

(FY 1997) and this period. First, we estimate the portion related to operating costs, which we estimate to be 69.075 percent for the proposed LTCH PPS rate year of July 1, 2003 through June 30, 2004, calculated based on the Medicare cost reports for excluded hospitals as the sum of the relative importance for wages and salaries (48.967), employee benefits (11.032), professional fees (4.518), and labor-intensive services (4.558), as shown in Table V. The labor-related share of capital costs in the market basket needed to be considered

as well. After an analysis of FY 1997 Medicare cost report data, we found no evidence to revise our current estimate of the portion of capital costs that is influenced by local labor markets of 46 percent (*see* 67 FR 56016, August 30, 2002). Based on the proposed change in the LTCH PPS rate update cycle, the relative importance of capital is estimated to be 7.692 percent. Because the relative importance of capital is 7.692 percent of the proposed FY 1997-based excluded hospital with capital market basket for the proposed 2004

LTCH PPS rate year, we multiplied 46 percent by 7.692 percent to determine the labor-related share of capital costs to be 3.538 percent. We then added the 3.543 that was calculated for capital costs to the 69.075 percent that was calculated for operating costs to determine the total labor-related relative importance of 72.612. Therefore, we are proposing to use a labor-related share of 72.612 percent for the proposed 2004 LTCH PPS rate year.

TABLE V.—PROPOSED LABOR-RELATED SHARE RELATIVE IMPORTANCE

Cost category	Relative importance FY 1992-based market basket (proposed 2004 LTCH PPS rate year)	Relative importance FY 1997-based market basket (proposed 2004 LTCH PPS rate year)
Wages and salaries	50.572	48.967
Employee benefits	11.882	11.032
Professional fees	2.052	4.518
Postage	0.254	
All other labor intensive services	5.242	4.558
Subtotal	70.001	69.075
Labor-related share of capital costs	3.412	3.538
Total	73.413	72.612*

* Although the weights of the cost categories appear to add to 76.213, this is due to rounding; the actual labor-related share is 72.61246.

2. Proposed Adjustment for Cost-of-Living in Alaska and Hawaii

Under § 412.525(b), we make a cost-of-living adjustment (COLA) for LTCHs located in Alaska and Hawaii to account for the higher costs incurred in those States.

For the proposed 2004 LTCH PPS rate year, under § 412.525(b), we are proposing to make a COLA to payments for LTCHs located in Alaska and Hawaii by multiplying the standard Federal payment rate by the appropriate factor listed in Table VI. below. These factors are obtained from the U.S. Office of Personnel Management (OPM). If OPM releases revised COLA factors before May 1, 2003, we propose to use them for the development of payments and will publish them in the final rule.

TABLE VI.—PROPOSED COST-OF-LIVING ADJUSTMENT FACTORS FOR ALASKA AND HAWAII HOSPITALS FOR THE PROPOSED 2004 LTCH PPS RATE YEAR

Alaska:	
All areas	1.25
Hawaii:	
Honolulu County	1.25
Hawaii County	1.165
Kauai County	1.2325

TABLE VI.—PROPOSED COST-OF-LIVING ADJUSTMENT FACTORS FOR ALASKA AND HAWAII HOSPITALS FOR THE PROPOSED 2004 LTCH PPS RATE YEAR—Continued

Maui County	1.2375
Kalawao County	1.2375

3. Proposed Adjustment for High-Cost Outliers

Under § 412.525(a), we make an adjustment for additional payments for outlier cases that have extraordinarily high costs relative to the costs of most discharges. Providing additional payments for outliers strongly improves the accuracy of the LTCH PPS in determining resource costs at the patient and hospital level. These additional payments reduce the financial losses that would otherwise be caused by treating patients who require more costly care and, therefore, reduce the incentives to underserve these patients. We include a provision for outlier payments under the LTCH PPS and set the outlier threshold before the beginning of the applicable proposed rate update year so that total outlier payments are projected to equal 8 percent of total payments under the LTCH PPS.

Under § 412.525(a), we make outlier payments for any discharges if the estimated cost of a case exceeds the adjusted LTCH PPS payment for the LTC-DRG plus a fixed-loss amount. The fixed-loss amount is the amount used to limit the loss that a hospital will incur under an outlier policy. This results in Medicare and the LTCH sharing financial risk in the treatment of extraordinarily costly cases. The LTCH's loss is limited to the fixed-loss amount and the percentage of costs above the marginal cost factor. We calculate the estimated cost of a case by multiplying the overall hospital cost-to-charge ratio by the Medicare allowable covered charge. In accordance with § 412.525(a), we pay outlier cases 80 percent of the difference between the estimated cost of the patient case and the outlier threshold (the sum of the adjusted Federal prospective payment for the LTC-DRG and the fixed-loss amount).

We determine a fixed-loss amount, that is, the maximum loss that a LTCH can incur under the PPS for a case with unusually high costs before the hospital will receive any additional payments. We calculate the fixed-loss amount by simulating aggregate payments with and without an outlier policy. The fixed loss amount would result in estimated total outlier payments being equal to 8