

on industry-wide average operating and capital-related costs. Under the average pricing system, payment is not based on the experience of an individual hospital. As discussed in the August 30, 2002, final rule (67 FR 56038), we believe that a 5-year phase-in will provide LTCHs time to adjust their operations and capital financing to the new LTCH PPS, which is based on prospectively determined Federal payment rates. Furthermore, we believe that the 5-year phase-in of the LTCH PPS allows LTCH personnel to develop proficiency with the LTC-DRG coding system, resulting in improvement in the quality of the data used for generating our annual determination of relative weights and payment rates.

In accordance with § 412.533, the transition period for all hospitals subject to the LTCH PPS begins with the hospital's first cost reporting period beginning on or after October 1, 2002, and extends through the hospital's last cost reporting period beginning before October 1, 2007. During the 5-year transition period, a LTCH's total payment under the LTCH PPS is based on two payment percentages—one based on reasonable cost-based (TEFRA) payments and the other based on the standard Federal prospective payment rate. The percentage of payment based on the LTCH PPS Federal rate increases by 20 percentage points each year, while the reasonable cost-based payment rate percentage decreases by 20 percentage points each year, for the next 4 fiscal years. For cost reporting periods beginning on or after October 1, 2006, Medicare payment to LTCHs will be determined entirely under the Federal PPS methodology. The blend percentages as set forth in § 412.533(a) are as follows:

Cost reporting periods beginning on or after	Federal rate percentage	Reasonable cost principles rate percentage
October 1, 2002	20	80
October 1, 2003	40	60
October 1, 2004	60	40
October 1, 2005	80	20
October 1, 2006	100	0

For a cost reporting period that began on or after October 1, 2002, and before October 1, 2003 (FY 2003), the total payment for a LTCH is 80 percent of the amount calculated under reasonable cost principles for that specific LTCH and 20 percent of the Federal prospective payment amount. For cost reporting periods beginning on or after October 1, 2003, and before October 1, 2004 (Federal FY 2004), the total payment for a LTCH will be 60 percent

of the amount calculated under reasonable cost principles for that specific LTCH and 40 percent of the Federal prospective payment amount. As we noted in the March 7, 2003, proposed rule (68 FR 11257), the change in the effective date of the annual LTCH PPS rate update discussed in section IV. of this preamble has no effect on the LTCH PPS transition period as set forth in § 412.533(a). That is, LTCHs paid under the transition blend under § 412.533(a), will receive those blend percentages for the entire 5-year transition period (unless they elect payments based on 100 percent of the Federal rate). Furthermore, LTCHs paid under the transition blend will receive the appropriate blend percentages of the Federal and reasonable cost-based rate for their entire cost reporting period as prescribed in § 412.533(a)(1) through (a)(5). For example, a LTCH with a cost reporting period beginning on July 1, 2003 (which is the LTCH's first cost reporting period since the implementation of the LTCH PPS), will receive payments based on 80 percent of the reasonable cost-based rate and 20 percent of the Federal rate for its discharges occurring on or after July 1, 2003, through June 30, 2004 (if the LTCH does not elect payment based on 100 percent of the Federal rate).

The reasonable cost-based rate percentage is a LTCH specific amount that is based on the amount that the LTCH would have been paid (under TEFRA) if the PPS were not implemented. As we discussed in the August 30, 2002, final rule (67 FR 56040), Medicare fiscal intermediaries will continue to compute the LTCH reasonable cost-based payment amount according to § 412.22(b) of the regulations and sections 1886(d) and (g) of the Act. We note that several reasonable cost-based payment provisions that were previously in effect are no longer effective, starting with cost reporting periods beginning in FY 2003. For instance, the caps on the target amounts for "existing" LTCHs provided for under section 4414 of the BBA (see § 413.40(c)(4)(iii)) for FYs 1998 through 2002 are no longer applicable for cost reporting periods beginning in FY 2003. Thus, a LTCH's target amount for FYs 2003 and beyond will be determined by updating its prior year's target amount (which for FY 2003 was subject to the FY 2002 cap). In addition, the 15-percent reduction to payments to LTCHs for capital-related costs provided for under section 4412 of Public Law 105-33 (§ 413.40(j)) is only applicable for portions of cost reporting periods occurring in FYs 1998 through FY 2002.

This reduction is no longer applicable for cost reporting periods beginning in FY 2003. Therefore, the TEFRA portion of a LTCH's payment for capital-related costs during the LTCH PPS transition period is based on 100 percent of its Medicare allowable capital costs.

As we discussed in the August 30, 2002, final rule (67 FR 56038), in implementing the PPS for LTCHs, one of our goals is to transition hospitals to full prospective payments as soon as appropriate. Therefore, under § 412.533(c), we allow a LTCH, which is subject to a blended rate, to elect payment based on 100 percent of the Federal rate at the start of any of its cost reporting periods during the 5-year transition period rather than incrementally shifting from reasonable cost-based payments to prospective payments. Once a LTCH elects to be paid based on 100 percent of the Federal rate, it will not be able to revert to the transition blend. For cost reporting periods beginning on or after December 1, 2002, and for the remainder of the 5-year transition period, a LTCH must notify its fiscal intermediary in writing of its election on or before the 30th day prior to the start of the LTCH's next cost reporting period. For example, a LTCH with a cost report period that begins on May 1, 2004, must notify its fiscal intermediary in writing of an election before April 1, 2004.

Under § 412.533(c)(2)(i), the notification by the LTCH to make the election must be made in writing to the Medicare fiscal intermediary. Under § 412.533(c)(2)(ii) and (iii), the intermediary must receive the request on or before the specified date (that is, on or before the 30th day before the applicable cost reporting period begins for cost reporting periods beginning on or after December 1, 2002, through September 30, 2006), regardless of any postmarks or anticipated delivery dates.

Notifications received, postmarked, or delivered by other means after the specified date will not be accepted. If the specified date falls on a day that the postal service or other delivery sources are not open for business, the LTCH will be responsible for allowing sufficient time for the delivery of the request before the deadline. If a LTCH's notification is not received timely, payment will be based on the transition period blend percentages.

#### X. Payments to New LTCHs

Under § 412.23(e)(4), for purposes of Medicare payment under the LTCH PPS, we define a new LTCH as a provider of inpatient hospital services that otherwise meets the qualifying criteria for LTCHs, set forth in § 412.23(e)(1)