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Insurance Alert

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District Of Columbia Court Of Appeals Invalidates Medicare Provider Reimbursement Manual Investment Restrictions for Foreign Captives

On August 13, 2010, the United States Court of Appeals for the District of Columbia issued a decision invalidating the provision of Provider Reimbursement Manual (PRM) § 2162.2.A.4, which governs the allowability of certain malpractice and other liability insurance premiums and includes restrictions relating to premiums paid to offshore insurance companies (known as "foreign captives" or "offshore captives") organized for the purpose of insuring the risks of, or related to, the health care provider owner(s). *See Catholic Health Initiatives v. Sebelius*, No. 09-5377 (D.C. Cir. Aug. 13, 2010) (available at **http://caselaw.findlaw.com/us-dc-circuit/1535009.html**). The Court of Appeals reversed the decision of the district court, which had affirmed the decision of the Provider Reimbursement Review Board that the PRM is a "valid extension" of the reasonable cost provisions of the Medicare Act and regulations.

Background

Despite the implementation of the Medicare payment under the Prospective Payment System, many hospitals, such as critical access hospitals, continue to receive Medicare reimbursement for the reasonable costs incurred in providing services to Medicare beneficiaries. The Medicare Act defines the "reasonable cost of any services" to be "the cost actually incurred, excluding therefrom any part of incurred cost found to be unnecessary in the efficient delivery of needed health services . . ." 42 U.S.C. § 1395x(v)(1)(A). Although the Centers for Medicare and Medicaid Services has issued formal regulations for certain categories of cost, in large part the Medicare Administrative Contractor (MAC, formerly the fiscal intermediary) relies on the PRM, which is not published as a regulation and does not have the force of law, for determining allowable costs. Thus, among many other cost categories, the PRM sets forth the principles of allowable cost for malpractice, workers' compensation, and other liability insurance premium. Premiums for such insurance paid either to commercial insurers or to foreign captives may be included among allowable costs. For foreign captives, however, PRM § 2162.2.A.4 restricts the investments in equity securities to ten percent of their assets and imposes additional limitations on how that ten percent may be invested. If a provider's foreign captive does not comply with these investment restrictions, then reimbursement for the provider's malpractice and other liability insurance premiums paid to the captive is to be denied in its entirety.

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The Decision Of the Court of Appeals

In *Catholic Health Initiatives*, the hospitals challenged the validity of PRM § 2162.2.A.4. The Secretary of Health and Human Services (Secretary) argued that § 2162.2.A.4 was an "interpretive rule," meaning that (1) it was derived from the substance and language of the Medicare Act, and (2) it is exempt from the notice-and-comment requirements of traditional rulemaking (*i.e.*, where a proposed rule is published in the *Federal Register* and is open to comment by the general public). Thus, the Secretary contended that premiums paid to a foreign captive are "reasonable" only if those premiums actually purchase reliable coverage, which, she argued, depends on the financial soundness of the insurer. The Court of Appeals rejected this argument. It found that, although the Medicare Act grants the Secretary the authority to promulgate regulations defining what constitutes a provider's reasonable costs, "there is no way an interpretation of 'reasonable costs' can produce the sort of detailed – and rigid – investment code set forth in § 2162.2.A.4." As a result, the Court of Appeals concluded that PRM § 2162.2.A.4 was not an interpretive rule.

Implications

The decision of the Court of Appeals in *Catholic Health Initiatives* is potentially significant for providers eligible for Medicare reasonable cost reimbursement because if it becomes a final decision to which the Secretary acquiesces nationally, the investment limitation imposed on foreign captives will be eliminated, which in turn will provide greater flexibility to such captives in the design of their investment portfolios.

The immediate substantive impact of the decision, however, remains unclear for two reasons. First, the decision is not final. The Secretary has the opportunity to request a rehearing from the Court of Appeals, and/or to petition the United States Supreme Court for its review. While statistically these review opportunities are rarely granted, the deadlines for the Secretary to pursue such proceedings will not expire until late 2010 or early 2011. Second, the Court of Appeals did not reach the merits of the investment restriction. Rather, the decision was based on procedural grounds: the Court of Appeals held that PRM § 2162.2.A.4 was not an interpretive rule, and thus that the Secretary lacked the authority to impose the investment restriction in the PRM. Accordingly, the Court of Appeals left the door open for the Secretary to issue identical investment restrictions as a duly published rule simply by complying with the notice-and-comment rulemaking requirements (it should be noted, however, that the Secretary lacks the authority to publish such a rule with retroactive effect).

Action Steps

Unless and until the Secretary acquiesces nationally, the decision in *Catholic Health Initiatives* only applies to the hospitals that litigated the issue in this case. At present, therefore, all other hospitals with foreign captives are unaffected, unless and until the decision becomes final.

Hospitals that have filed an appeal challenging the investment limitation clearly will benefit from this decision if it becomes final, because the authority of the District of Columbia Court of Appeals has a highly persuasive precedential value and, after exhausting administrative remedies, all hospitals have the right to commence a judicial appeal in the jurisdiction of that Court. Similarly, if this decision becomes final it will serve as a valuable precedent for the appeals of hospitals filing future appeals. In addition, based on the "self disallowance" appeal procedure, hospitals may have the right to appeal this limitation, even though their foreign captive has complied with the investment limitation, by including a protested item on their cost report, thus preserving the issue for appeal.

Should you have any questions regarding the subject of this Alert, please do not hesitate to contact any member of the Insurance Department. For specific questions regarding appeal opportunities or procedures, please contact Kenneth R. Marcus (kmarcus@honigman.com).