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STATE OF HAWAII
DEPARTMENT OF HUMAN SERVICES
P. O. Box 339
Honolulu, Hawaii 96809-0339

April 02, 2009

MEMORANDUM

TO: Honorable Brain T. Taniguchi, Chair
Senate Committee on Judiciary and Government Operations

FROM: Lillian B. Koller, Director

SUBJECT: **H.B. 1642, H.D. 1, S.D. 1 – RELATING TO THE PURCHASES OF HEALTH AND HUMAN SERVICES**

Hearing: Thursday, April 02, 2009, 10:15 a.m.
Conference Room 016, State Capitol

PURPOSE: The purpose of this bill is to specify that proposals for purchases of health and human services must be submitted by duly licensed providers and for the exact amount to be expended by the State.

DEPARTMENT'S POSITION: The Department of Human Services (DHS) strongly opposes this bill because it is unfair to non-profit contracting entities and decreases fair competition among potential bidders and will result in decreased Federal funding and increased cost to the State.

First, the premise stated in Section 1 of this bill as the reason for the need to clarify the procurement law is utterly false. Specifically, the alleged "illegal" "rebate" by DHS to the QUEST Expanded Access (QExA) health plans never happened.

What DHS did in the QExA procurement was not an illegal rebate nor any other type of rebate. This fact was explained in a letter to Senate President Hanabusa who inquired about

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this issue and was later affirmed in a letter to Congressman Neil Abercrombie from the Federal Centers for Medicare and Medicaid Services (CMS). See attached letters.

This bill appears to be prompted by incorrect assumptions. Section 1 of this bill states that the Administration and DHS agreed to rebate $25 million of insurance premium tax to the two for-profit companies that were awarded the QExA contracts. DHS pays the insurance premium tax as a pass through cost, not as a rebate. This approach has been followed in prior procurements for QUEST health plans, and is consistent with procurement practices followed generally by State agencies. Nothing in this approach relieves those subject to either the general excise tax or the insurance premium tax from paying those taxes to the State. Rather, the approach recognizes that these taxes are an accepted cost of doing business in the State, which purchasers (including state agencies) typically absorb in their contracts for goods and services.

For-profit plans pay the full amount of the premium tax due to the State, therefore, this does not constitute an exemption from the insurance premium tax. There is an impression that the State loses money by contracting with for-profit companies in our Medicaid programs, when in fact the contrary is true – the State nets millions of dollars in new revenue to the State. This is because CMS considers taxes as operating expenses and allows Federal match for this, approximately 55% of the taxes collected by the State from for-profit entities are Federally funded.

The two for-profit health plans awarded the contracts for QExA generate approximately $35 million in new Federal funds to the State. If these plans were non-profits, zero new Federal funds would be generated. Because CMS considers taxes as operating expenses and allows Federal match for this, approximately 55% of the taxes collected by the State from for-profit entities are Federally funded.

Moreover, if it were not appropriate for DHS to pay the pass-through tax, payments for the full range of health and human services would be adversely impacted. Overhead costs, including taxes, are routinely included in reimbursement. If the State stopped paying the pass-

through tax because it was deemed to be a "rebate," then hospitals, nursing homes, physicians and others would see reduced reimbursements.

Of note, in our QExA procurement, five proposals were received of which only one was from a non-profit health plan. Of the three proposals determined by *a priori* criteria to meet the minimum technical requirements, all were from for-profit health plans. Therefore, the consideration of tax status was, in fact, a moot point regarding the recent QExA procurement.

The QExA Request For Proposal (RFP) was reviewed and approved by CMS. Further, DHS was advised by its actuaries that the insurance premium tax must be removed from the calculation of rates in order for the rates to be actuarially sound. The State may draw Federal funds for this cost, just as it would for payment of Hawaii general excise tax to contractors under other contracts.

The RFPs for QExA were structured to ensure the most even-handed and fair comparison of the bidders seeking contracts in the program. This was accomplished by soliciting bids on a pre-tax basis. This method is used because not all potential bidders are subject to the general excise tax or the insurance premium tax. Application of the taxes depends on the profit vs. non-profit status as well as the licensure status of the bidders. This approach ensured an "apples-to-apples" comparison that provides no bidder with an unfair advantage.

Let's look at three scenarios:

1) A for-profit health plan is awarded a contract for $600 million ($270 million general funds). Taxes paid will be $25 million. DHS incorporates into the capitation rates $11 million of additional State funds and $14 million of new Federal funds. When the plan pays $25 million in taxes, the net State expenditure is $270 M + $11 M - $25 M = $256 M.
2) Some would instead have you believe that the State is better off by excluding the taxes from the capitation rates and not bringing in new Federal money. They would make the argument that the for-profit health plan would still contract for $600 million

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($270 million general funds) and then pay $25 million in taxes, so the net State expenditure would be $270 M - $25 M = $245 M.

3) However, scenario 2 is based on very false assumptions. These for-profit companies would not be expected to accept a lower return. If they bid at all, what we would most likely see is an increased bid price of $626 million ($282 million general funds) on which $26 million would be paid in taxes. Thus the net State expenditure would be $282 M - $26 M = $256 M. But what we will have done is discourage them from applying or have artificially inflated their bid price compared to a non-profit and to make the bid much less competitive.

4) So what the State would most likely be left with are bids from non-profits. In this scenario, a non-profit health plan is awarded a contract for $600 million ($270 million general funds) and pays no taxes. The net State expenditure is $270 M - $0 M = $270 M.

This bill adds a barrier to fair competition in the bidding process by disadvantaging the entry of new entities into the Hawaii market. Decreased competition does not maximize incentives to improve quality and value of care, thereby disadvantaging clients and tax payers. DHS seeks fair competition to ensure the highest quality care for its clients and best value to the State taxpayers.

Regarding Section 2 of this bill, the licensure process can be time consuming and expensive. The RFP specifies timelines for requiring licensure based on DHS' requirements, which are designed to ensure that ample time is provided for the wining bidder(s) to obtain appropriate licensure. This may or may not require licensure at the time the proposal is submitted. If the start date is expected to be shortly after the award, then DHS may require licensure at the time of bidding, but the timing should be designed to meet DHS' needs without disincentivizing potential bidders. Otherwise, bidders should not be required to have gone through that process ahead of time. Since this requisite time for licensure is already addressed in the procurement process, there is no need to change procurement law.

Finally, DHS has contracts with numerous for-profit small businesses. This bill would substantially and adversely impact their ability to be competitive in a bidding process and significantly lessen their margin. As a result of this bill, people will lose jobs and many small businesses will go out of business.

This bill makes a false assumption that only non-profit entities constitute the safety-net for our needy DHS clients. This is patently false. In fact, for example, most of the Medicaid clients receiving care in a nursing facility are doing so in for-profit nursing homes and do not deserve to be punished by this bill for their contributions to the safety-net.

Let us take a look at who this bill proposes to protect. The non-profit health plans in our Medicaid programs are HMSA, the predominant insurer in Hawaii, Kaiser Permanente whose non-profit QUEST health plan is a non-profit but the parent company is a mainland for-profit company, and AlohaCare, the third largest insurer in Hawaii. This bill will cause the State to lose $35 million in new revenue to the State from two for-profit QExA health plans, in order to protect the market shares of these three powerful non-profits from future competition in the QUEST and QExA Medicaid programs.

This bill will, no doubt, result in lost Federal funding and increased cost to the State as well as decreased competition. Decreased competition does not maximize incentives to improve quality and value of care, thereby disadvantaging clients and tax payers. This bill deserves no further consideration.

Thank you for the opportunity to testify.

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07:1152

STATE OF HAWAII
DEPARTMENT OF HUMAN SERVICES
P. O. Box 339
Honolulu, Hawaii 96809-0339

December 26, 2007

The Honorable Colleen Hanabusa
Senate President
Hawaii State Capitol, Room 409
Honolulu, Hawaii 96813

Dear Senator Hanabusa:

Thank you for your letter dated December 5, 2007. I share your expectation that the Hawaii Medicaid program be operated legally and fairly, and was surprised that you were led to believe that the Department of Human Services was not acting in accordance with that expectation in connection with its procurement for the QUEST Expanded Access (QExA) program.

We have structured the RFP to assure the most even-handed and fair comparison of the bidders seeking contracts in the program. We do this by soliciting bids on a pre-tax basis. This is because not all potential bidders are subject to the general excise tax or the insurance premium tax. Application of the taxes depends on the profit vs. non-profit status and the licensure status of the bidders. Our approach assures an "apples-to-apples" comparison that provides no bidder with an unfair advantage.

Once contractors are selected to operate health plans, the pre-tax rates submitted by the winning bidders are adjusted to take account of the general excise tax or insurance premium tax, if any, to which the contractor is subject, as well as the age/gender mix of the persons actually enrolled with the plans.

This approach has been followed in prior procurements for QUEST health plans, and is consistent with procurement practices followed generally by State agencies. Nothing in this approach relieves those subject to either the general excise tax or the insurance premium tax from paying those taxes to the State. Rather, the approach recognizes that these taxes are an accepted cost of doing business in the State, which purchasers (including State agencies) typically absorb in their contracts for goods and services.

We have been advised by our Deputy Attorney General that this approach does not constitute a repeal or exemption of the taxes applicable to those who are subject to them. In fact, businesses are specifically advised by the Hawaii Department of Taxation

that, because the general excise tax is imposed on the business rather than on the customer, the business may charge the customer in the same way that it includes other costs of doing business. This is so whether the business visibly passes on the tax to the customer or not. See section 7 of *An Introduction to the General Excise Tax*, State of Hawaii Department of Taxation (12/06). There does not appear to be anything in the Insurance Code or the Tax Code that would require the insurance premium tax to be treated differently from the general excise tax.

While we think that potential bidders for QExA health plan contracts have understood the Department's approach (which is identical to that followed one year ago in connection with the QUEST QExA procurement and which was explained at a business proposal orientation meeting on November 9, 2007, at which the Department's actuaries and all interested health plans were present), to avoid any possibility of confusion, we have posted a clarification to the QExA RFP to spell out in detail the manner in which the Department will compare the bids for QExA health plan contracts.

The RFP had previously afforded bidders the opportunity to submit revised business proposals by January 7, 2008. In connection with this clarification to the RFP, we have extended the date for final submission of business proposals to January 14, 2008. Thus, any bidder that wishes to modify its bid in light of the clarification will have a full opportunity to do so.

You may access the clarification on the State Procurement Office website: http://www.havaii.gov/so2/health/rfp103f/detail.php?rfpID=532. Click on the links to RFP-MQD-2008 Amendment #9 and RFP-MQD-2008 Amendment #10.

I would also like to assure you that, to the extent that our contractors pass the cost of their tax obligations to the Department under the contract, federal Medicaid funds are available to share in those payments.

Finally, your concern that out-of-state companies will hire fewer Hawaii residents should be alleviated by the provisions in the QExA RFP, which require that most of the positions of the winning bidders must be filled by individuals residing and working full-time in Hawaii. At the same website identified above, click on the link to RFP-MQD-2008-006, and refer to section 51.210 on page 240. We expect this procurement to result in the creation of a substantial number of new jobs for our State's citizens, no matter which health plans are offered contracts.

Thank you for bringing your concerns to our attention, and for your continuing support for the Hawaii Medicaid program.

Sincerely,

Lillian B. Koller
Director

DEPARTMENT OF HEALTH & HUMAN SERVICES

Centers for Medicare & Medicaid Services

Region IX
Division of Medicaid & Children's Health Operations
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MAY 2 1 2008

The Honorable Neil Abercrombie
Congress of the United States
House of Representatives
1502 Longworth House Office Building
Washington, D.C. 20515

Dear Representative Abercrombie:

I am responding to your letter to Acting Administrator Kerry Weems, who has referred your letter to me. You had two questions related to the recent award by the Hawaii Department of Human Services of two contracts under its QUEST Expanded Access (QEXA) managed care program to serve its Medicaid Aged, Blind and Disabled (ABD) population.

Your first question concerns why the Federal government is paying state premium taxes as part of the Hawaii Medicaid program managed care contracts to serve the Aged, Blind and Disabled (ABD) population under Hawaii's QEXA program.

Under the Medicaid program, the states can consider Medicaid's portion of a permissible health care-related tax as an allowable cost for purposes of developing Medicaid reimbursement rates. We affirmed this in the preamble of our recent Medicaid final rule at 42 CFR 433 on health-care related taxes issued on February 22, 2008.

Your second question concerns the two managed care organizations (MCOs) selected by the Department of Human Services: you note that these plans have neither "significant operations in Hawaii" nor any "experience or network in the community." CMS requires States to implement a free and open competitive procurement of Medicaid services that follows applicable state procurement laws as set forth in Medicaid regulations at 42 CFR 457.940. While CMS requires states to follow their own procurement laws when contracting for Medicaid services, CMS also has extensive regulations at 42 CFR 438.206 and 42 CFR 438.207 that states must follow to ensure access to available services and adequate provider network capacity when implementing Medicaid managed care.

I hope this information is helpful. Should you need any other assistance from my staff, please contact Cheryl Young, CMS State Medicaid Coordinator for Hawaii, at 415-744-3598 or at Cheryl.Young@cms.hhs.gov.

Sincerely,

Jackie L. Glaze
Acting Associate Regional Administrator
Division of Medicaid and Children's Health Operations

cc: Lillian Koller, Department of Human Services
Patty Johnson, Department of Human Services
Mary Rydell, CMS