOs) and competitive medical plans (CMPs) is inconsistent with decisions of the Courts of Appeals for the Ninth and Eleventh Circuits, which have addressed absolute cost limits in other contexts. HCFA will, therefore, not apply the Part 417 absolute cost limit in determining whether HMO or CMP costs are reasonable and will promulgate an amendment to the Medicare regulations to conform those provisions to the court decisions.

CITATIONS: Sections 1861(v)(l)(A), 1871, 1876(h) of the Social Security Act (42 U.S.C. 1395x(v)(1)(A), 1395hh, 1395mm(h)); 42 C.F.R. section 417.532.

PERTINENT HISTORY: Section 114 of the Tax Equity and Fiscal Responsibility Act of 1982 amended section 1876 of the Social Security Act (the Act) to authorize two types of Medicare contracts with HMOs and CMPs: (1) "risk contracts, "under which the organization is paid a pre-determined per capita rate of payment based on 95% of the Adjusted Average Per Capita Cost (AAPCC) to the Medicare program of providing covered services to beneficiaries who are not enrolled in HMOs or CMPs, and (2) "cost contracts," under which the organization is paid its "reasonable cost" of providing services to its enrolled Medicare beneficiaries. Section 1876(h)(1) specifies that payments under such cost contracts are based on the reasonable cost "as defined in section 1861(v)" of the Act.

Section 1861(v) (1)(A) in turn provides that the reasonable cost of any services

> ... shall be the cost actually incurred, excluding therefrom any part of incurred cost found to be unnecessary in the efficient delivery of needed health services, and shall be determined in accordance with regulations . . . [which] provide for the making of suitable retroactive corrective adjustments ....

Like the provisions of section 1861(v)(1)(A) of the Act, which are applicable to costs incurred by Medicare providers, section 1876(h)(3) provides that payments to cost-contracting HMOs and CMPs

> ... shall be subject to appropriate retroactive corrective adjustment at the end of each contract year so as to assure that such organization is paid for the reasonable cost actually incurred (excluding any part of incurred cost found to be unnecessary in the efficient delivery of health services) ….

Medicare regulations published in 1985 to implement the TEFRA provisions added the requirement that, effective with cost reports beginning on or after January 1, 1986, the AAPCC would constitute an absolute limit on the amount payable to a cost-contracting HMO and CMP. Specifically 42 C.F.R. 417.532(a) provides that in addition to applying Medicare cost reimbursement principles,

> ... in judging whether costs are reasonable, HCFA applies the weighted average of the AAPCCs of each class of the organization's Medicare enrollees ... for the organization's geographic area as an absolute limitation on the total amount payable.

As explained in the preamble to the final regulation, this rule was promulgated pursuant to the section 1861(v)(1)(A) authority to exclude costs found to be unnecessary in the efficient delivery of health services. See 50 FR 1329 (January 1, 1985). As promulgated, the rule provides for no exceptions.

Since the time that §417.532 of the regulations was promulgated, the courts have construed the authority to set cost limits under section 1861(v)(1)(A) to support generalized cost limits applied on a presumptive basis, but not absolute cost limits applied on a final or conclusive basis. See Medical Center Hospital v. Bowen, 839 F.2d 1504 (11th Cir. 1988); Regents of University of California v. Heckler, 771 F.2d

1182 (9th Cir. 1985). The courts have interpreted section 186l(v)(1)(A) as requiring that a Medicare provider be afforded an opportunity under the regulations to show that in its particular case, costs in excess of the applicable cost limits were reasonable and, therefore, reimbursable. The courts relied on the requirement for retroactive corrective adjustments, reasoning that this language precluded absolute limits. As shown above, this language appears in both sections 1861(v)(1)(A) and section 1876(h).

The cost limit regulation adopted under section 1861(v)(1)(A) that is applicable to Medicare providers (42 C.F.R. 413.30) includes an exceptions process, and we believe application of that regulation to be within our statutory authority. However, the regulation applicable to cost-contracting HMOs and CMPs under section

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1876(h) of the Act imposes an absolute limit on reimbursement, without an exceptions process or criteria for evaluating whether costs in excess of the limit were in fact reasonable. We have, therefore, determined that section 417.532 of the regulations should be revised to assure that claims for reasonable costs incurred by HMOs or CMPs with cost contracts are not inappropriately denied. However, given the Supreme Court's decision that retroactive rulemaking is not authorized under the Medicare statute (Bowen v. Georgetown University Hospital, 109 S. Ct. 468 (1988)), any revised regulation could not affect cost reports that are currently pending.

We have made tentative settlement on HMOs' and CMPs' cost reports for periods beginning on or after January 1, 1986. We now determine that, in view of the adverse decisions of the Federal courts on the application of cost limits applicable to providers, until the regulations are revised, we will not apply the provisions of 42 C.F.R. 417.532(a)(3) in calculating the final amount of payments due cost-contracting HMOs or CMPs for periods beginning on or after January 1, 1986. Because any revisions in §417.532 would apply prospectively only, it would serve no purpose to delay final settlement of cost reports until after the revisions are promulgated. In reviewing cost reports of HMOs, HCFA may use area AAPCC levels as a guideline in evaluating whether further examination of specific cost reports is necessary to determine whether incurred costs are reasonable.

RULING: 42 C.F.R. 417.532(a)(3) is inconsistent with the interpretation adopted by the Federal courts with respect to HCFA's underlying statutory authority to impose cost limits. We will not apply the absolute cost limit contained in the regulation to cost reports submitted by Health Maintenance Organizations or Competitive Medical Plans under section 1876(h) of the Act. HCFA will initiate rulemaking procedures to conform §417.532 to the holdings of the Federal courts with respect to the establishment of Medicare cost limits under the authority of section 1861(v)(1)(A) of the Act.

DATED: 10/31/89

Louis B. Hays
Acting Administrator
Health Care Financing
Administration