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President Obama Outlines Proposal to Deficit Reduction Super-Committee; Medicare Provisions Loom Large

On September 19, 2011, President Obama presented his deficit reduction plan – including $320 billion in proposed federal health spending cuts – to the Joint Select Committee on Deficit Reduction, which was created by the Budget Control Act of 2011 to craft a legislative package to cut the federal deficit by at least $1.5 trillion. If legislation is not adopted to achieve deficit reduction targets by January 2012, $1.2 trillion in across-the-board spending cuts (sequestration) would be triggered, effective January 2013.

The health care industry has a significant stake in the outcome of the Joint Select Committee's work, since Medicare spending in particular is expected to figure prominently in the Committee's package. Under President Obama's plan (which the Joint Select Committee is not obligated to follow), Medicare spending would be cut by about $248 billion over 10 years, with more than half of the savings coming from new Medicare drug rebates. Medicaid and other health funding also would be reduced by about $72 billion. If sequestration ultimately is triggered, on the other hand, Medicare provider payments also would be subject to reduction; but the Congressional Budget Office (CBO) recently estimated that the level of Medicare cuts under sequestration would be approximately $123 billion between 2013 and 2021.

This Alert provides an overview of the Budget Control Act, including the two possible mechanisms for lowering the federal deficit: (1) enactment of the Joint Select Committee's proposal; and (2) sequestration. In addition, this Alert discusses recent developments, including President Obama's deficit reduction plan, and provides a timeline for action under the Budget Control Act.

Overview of the Deficit Reduction Act

On August 2, 2011, President Obama signed the Budget Control Act of 2011 into law, following months of intense negotiations between Congressional leaders and the Administration as the nation's debt approached the $14.3 trillion debt ceiling.

The first phase of the Budget Control Act imposed caps that reduced spending on discretionary (non-entitlement) spending by almost $1 trillion over the next decade, while providing for an immediate increase in the debt ceiling. In the second phase, a 12-member Joint Select Committee on Deficit Reduction (dubbed the "super committee") is charged with drafting legislation that provides an additional $1.5 trillion in deficit reduction, which could include Medicare and other entitlement reforms. If legislation that achieves at least $1.2 trillion in deficit reduction is not enacted by January 15, 2012, automatic, across-the-board budget cuts (also known as sequestration) will be applied to all but a few exempt programs (as discussed below, Medicare provider payments are subject to sequestration, but reductions are capped at 2 percent).

The Budget Control Act also sets forth complex procedures for further increasing the debt limit, and it requires the House and Senate to vote this fall on a Constitutional amendment that would require a balanced budget every year.

The Joint Select Committee

The Budget Control Act charged the Joint Select Committee with reducing projected federal deficits by $1.5 trillion between FY 2012 and FY 2021. In order to achieve its deficit-reduction target, the Committee may recommend any number of proposals, including further cuts to discretionary spending caps, defense spending decreases, reductions to any entitlement program (including Medicare, Medicaid, and Social Security), and tax increases.

The Joint Select Committee is required to vote on a proposal and report its recommendations by November 23, 2011. If a majority of the Joint Select Committee votes to approve its proposed bill, House and Senate panels with jurisdiction must report the bill without any revision by November 23, 2011. Congress then will consider the Joint Select Committee's proposals under expedited rules that do not allow any amendments, with a simple majority vote by December 23, 2011. The deadline for the proposal to be signed into law is January 15, 2012, to avoid sequestration (as described below).

Congressional leaders have selected the following members to serve on the Joint Select Committee:

- Senate Majority Leader Harry Reid's Appointees: Patty Murray (D-WA), John Kerry (D-MA), Max Baucus (D-MT).
- Senate Republican Leader Mitch McConnell's Appointees: Jon Kyl (R-AZ), Pat Toomey (R-PA), Rob Portman (R-OH).
- House Speaker John Boehner's Appointees: Jeb Hensarling (R-TX), Dave Camp (R-MI), Fred Upton (R-MI).
- House Democratic Leader Nancy Pelosi's Appointees: James Clyburn (D-SC), Xavier Becerra (D-CA), Chris Van Hollen (D-MD).

Senator Murray and Representative Hensarling are the Joint Select Committee's co-chairs.

The Joint Select Committee held its first organizational meeting on September 8, 2011, In addition, on September 13, the panel convened its first hearing, on "The History and Drivers of Our Nation's Debt and Its Threats," featuring testimony from CBO Director Douglas Elmendorf.

Sequestration Procedures

If the Joint Select Committee's legislation is not enacted, or if its legislation contains less than $1.2 trillion in deficit reduction through 2021, sequestration would be triggered, applicable beginning in January 2013, in order to generate sufficient savings to reach a total of $1.2 trillion in deficit reduction. The spending cuts would be apportioned equally among fiscal years 2013 through 2021, and divided evenly between defense functions and non-defense functions (including Medicare provider payments subject to a cap and cost-sharing subsidies in the health reform exchanges). Mandatory programs exempt from sequestration, include, among others, Social Security, Medicaid, the Children's Health Insurance Program ("CHIP"), and veterans' benefits.

The Budget Control Act imposes a number of special rules regarding the application of sequestration to the Medicare program. Most notably, Medicare cuts would be limited to provider payments, and reductions would be capped at 2 percent of payments to providers and plans per year of sequestration. Specifically, sequestration would apply to individual provider payments under Medicare Parts A and B, along with monthly payments under Part C (Medicare Advantage) and Part D prescription drug plan contracts. Payment reductions must be made at a uniform rate across all programs and activities subject to a sequestration order. Sequestration reductions would be disregarded for purposes of computing any adjustments to Medicare payment rates, including the Part C growth percentage, the Part D annual growth rate, and application of risk corridors to Part D payment rates. Also specifically exempt from sequestration are Part D low-income subsidies, Part D catastrophic subsidies, and payments to states for Qualified Individual premiums.

In an analysis released September 12, 2011, the CBO estimates that if the full $1.2 trillion sequestration were triggered, Medicare reductions would total $11 billion in 2013 and $123 billion over the 2013 to 2021 period. Were it not for the 2 percent cap on Medicare reductions, however, CBO estimates that Medicare cuts would total $256 billion between 2013 and 2021.

Note that under this structure, the Joint Select Committee could draft legislation that includes some level of Medicare provider cuts, but does not achieve the full $1.2 trillion in deficit reduction. This would necessitate some level of sequestration to bring total savings to the $1.2 trillion level, potentially subjecting the Medicare program to both targeted cuts and across-the-board sequestration cuts.

President Obama's Deficit Reduction Plan

On September 19, 2011, President Obama released his recommendations for the Joint Select Committee as it deliberates deficit reduction options. The White House estimates that the plan, coupled with the president's job creation proposals, would produce net savings of more than $3 trillion over the next decade through spending reductions and tax increases. With regard to Medicare, the majority of the savings would be achieved through a new Medicare prescription

drug rebate, but a wide variety of providers also would be subject to cuts. As previously noted, the president's proposals are not binding on the Joint Select Committee, although the panel can be expected to give serious consideration to the White House plan's for spending reductions.

The following are highlights of the president's Medicare proposals (all savings are over 10 years):

- Reduce bad debt payments to 25 percent for all eligible providers over three years starting in 2013 (saving approximately $20 billion).
- Reduce the Indirect Medical Education adjustment by 10 percent beginning in 2013 (approximately $9 billion).
- Encourage efficient post-acute care by adjusting payment updates for certain post-acute care providers, equalizing payments for certain conditions commonly treated in inpatient rehabilitation facilities (IRFs) and skilled nursing facilities (SNFs); encourage appropriate use of IRFs by returning the compliance threshold to 75 percent; and adjusting SNF payments to reduce hospital readmissions (total savings of $42 billion).
- Allow Medicare to receive the same rebates that Medicaid receives for brand name and generic drugs provided to beneficiaries who receive the Medicare Low-Income Subsidy beginning in 2013 ($135 billion).
- Cut waste, fraud, and abuse in Medicare by approximately $5 billion by recouping overpayments to Medicare Advantage plans; reducing improper Medicare fee-for-service payments (e.g., increasing scrutiny of providers using high-risk banking arrangements, allowing civil monetary penalties for providers who do not update enrollment information, creating a Medicare claims ordering system to validate physician orders for certain high-risk services, requiring prepayment or earlier review for all power wheelchairs, using a portion of Recovery Audit Contractor recoveries to implement actions that prevent improper payments and fraud, permitting exclusion of individuals affiliated with entities sanctioned for fraudulent or other prohibited actions from federal health care programs, limiting the discharge of debt in bankruptcy proceedings in cases of fraudulent activity, and strengthening penalties for illegal distribution by others of Medicare, Medicaid, or CHIP beneficiary identification or billing privileges); dedicating penalties for failure to use electronic health records toward deficit reduction; reducing Medicare payment to account for higher levels of utilization for certain advanced imaging equipment, and requiring prior authorization for advanced imaging.
- Increase income-related premiums under Medicare Parts B and D ($20 billion).
- Introduce home health co-payments for new beneficiaries (approximately $400 million).
- Introduce a Part B premium surcharge for new beneficiaries that purchase near first-dollar Medigap coverage ($2.5 billion).
- Strengthen the Independent Payment Advisory Board (IPAB), created by the Affordable Care Act, to reduce long-term drivers of Medicare cost growth by lowering the target rate from the GDP per capita growth rate plus 1 percent to plus 0.5 percent, and giving IPAB additional tools like the ability to consider value-based benefit design and enforcement mechanisms such as an automatic sequester. This proposal would act as a backstop to the other proposed reforms.
- Implement a number of proposals to better align payments to rural providers with the cost of care.

The White House also proposes $66 billion in Medicaid savings over 10 years, including the following proposals:

- Phase down the Medicaid provider tax threshold, from the current law level of 6 percent in 2014, to 4.5 percent in 2015, 4 percent in 2016, and 3.5 percent in 2017 and beyond ($26.3 billion).
- Apply a single blended matching rate to Medicaid and CHIP starting in 2017 ($14.9 billion).
- Limit Medicaid reimbursement of durable medical equipment to what Medicare would have paid in the same state for the same services, starting in 2013 ($4.2 billion).
- Strengthen third-party liability for Medicaid beneficiary claims ($1.3 billion).
- Re-base Medicaid disproportionate share hospital (DSH) allotments in 2021 based on states' actual 2020 DSH allotments ($4.1 billion).

- Amend modified adjusted gross income for health insurance assistance programs to include Social Security benefits ($14.6 billion).
- Reduce waste, fraud, and abuse in Medicaid by $110 million over 10 years by: requiring manufacturers that improperly report items for Medicaid drug coverage to fully repay states; requiring states to track drug claims for indications of waste, fraud, or abuse by providers or beneficiaries and to take steps to reduce wasteful or abusive prescribing practices; enforcing Medicaid drug rebate agreements through audits and surveys; increasing civil monetary penalties on drug manufacturers that knowingly report false information under their drug rebate agreements for calculation of Medicaid rebates; requiring drugs to be properly listed with the FDA to receive Medicaid coverage; and prohibiting states from using federal funds as the state share of Medicaid or CHIP, unless specifically authorized by law.

Finally, the White House offers a number of other health savings proposals, such as:

- Prohibiting "pay for delay" agreements to increase the availability of generic drugs and biologics ($2.7 billion over 10 years in savings to federal health programs).
- Beginning in 2012, awarding brand biologic manufacturers seven years of exclusivity rather than 12 years, and prohibiting additional periods of exclusivity for brand biologics due minor changes in product formulations ($3.5 billion in savings to federal health programs).
- Streamline Federal Employee Health Benefit (FEHB) pharmacy benefit contracting by having the Office of Personnel Management contract directly for pharmacy benefit management services on behalf of all FEHB enrollees and their dependents ($1.6 billion).

Conclusion

The Budget Control Act is likely to have a significant impact on the health industry, especially after the wide-ranging changes included in the Affordable Care Act, but the impact could vary greatly depending on whether the Joint Select Committee reaches a broad deficit-reduction plan or whether sequestration is triggered.

For instance, as previously noted, the CBO has estimated that sequestration would result in up to $123 billion in cuts over nine years, spread among all Part A and Part B providers, Medicare Advantage, and Part D drug plans. Other Medicare budget reduction options under consideration could have a much larger impact on specific segments of the health care industry, such as the Medicare drug rebate proposal and proposed changes to Medicare post-acute care payment policies.

Also complicating the Medicare budget picture is an almost 30 percent reduction in Medicare physician fee schedule payments scheduled to go into effect January 1, 2012, under the statutory Sustainable Growth Rate formula unless Congress takes action. The CBO has estimated that averting the cut and providing a 10 year freeze would cost almost $300 billion (a one-year fix would cost $12 billion). In addition to indentifying deficit savings, the Joint Select Committee also is expected to attempt to identify offsets for at least a temporary solution.

Reed Smith will be closely monitoring Congress's actions with respect to the Budget Control Act in the coming months, and we will report on major developments on our policy blog, *www.healthindustrywashingtonwatch.com.*

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Timeline of Kep Dates in Budget Control Act

Date	Deadline/Action
August 2, 2011	*Debt ceiling increased by $400 billion. Establishment of discretionary caps for ten fiscal years, with firewalls for fiscal year 2012 and 2013 between defense and non-defense spending.*
September 16, 2011	*Joint Select Committee must hold first public meeting, which it held on September 8th.*
September 21, 2011	*Debt ceiling raised by an additional $500 billion unless Joint Resolution of Disapproval is enacted. Senate procedural vote on disapproval resolution (S.J.Res. 25) failed on Sept. 8.*
October 1 -- December 31, 2011	*Congress required to vote on Constitutional Balanced Budget Amendment.*
October 14, 2011	*Deadline for House and Senate Committees to send suggestions to Joint Select Committee (optional).*
November 23, 2011	*Deadline for Joint Select Committee to vote on a proposal and report its recommendations.*
December 9, 2011	*House and Senate Committees with jurisdiction must report the Joint Select Committee's bill without any revision and with a favorable recommendation, an unfavorable recommendation, or without recommendation.*
December 23, 2011	*Deadline for Congress to vote on Joint Select Committee bill.*
January 15, 2012	*Deadline for enactment of measure achieving at least $1.2 trillion in deficit reduction.*
Late 2011/2012	*Debt ceiling to increase by $1.2-$1.5 trillion, unless Joint Resolution of Disapproval is enacted.*
January 2013 -- FY 2021	*Sequester of $1.2 trillion, less the amount saved by the Joint Select Committee*

1. Public Law 112-25.
2. The Joint Committee has established a website that tracks its scheduled events and latest news: http://deficitreduction.senate.gov/public/index.cfm/.
3. Note that the $1.2 trillion in required cuts are in addition to the deficit reduction produced by the enactment of the Budget Control Act's discretionary spending caps.
4. Congressional Budget Office, Estimated Impact of Automatic Budget Enforcement Procedures Specified in the Budget Control Act (Sept. 2011), available at http://www.cbo.gov/doc.cfm?index=12414.
5. The CBO notes that some Medicare savings would be offset by reduced Medicare Part B premium receipts.
6. The President's proposal is available at http://www.whitehouse.gov/sites/default/files/omb/budget/fy2012/assets/jointcommitteereport.pdf.

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