



January 3, 2007

Mark Miller, Ph.D.  
Sally Kaplan, Ph.D.  
MedPAC  
601 New Jersey Avenue, NW  
Suite 9000  
Washington, D.C. 20001

Dear Mark and Sally,

The Acute Long Term Hospital Association (ALPHA) and the Federation of American Hospitals, respectfully request that MedPAC staff reconsider its preliminary recommendation that LTACHs receive a zero market basket update for 2007. We understand from the December 2006 MedPAC hearing presentation that LTACH margins are projected to be between 0% and 2%. Notwithstanding this low projected margin, MedPAC staff recommends a zero market basket update based primarily on two factors: 1) The number of LTACHs continues to increase unabated despite numerous CMS policy changes; and 2) In the past, LTACHs have been able to adjust to payment changes and maintain margins.<sup>1</sup>

**Growth.** MedPAC's conclusion that LTACH growth continues unabated is based on 2005 data. More recent CMS data shows that LTACH growth has come to a virtual standstill in 2006. According to the October 2006 CMS Provider of Service (POS) file, there has been a net reduction of 2 LTACHs in 2006, year to date.<sup>2</sup> This net reduction compares with a net increase of 28 LTACHs during 2005.

The net standstill in LTACH growth in 2006 is the cumulative result of CMS policy changes, most specifically the HwH 25% rule. As you know, the 25% HwH LTACH rule limits the percentage of admissions from a host hospital to a co-located LTACH. This rule is still being phased-in after a one-year hold harmless period and will not take full effect until 2008. The growth in the number of LTACHs in 2005 likely reflects projects that were initiated in 2003 and 2004, prior to the HwH rule's adoption and implementation, especially given that LTACHs must establish a 25-day length of stay during a 6-month demonstration period before achieving Medicare certification as an LTACH. In fact, half of the LTACH certifications occurred in the first quarter of 2005 alone. The 2006 net reduction in LTACHs reflects the current and anticipated effect of the 25% rule and other policies. It is reasonable to expect that more HwHs will decertify as LTACHs when the HwH rule is fully phased-in. It is also reasonable to expect that new HwH projects will be extremely rare. While it is possible that freestanding LTACHs may

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<sup>1</sup> MedPAC staff also believes that private capital is readily available to LTACHs, a conclusion with which we disagree but do not address in this letter. We would be happy to discuss this issue with you further.

<sup>2</sup> This decrease in 2006 results from the certification of 5 new LTACHs and the voluntary decertification of 7 LTACHs.

replace some HwHs, this replacement, if it happens, will not be observed for quite some time and MedPAC will have opportunities to respond.

In other words, one primary goal of the HwH 25% rule policy has been achieved—LTACH growth has been brought to a virtual standstill.

**Margin.** There have also been numerous payment changes affecting LTACHs that can be anticipated to stem future growth and, equally important, control margins. Many of these changes limit LTACHs' ability to adapt their operating strategies and control costs to maintain margins. Table One summarizes recent LTACH payment changes:

Table One

<u>Effective Date</u>	<u>Payment Change</u>
October 2004	25% HwH Rule
October 2005	DRG Re-weight (4.2% rate reduction)
July 2006	1. Zero Market Basket Update 2. Short Stay Outliers Paid at Cost (3.7% payment reduction)
October 2006	DRG Re-weight (1.4% rate reduction)

The cumulative effect of these payment changes is to bring LTACH margins close to zero, as your analysis projects. LTACHs' ability to adjust to these changes and maintain margins is limited, for two primary reasons.

**Non-budget Neutral DRG Re-weighting.** First, as you know, CMS re-weights DRGs annually. For LTACHs, this DRG re-weighting is not budget neutral. Accordingly, every increment of efficiency (and margin) achieved by LTACHs is offset by an annual DRG-specific reduction in weights. If margins become excessive, the LTACH payment system has a built-in margin control mechanism designed to align payments with costs. To withhold a market basket update and at the same time re-weight DRGs in a non-budget neutral manner is adjusting for the same thing twice. This is consistent with MedPAC's recommendation that "CMS should recalibrate the LTCH PPS weights in a budget neutral manner." See, MedPAC Letter to CMS dated June 12, 2006, p. 13. To date, CMS has not adopted this recommendation and has given no indication that it will do so in the future.

**Short Stay Outlier Payment Changes.** Second, effective July 1, 2006, all "short stay outlier" cases are paid at no greater than cost and, in some cases, below cost.<sup>3</sup> Prior to this rule change, short stay outlier cases were reimbursed according to a "lesser of" payment methodology, which for most cases was above cost. The short stay outlier definition ensures that roughly 35% of cases will always be defined as "short stay outliers" since the geometric mean for each DRG is recalculated every year according to more recent data. In 2005, 35% of cases were short stay outliers. The LTACH payment methodology also

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<sup>3</sup> As you know, "short stay outliers" are defined as cases with a length of stay less than 5/6ths of the mean length of stay for each DRG.

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pays for "high cost outliers" at 80% of cost after LTACHs incur a stop loss. In 2005, 9% of cases were high cost outliers. Nearly half of all cases are now paid at or below cost, with no opportunity for margin on these cases. The new short stay outlier refinements have been in effect for only six months and significantly limit margin enhancement opportunities.

**Conclusion.** The cumulative effect of these recent payment changes is that two primary policy goals have been achieved-- LTACH growth has been slowed to a standstill and margins have been substantially suppressed. As you know, CMS's release of the annual LTACH payment rule update is imminent and we anticipate yet more changes that will further suppress margins. Given these numerous payment changes and MedPAC's previous update recommendations for providers with margins near zero percent, we respectfully request that MedPAC staff reconsider its preliminary recommendation that LTACHs receive a zero market basket update for 2007.

Sincerely,



William Walters  
Chief Executive Officer, ALTHA



Charles N. Kahn  
President, Federation of American Hospitals