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CMS Proposes to Amend the New Medicaid Managed Care Rules to Limit the Use of Pass-Through Payments

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Health Care

On November 22, 2016, the Centers for Medicare & Medicaid Services (CMS) proposed rules to narrow the "pass-through payment" exception in the managed care regulations such that States would only be able to use the exception for pass-through payments that existed in contract or rating years that started on or before July 5, 2016. 81 Fed. Reg. 83,777. It is uncertain whether this rule will be finalized before the end of President Obama's term and/or whether the new administration will continue to support this restriction on the use of pass-through payments.

Background

On May 6, 2016, CMS finalized new rules governing Medicaid managed care. 81 Fed. Reg. 27,498. The final rules generally prohibit States from directing managed care entities to make payments to certain providers, which CMS believes is inconsistent with the concept of paying managed care entities through an actuarially sound ratemaking process. *Id.* at 27,589.

However, the regulations include several exceptions to this general prohibition, including a temporary exception for "pass-through payments," defined as "any amount required by the State to be added to the contracted payment rates . . . between the [managed care entity] and hospitals, physicians, or nursing facilities." 42 C.F.R. § 438.6(a). Because CMS recognizes that these pass-through payments have been "an important revenue source for safety-net providers" in many States, CMS decided to allow such payments to continue temporarily for hospitals, nursing facilities, and physicians. *See id.* § 438.6(a), (c), (d); 81 Fed. Reg. at 27,587-88. Starting with rating periods for contracts that begin on after July 1, 2017, States will have ten (10) years to phase-out pass-through payments to hospitals and five (5) years to phase out pass-through payments to nursing facilities and physicians. § 438.6(d).

The final rules also limit the size of pass-through payments to hospitals. Specifically, they provide that pass-through payments cannot exceed 100 percent of a "base amount" in the first contract year starting on or after July 1, 2017, and States must decrease those payments by at least 10 percentage points each successive year thereafter until they are phased out entirely in 2027. *Id.* § 438.6(d)(3). The "base amount" is an amount analogous to an Upper Payment Limit calculated pursuant to a formula set out in the regulations. *Id.* § 438.6(d)(2)(i). We described the specific calculation for the base amount, and the other rules governing these pass-through payments, in Advisory #16-15.

Proposed Changes

The rules finalized in May did not prohibit States from implementing new pass-through payments during the transitional period in which pass-through payments remain permissible. That is, the rules allow new pass-through payments that had not existed before the new managed care rules became effective. However, in an Informational Bulletin issued on July 29, 2016, CMS announced that it would not approve any "new or increased pass-through payments" under the final rules. Rather, CMS stated that it would limit the temporary pass-through payment exception to payment amounts that existed as of July 5, 2016. CMS explained that it views pass-through payments as a "problematic practice," which it is only allowing to continue temporarily to give States time to transition to new payment structures.

As previewed in the Informational Bulletin, CMS now proposes to amend the managed care regulations to limit the temporary pass-through payment exception to preexisting payments and payment amounts. Specifically, CMS proposes to require that, in order to implement pass-through payments for hospitals, nursing facilities, and/or physicians:

> a State must demonstrate that it had pass-through payments for hospitals, physicians, or nursing facilities in:
>
> > (A) Managed care contract(s) and rate certification(s) for the rating period that includes July 5, 2016, and were submitted for CMS review and approval on or before July 5, 2016; or
> > (B) If the managed care contract(s) and rate certification(s) for the rating period that includes July 5, 2016 had not been submitted to CMS on or before July 5, 2016, the managed care contract(s) and rate certification(s) for a rating period before July 5, 2016 that had been most recently submitted for CMS review and approval as of July 5, 2016.

Proposed 42 C.F.R. § 438.6(d)(1)(i); *see also id.* § 438.6(d)(5). The proposed rules also specify that "CMS will not approve a retroactive adjustment or amendment . . . to managed care contract(s) and rate certification(s) to add new pass-through payments or increase existing pass-through payments." *Id.* § 438.6(d)(1)(ii).

In addition, CMS proposes to cap the State's total pass-through payments to hospitals, nursing facilities, and physicians at the total aggregate dollar amount of pass-through payments to each category of provider that were made in the contract or rating year that includes July 5, 2015 (or, if the contract or certification for the rating year that includes July 5, 2016 were not submitted to CMS by July 5, 2016, then the contract or rating period for the previous year). *Id.* § 438.6(d)(3)(ii), (5). This cap would be in addition to the cap the final rule places on hospital payments based on a percent of the "base amount," as described in the background section above.

The proposed rule does not include a proposed effective date, but it seems clear that CMS intends to reject any new pass-through payments proposed for a contract or rating periods that started on or after July 5, 2016. It is unclear whether CMS has the authority under the Administrative Procedure Act (APA) to implement a regulation the practical effect of which will be retroactive.

In addition, it is uncertain whether CMS will be able to finalize these proposed rules before President Obama's term ends in January, and/or whether the Trump Administration would support this change to the managed care regulations. If the rules are not finalized prior to the change in administration, President-elect Trump could halt their implementation by executive order, without going through the APA's notice-and-comment rulemaking process to repeal them.

Comments

Comments on the proposed rules are due by 5 pm on December 22, 2016.

If you have any questions concerning the material discussed in this client advisory, please contact the following members of our Health Care practice group:

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