DEPARTMENTAL GRANT APPEALS BOARD

Department of Health and Human Services

SUBJECT: California Department of Health Services
Docket No. 80-132-CA-HC
Decision No. 234

DATE: November 30, 1981

DECISION

This is an appeal by the California Department of Health Services (State) from the determination of the Director, Bureau of Program Operations, Health Care Financing Administration (Agency), disallowing Federal financial participation in the amount of $1,147,876 claimed under Title XIX of the Social Security Act. The amount disallowed represents payments by the State in fiscal years 1973, 1974 and 1975 to Foundation Community Health Plan (FCHP), a prepaid health plan, for Medicaid recipients enrolled in the plan. The Agency determined that such payments exceeded, by the amount disallowed, the cost for comparable services provided under the fee-for-service system, in violation of 45 CFR 250.30(b)(4). The Agency subsequently increased the amount of the disallowance to $1,329,331. (Reply to Petitioner's Response to Invitation to Brief, dated September 1, 1981, pp. 8-9.) For the reasons explained below, we sustain the disallowance in the increased amount.

This decision is based on the State's application for review and on written information and briefing supplied by the parties both sua sponte and at the Board's request. We have determined that this decision can be made based on the written record without a hearing or an informal conference.

Applicable Law

The State receives reimbursement under Title XIX for a percentage of payments made for medical services provided to persons eligible for "Medi-Cal," the State's Medicaid program. Persons eligible for Medi-Cal may obtain services from providers on a "fee-for-service" (FFS) basis, in which case the State pays the providers for actual services rendered, or they may enroll in a "prepaid health plan" (PHP), in which case the State pays the plan a fixed monthly amount for each person enrolled (capitation payment) regardless of actual services rendered. While the Federal government will reimburse states for payments to PHPs for Medicaid eligibles, Federal regulations limit the payments to the cost of comparable services provided under the FFS system. Specifically, 45 CFR 250.30(b)(4) provides that--

> The upper limit for payment for services provided on a prepaid capitation basis shall be established by ascertaining what other third parties are paying for comparable services under comparable circumstances. The cost for providing a given scope of services to a given number of individuals under a capitation arrangement shall not exceed the cost of providing the same services while paying for them under the requirements imposed for specific provider services.

Both parties agree that the regulation prohibits the State from making payments to a PHP exceeding the amount it would have cost to provide health care services to the individuals involved on a FFS basis. The method used to determine compliance with this provision both in this case and in a prior appeal by the State (discussed below) was to compare payments made to FCHP for Medi-Cal eligibles to FFS costs for Medi-Cal recipients who were not enrolled in FCHP but who resided in the same area served by it.

Prior Board Decision

The disallowance in this case was based on findings of the HEW Audit Agency and the U.S. General Accounting Office pertaining to fiscal years 1973, 1974 and 1975. Before the disallowance was taken, however, the Board issued a decision regarding the disallowance of similar costs claimed by the State for calendar year 1974. Foundation Community Health Plan (California State Department of Health), Decision No. 89, March 24, 1980. That disallowance was based on a report issued by the State Auditor General in April 1975 which concluded that excess payments of $802,388 (after deducting $661,500 saved in claims processing costs) for 1974 had been made to FCHP. The State appealed that disallowance on the ground that certain categories of Medi-Cal recipients enrolled in FCHP required both more care and more costly types of care than did persons in the same categories who remained under the FFS system, so that there was "adverse selection" in the FCHP population. The State argued that since the provision of comparable services to FCHP enrollees would have cost more under the FFS system, the fact that payments to FCHP were in excess of those made for Medi-Cal recipients not enrolled in the plan did not indicate a violation of Section 250.30(b)(4).

In support of this "adverse selection" argument, the State submitted a report prepared by the State on the "Prepaid Health Research, Evaluation and Demonstration" (PHRED) project funded by an HEW grant awarded during an earlier stage of proceedings in the prior appeal. A specific objective of the grant was to investigate the issue of adverse selection raised by the case, and proceedings were delayed at the State's request pending the results of the PHRED project. The PHRED report concluded

that there was some adverse selection with respect to two of the four categories of Medi-Cal recipients enrolled in FCHP and that, taking into account the savings to the State in claims processing costs for FCHP enrollees, there was no net overpayment to FCHP. In proceedings before the Board, the Agency challenged the validity of the PHRED report only in one specific respect--its failure to take into account the use of "Medi labels" in the FFS system. (The Medi label system in effect required that special authorization be obtained from the State for the provision of outpatient services to a Medi-Cal recipient in a given month after two claims had been submitted for that individual in that month.) Based on information furnished by the State regarding the effect of this factor on the PHRED report's conclusions, the Board found in Decision No. 89 that there had been an overpayment to FCHP of only $297,000 rather than the $802,388 disallowed by the Agency.

Amount of Disallowance

As noted above, the disallowance in the case now before us was based on audit findings pertaining to fiscal years 1973, 1974 and 1975. The disallowance represents the difference between average FFS costs and FCHP per capita rates for each category of Medi-Cal eligible multiplied by the number of eligibles. (Response of the Health Care Financing Administration to Petitioner's Application for Review, dated January 16, 1981, Appendix 2, pp. 5-6 of audit report.) The Agency subtracted $802,388 from this amount on the ground that it had already disallowed $802,388 for calendar year 1974 based on findings of the California Auditor General. In its application for review, however, the State argued that the Agency was precluded by the Board's Decision No. 89 from disallowing any additional amounts for calendar year 1974, and that it was possible that more than the $802,388 already excluded by the Agency pertained to calendar year 1974. It stated that the Agency should be required to clearly identify and then exclude from the disallowance all costs pertaining to calendar year 1974. The Agency subsequently agreed to do so.

The Agency's "Reply to Petitioner's Response to Invitation to Brief" shows the following breakdown of costs:

July 1, 1972 - June 30, 1973	.....	$421,058
July 1, 1973 - December 31, 1973	.....	$805,121
January 1, 1975 - June 30, 1975	.....	$103,152

Subtracting the total for these periods ($1,329,331) from the amount of the overpayment found by the auditors for fiscal years 1973, 1974 and 1975 ($1,147,876 plus $802,388) leaves $620,933 as the amount attributable to calendar year 1974. This, of course, is less than the $802,388 disallowed by the Agency for calendar 1974 in the prior case.

The State now argues that the discrepancy between the $802,388 overpayment previously identified by the Agency for calendar year 1974 and the $620,933 overpayment which the Agency now attributes to the same period calls into question the accuracy of the amounts which the Agency seeks to disallow for the remaining periods. It argues that the Agency should be "required to show to the Board that the audits upon which it relies were properly done," and that if the Agency is unable to explain the discrepancy, "the disallowance should be dismissed on the basis that the alleged overpayment amounts are so lacking in credibility that they cannot form the basis of a requirement that the State repay federal funds." (State's submission dated October 14, 1981, pp. 2-3, 7-8.)

We do not accept the State's argument that the discrepancy between the two figures implies that the amounts which the Agency now seeks to disallow for the periods exclusive of calendar year 1974 are inaccurate. The disallowance taken by the Agency in the prior appeal was based directly on the overpayment identified by the State Auditor General for calendar year 1974. The disallowance in this case is based on audits conducted independently of the State by the HEW Audit Agency (HEWAA) and the U.S. General Accounting Office (GAO). The fact that the HEWAA and GAO found a smaller overpayment for calendar year 1974 than did the State Auditor General does not necessarily call into question the reliability of HEWAA's and GAO's audit methods. The difference in results could just as easily raise questions about the reliability of the State Auditor General's methods. In the absence of any identification of specific deficiencies in the HEWAA and GAO audits, we cannot conclude that they are in error. Moreover, since the Board in Decision No. 89 sustained only $297,000 of the Agency's $802,388 disallowance, we do not see how the State is prejudiced by the fact that the Agency is now excluding $620,933 rather than $802,388 for calendar year 1974. Accordingly, we conclude that the amount in dispute was correctly determined by the Agency to be $1,329,331.

Collateral Estoppel Argument

The State in its application for review in this case asserted that since the Board in Decision No. 89 had accepted the PHRED report's findings of adverse selection, the Agency should be collaterally estopped from denying that adverse selection was present in the years in question in this case. It requested that the Agency recompute the disallowance on the assumption that there was some adverse selection in the population of Medi-Cal recipients enrolled in FCHP, or alternatively, that the Board reduce the disallowance based on the same percentage of overpayment found in Decision No. 89. The Agency took the position, however, that Decision No. 89 "never addressed the question whether adverse selection occurred in 1972, 1973, or 1975, time periods covered by the instant

disallowance." It further contended that the PHRED report was "primarily based on calendar year 1974 cost and utilization data," and that its "conclusions regarding adverse selection...[cannot] be validly applied beyond the 1974 calendar year to 1972, 1973, or 1975." (Response to Petitioner's Supplemental Statement in Support of Application for Review, dated April 3, 1981, p. 3.)

We adopt the tentative conclusion of the Panel Chair (now called Presiding Board Member) in his May 7, 1981 Invitation to Brief, that Decision No. 89 did not address the issue of whether adverse selection existed in other than calendar year 1974, the period of time involved in that case. As stated in the Invitation, while the Decision does not preclude a finding of adverse selection in other years, there is no evidence that the Board considered the question outside the context of the particular facts of the case. Accordingly, we reject the State's collateral estoppel argument. 1/

Adverse Selection in Periods Other Than Calendar Year 1974

The Invitation to Brief suggested, however, that, if the State could show that there was no significant change in the data on which the PHRED report relied in the years covered by the disallowance in this case, the Board might find that adverse selection existed in those years to the same extent as found in Decision No. 89. The State was therefore invited to provide additional briefing and documentation in support of its appeal. The State has now furnished data, described below, designed to show that in fact there was no significant change.

1/ The related doctrines of res judicata and collateral estoppel are defined and distinguished in a quotation from 1B J. MOORE, FEDERAL PRACTICE, ¶ 0.405(1), pp. 622-624 (2d ed. 1974), cited in n. 5 of Parklane Hoisery Co., Inc. v. Shore, 439 U.S. 322, 326 (1979):

> Under the doctrine of res judicata, a judgment on the merits in a prior suit bars a second suit involving the same parties or their privies based on the same cause of action. Under the doctrine of collateral estoppel, on the other hand, the second action is upon a different cause of action and the judgment in the prior suit precludes litigation of issues actually litigated and necessary to the outcome of the first action.

The doctrine of res judicata does not apply here, however, since the calendar year 1974 disallowance, passed on by the Board in Decision No. 89, has been excluded from the disallowance taken in this case. Collateral estoppel does not apply because the issue of adverse selection in the other years (1972, 1973 and 1975) was not ruled upon in that decision, nor was it even considered as necessary to the outcome.

The State concedes that "the data is not conclusive," but asserts that "neither does it support HCFA's contentions that no adverse selection occurred and that no stability was shown." (State's submission dated October 14, 1981, p. 7.)

The State's position appears to be in effect that the Agency bears the burden of showing that no adverse selection occurred. On the contrary, however, we conclude that the State must affirmatively show, if not conclusively, at least with a fair degree of certainty, that there was adverse selection among the population of Medi-Cal eligibles enrolled in FCHP. The applicable regulation provides that the upper limit for payments to a PHP for Medicaid eligibles "shall be established by ascertaining what other third parties are paying for comparable services under comparable circumstances." The Agency's comparison of the FCHP payments to payments for services to Medi-Cal eligibles residing in the area served by FCHP who received services under the FFS system is a reasonable one. The regulation does not require that the Agency rebut any conceivable objections that may be advanced by the State once the Agency has made a prima facie showing of comparability. In this case, placing such a burden on the Agency would render the regulation virtually unenforceable, since the process of analyzing the characteristics of the two populations is a complicated and time-consuming one, as illustrated by the PHRED report. The State's position is particularly untenable in view of the fact that the State Auditor General, in the report that was the basis for the prior disallowance, operated on the assumption that the two populations were comparable. Thus, the State bears the burden of proof, and, as discussed below, we find that the State has not met that burden.

The basic methodology used by the PHRED project was to determine the actual FFS per capita cost for each of two major categories of Medi-Cal recipients (those receiving Aid to Families with Dependent Children (AFDC), and those receiving Aid to the Totally Disabled (ATD)), and to then adjust it to match the FCHP "utilization pattern," that is, the quantities and types of health care services actually used by the same categories of FCHP enrollees. According to the PHRED report, this yielded the cost that would have been incurred under the FFS system to provide the same services as were actually provided to the FCHP enrollees. To the extent that this figure was higher than the cost of services provided to persons remaining under the FFS system, the PHRED report concluded that FCHP has suffered adverse selection and that there was no overpayment. Decision No. 89, p. 3. This conclusion was based on a comparison of FCHP and FFS figures (for both the AFDC and the ATD categories) on the number of admissions per month and the cost per admission for hospital services, and the utilization and cost per unit of service for ambulatory services. (State's Response to Invitation to Brief, dated July 10, 1981, pp. 2-3.) As noted previously, the data examined was for calendar

year 1974 only. The Invitation to Brief suggested that one way of showing that the findings based on this data were valid for other periods of time without requiring the production of utilization data (which might be difficult to obtain) would be to demonstrate that there were no significant changes in the FCHP population or in the cost of services provided.

In response to the Invitation, the State submitted, first, charts showing (1) the average number of enrollees per month and (2) the total annual enrollment, for each of several categories of FCHP enrollees (including AFDC and ATD) for the years 1972 through 1976. (State's Response to Invitation to Brief, dated July 10, 1981, pp. 3-4.) The State commented with respect to this data: "It would appear from this data that the FCHP population changed very little over the period during which the program existed. Persons moved into the program over its early months, stayed in it with remarkable consistency during the middle period, and moved out over the closing months." (State's Response to Invitation to Brief, dated July 10, 1981, p. 4.) The Agency disagreed, contending that the figures submitted by the State showed "substantial" changes in the AFDC and ATD categories both before and after calendar year 1974. (Reply to Petitioner's Response to Invitation to Brief, dated September 1, 1981, pp. 2, 8.)

The concern in this case, however, is the effect of any changes in population on the PHRED report's conclusions. The Invitation to Brief thus specifically asked the State to discuss the extent to which any changes in the number and characteristics of Medi-Cal recipients enrolled in FCHP during the period 1972 through 1976 would have affected utilization. The State responded without further explanation that the data provided "...suggest[ed] the utilization patterns remained essentially the same." (State's Response to Invitation to Brief, dated July 10, 1981, p. 6.) In the absence of any analysis of the effects of the changes on the PHRED report's conclusions, however, this data cannot support the State's contention that the PHRED report's conclusions were valid for periods other than calendar year 1974.

Information provided by the State regarding per capita costs contains a similar deficiency. The State submitted a chart showing the capitation rate for various categories of FCHP enrollees for periods from July 1972 through May 1976. It commented with respect to this data: "The breakdown of the FCHP rates shows little that would not be expected. The rate crept upward, as did all costs of medical care... It did not do so at an unusual pace." (State's Response to Invitation to Brief, dated July 10, 1981, pp. 5, 5a, and 6.) The State submitted in addition charts showing the change in FFS costs per eligible per month for

acute inpatient hospital care and for hospital outpatient services for the periods in question in this case. (State's Response to Invitation to Brief, dated July 10, 1981, Exhibit B, Charts A and B.) It also referred to FFS cost data contained in the audit reports on which the current disallowance is based. (State's Response to Invitation to Brief, dated July 10, 1981, p. 7.) In response to the Invitation's request that the State discuss the manner in which any variations in per capita costs would affect the PHRED report's analysis, the State commented: "...we have noted no factors which present clear irregularities. It would appear that the characteristics of the FFS and FCHP populations most likely remained comparable [to their respective characteristics in calendar year 1974] during this period." (State's Response to Invitation to Brief, dated July 10, 1981, p. 7.) The Agency contends, on the other hand, that "the FCHP capitation figures evidence so substantial a change between 1972 and 1975 as to make unreliable PHRED's 1974 conclusions when applied to 1972, 1973, or 1975." (Reply to Petitioner's Response to Invitation to Brief, dated September 1, 1981, p. 5.) The State's response is not supported by any analysis of how the variations in per capita costs would have affected the PHRED report's conclusions. In the absence of any such analysis, the data submitted by the State regarding per capita costs cannot advance its case.

The Agency also criticized the State's response to the Invitation on various other grounds. It contended that data regarding FFS utilization should have been provided in addition to data regarding FCHP utilization in order to provide a basis of comparison. (Reply to Petitioner's Response to Invitation to Brief, dated September 1, 1981, p. 2.) We note that the data provided by the State concerned changes in the FCHP population, not FCHP utilization. We note further that the Invitation to Brief requested only information regarding the FCHP population. In any event, we need not reach the question whether information regarding changes in the FFS population would be required, since the State has not even attempted an analysis of the effects of the changes in the FCHP population. For the same reason, we need not address the Agency's contentions that the average enrollment figures presented by the State were incomplete or that the State cannot properly compare FCHP per capita costs to FFS per capita costs. (Reply to Petitioner's Response to Invitation to Brief, dated September 1, 1981, pp. 4, 6.)

Adverse Selection in 1975--Another Approach

Another approach which the PHRED project took to determine whether there was adverse selection was suggested by the fact that FCHP cancelled its contract with the State in 1976, thus forcing all of the FCHP enrollees to return to the FFS system. The PHRED project

found that there was a change in the FFS utilization pattern after that time which reflected the utilization pattern previously experienced by FCHP. Decision No. 89, p. 3. Accordingly, the Invitation to Brief inquired whether there was any way of measuring adverse selection during the time periods in question in the instant case using this method. In response, the State submitted documentation showing that for five categories of service, FFS costs increased or decreased following the influx of the ATD and AFDC recipients formerly enrolled in FCHP in the manner that would have been expected based on their use of such services when enrolled in FCHP. (State's Response to Invitation to Brief, dated July 10, 1981, pp. 7-10, and Charts A-E.) It contended that this data clearly showed that the adverse selection found by the PHRED report in calendar year 1974 continued in 1975. (The State did not contend that this data showed adverse selection during 1972 or 1973, however.) (State's Response to Invitation to Brief, dated July 10, 1981, p. 12.) The Agency challenged the State's conclusion regarding adverse selection in 1975, presenting a chart which showed that FFS admissions for acute hospital services for the ATD category decreased following the termination of ATD coverage by FCHP. (Reply to Petitioner's Response to Invitation to Brief, dated September 1, 1981, p. 7 and Exhibit A.)

Even assuming that the State's data is accurate and that the Agency's is not, however, the State has not provided a sufficient basis for finding that the PHRED report's conclusions are validly applied to 1975. The methodology in question here was used by the PHRED report merely to confirm its conclusion, based on the analysis of utilization and costs previously described, that adverse selection existed in 1974. (PHRED report, pp. 10, 12, at Appendix 6 of Response of the Health Care Financing Administration to Petitioner's Application for Review, dated January 16, 1981.) Thus, in the absence of a showing by the State that changes in population and in cost from 1974 to 1975 would not have affected the PHRED report's primary analysis, we are reluctant to rely solely on this secondary method of proving adverse selection. Moreover, the State concedes that "the charts the State submitted show only trends and are not without ambiguities." (State's submission dated October 14, 1981, p. 5.) While we do not believe that the State is required to prove with absolute certainty that adverse selection existed, we cannot reverse the disallowance with respect to 1975 based on admittedly ambiguous and inconclusive data.

Conclusion

For the reasons discussed above, we sustain the disallowance in the amount of $1,329,331.

/s/ Cecilia Sparks Ford

/s/ Donald F. Garrett

/s/ Alexander G. Teitz, Presiding Board Member