

could “transfer” bed capacity from the parent facility to the satellite, it could not increase its total bed capacity beyond the level it had in the most recent cost reporting period beginning before October 1, 1997, and still be paid as a hospital excluded from the IPPS. However, no such limitation was imposed on a LTCH (or other excluded facility) established after October 1, 1997 because it would have already been subject to the lower payment limits under § 413.40(f)(2)(ii) of 110 percent of the national median of target amounts for similarly classified hospitals. Therefore, it would not benefit from the higher 75 percent cap on target amounts under § 413.40(c)(4) by establishing a satellite facility, as would a pre-1997 LTCH.

The rationale for the bed-limit provision based on the distinction between these groups of hospitals was the potential for gaming, by creating a satellite facility with a higher TEFRA target cap where, in reality, the satellite facility should have been a separately certified excluded facility, which would have been subject to the lower cap on payments to new (post-1997) facilities paid under the TEFRA system. Once the LTCH is paid based on 100 percent of the Federal prospective rate, however, the LTCH will no longer be subject to TEFRA caps and LTCH prospective payments will be the same regardless of when the LTCH was established. Therefore, we are proposing to eliminate the bed-limit provision once the LTCH is paid based on 100 percent of the LTCH Federal PPS rate. Finally, under this proposed policy, the bed limitation on “existing” LTCHs would, however, continue to apply to those LTCHs while they are paid based on the transition blend, and, therefore, continue to receive a percentage of their payments based on the TEFRA payment rules, until they transition to a rate based on 100 percent of the Federal prospective payment rate.

## **VI. Proposed Changes to the LTCH PPS Rates for the Proposed 2004 LTCH PPS Rate Year**

### *A. Overview of the Development of the Proposed Payment Rates*

The PPS for LTCHs was effective for cost reporting periods beginning on or after October 1, 2002. Effective with that cost reporting period, LTCHs are paid, during a 5-year transition period, on the basis of an increasing proportion of the LTCH PPS Federal rate and a decreasing proportion of a hospital's payment under TEFRA, unless the hospital makes a one-time election to receive payment based on 100 percent of the

Federal rate (see § 412.533). New LTCHs (as defined at § 412.23(e)(4)) are paid based on 100 percent of the Federal rate, with no phase-in transition payments.

The basic methodology for determining LTCH PPS Federal prospective payment rates is set forth in our regulations at §§ 412.521 through 412.529. Below we discuss the factors that we are proposing to use to update the LTCH PPS standard Federal rate for the proposed 2004 LTCH PPS rate year, which would be effective for LTCHs paid under the PPS for discharges occurring on or after July 1, 2003 through June 30, 2004.

In the August 30, 2002 final rule (67 FR 56029–56031), for cost reporting periods beginning on or after October 1, 2002 (FY 2003), we computed the LTCH PPS standard Federal payment rate by updating the best available (FY 1998 or FY 1999) Medicare inpatient operating and capital costs per case data, using the excluded hospital market basket.

Section 123(a)(1) of Pub. L. 106–113 requires that the PPS developed for LTCHs be budget neutral. Therefore, in calculating the standard Federal rate for FY 2003 under § 412.523(d)(2), we set total estimated PPS payments equal to estimated payments that would have been made under the TEFRA methodology if the PPS for LTCHs were not implemented. Section 307(a) of Pub. L. 106–554 specified that the increases to the hospital-specific target amounts and cap on the target amounts for LTCHs for FY 2002 provided for by section 307(a)(1) of Pub. L. 106–554 shall not be taken into account in the development and implementation of the LTCH PPS. In addition, the statute provides for enhanced bonus payments for LTCHs for FY 2001 and FY 2002 provided for by section 122 of Pub. L. 106–113. Furthermore, as specified at § 412.523(d)(1), the standard Federal rate is reduced by an adjustment factor to account for the estimated proportion of outlier payments under the LTCH PPS to total LTCH PPS payments (8 percent). For further details on the development of the FY 2003 standard Federal rate, see the August 30, 2002 final rule (67 FR 56027–56037). Under the existing regulations at § 412.523(c)(3)(ii) for fiscal years after FY 2003, we update the standard Federal rate annually to adjust for the most recent estimate of the projected increases in prices for LTCH inpatient hospital services.

### *B. Proposed Update to the Standard Federal Rate for the Proposed 2004 LTCH PPS Rate Year*

In the August 30, 2002 final rule (67 FR 56033), we established a LTCH PPS

standard Federal rate of \$34,956.15 for FY 2003. Based on the most recent estimate of the excluded hospital with capital market basket, adjusted to account for the proposed change in the rate year update cycle for the LTCH PPS rates discussed in section III. of this proposed rule, the proposed LTCH PPS standard Federal rate, effective from July 1, 2003 through June 30, 2004, would be \$35,726.64 (as discussed below).

In the discussion that follows, we explain how we developed the proposed update to the standard Federal rate. The proposed Federal rate for the proposed 2004 LTCH PPS rate year is calculated based on the proposed update factor of 1.0250. Thus, the proposed standard Federal rate for the proposed 2004 LTCH PPS rate year would increase 2.2 percent compared to the FY 2003 standard Federal rate.

### **1. Proposed Standard Federal Rate Update**

In the August 30, 2002 final rule, we established in § 412.523 that, for years after FY 2003, the annual update to the LTCH PPS standard Federal rate will be equal to the percentage change in the excluded hospital with capital market basket (described in further detail below). As we discussed in the August 30, 2002 final rule (67 FR 56087), in the future we may propose to develop a framework to update payments to LTCHs that would account for other appropriate factors that affect the efficient delivery of services and care provided to Medicare patients. Because the LTCH PPS has only been implemented for cost reporting periods beginning on or after October 1, 2002, we have not yet collected sufficient data to allow for the analysis and development of an update framework under the LTCH PPS. Therefore, at this time, we are not proposing an update framework for the LTCH PPS. However, a conceptual basis for the proposal of developing an update framework in the future can be found in Appendix B of the August 30, 2002 final rule (67 FR 56086–56090).

### **a. Description of the Proposed Market Basket for LTCHs for the Proposed 2004 LTCH PPS Rate Year**

A market basket has historically been used in the Medicare program to account for price increases of the services furnished by providers. The market basket used for the LTCH PPS includes both operating and capital-related costs of LTCHs because the LTCH PPS uses a single payment rate for both operating and capital-related costs. The development of the LTCH