

applicable \$250.56 ESRD PPS amount. The outlier payments are computed as follows:

Amount in excess of fixed dollar loss amount

$$(\$270.83 - \$256.40) = \$14.43$$

Loss sharing ratio 80%

Outlier payments per treatment

$$(\$14.43 * .80) = \$11.54 \quad \$11.54$$

Outlier payments

$$(\$11.54 * 12) = \$138.48 \quad \$138.48$$

The total ESRD payments to this facility on behalf of Timmy for January would be:

Regular ESRD payments

$$(\$250.56 * 12) = \$3006.72 \quad \$3006.72$$

Outlier payments 138.48

Total payments \$3145.20

XII. ESRD Bundled Market Basket

Under section 1881(b)(14)(F)(i) of the Act, as added by section 153(b) of MIPPA, beginning in 2012, the ESRD bundled payment amounts are required to be annually increased by an ESRD market basket increase factor minus 1.0 percentage point. The statute further provides that the market basket increase factor should reflect the changes over time in the prices of an appropriate mix of goods and services used to furnish renal dialysis services.

As noted in section VII.B of this proposed rule, under section 1881(b)(14)(F)(ii) of the Act, the ESRD bundled rate market basket will also be used to update the composite rate portion of ESRD payments during the PPS phase-in period from 2011 through 2013.

As required under section 1881(b)(14) of the Act, effective for CY 2012, CMS has developed an all inclusive ESRD bundled rate (ESRDB) input price index. Although "market basket" technically describes the mix of goods and services used to produce ESRD care, this term is also commonly used to denote the input price index (that is, cost categories, their respective weights, and price proxies combined) derived from that market basket. Accordingly, the term "ESRDB market basket" as used in this document refers to the ESRDB input price index.

A market basket has historically been used under the Medicare program to account for the price increases of the requisite inputs associated with the services furnished by providers. The percentage change in the ESRDB market basket reflects the average change in the price of goods and services purchased by ESRD facilities in providing renal dialysis services. Since we are proposing a single payment rate for both operating and capital-related costs,

the proposed ESRDB market basket for ESRD facilities includes both operating and capital-related costs.

The following discussion includes an explanation of the methodology and results of the proposed ESRDB market basket. First, we describe the methodology behind the development of the proposed cost category weights. Next, we explain the basis for the selection of each price measure used to proxy the rate of price change for each expenditure or cost category. Next, we present the results of the proposed ESRDB market basket, and finally we propose our definition of the ESRDB labor-related share.

The ESRDB market basket is constructed in three steps. First, a base period is selected and total base period expenditures are estimated for a set of mutually exclusive and exhaustive spending categories. Then, the proportion of total costs that each category represents is determined. These proportions are called cost or expenditure weights. Each expenditure weight category is then matched to an appropriate price or wage variable, referred to as a price proxy. These price proxies are price index levels derived from publicly available statistical series that are published on a consistent schedule, preferably at least on a quarterly basis. Finally, the expenditure weight for each category is multiplied by the index level of the

respective price proxy to arrive at a weighted index level for each cost category. The sum of the products (that is, the expenditure weights multiplied by the price levels) for all cost categories yields the aggregate index level of the market basket in a given year. Repeating this step for different time periods produces a series of market basket index levels over time. Dividing an index level in one period by an index level in an earlier period produces a rate of growth in the input price index over that time period.

We are proposing to use CY 2007 as the base year for the development of the ESRDB market basket cost weights. The cost weights for this proposed ESRDB market basket are based on the cost report data for independent ESRD facilities.

We refer to the market basket as a CY market basket because the base period for all price proxies and weights are set to CY 2007 = 100. Source data included CY 2007 Medicare cost reports (Form CMS-265-94), supplemented with 2002 data from the U.S. Department of Commerce, Bureau of the Census' Business Expenditure Survey (BES). The BES data were aged to 2007 using appropriate price proxies to estimate price growth. The price proxies used for the aging of the BES data come from publicly available price

indexes such as various producer price indexes (PPI), consumer price indexes (CPI), or employment cost indexes (ECI). All of these price proxies are published by the U.S. Department of Labor, Bureau of Labor Statistics (BLS). We are proposing to use CY 2007 because it is the most recent year that both relatively complete Medicare cost report data and supplemental BES data is available. Analysis of Medicare cost reports for CY 2002 through CY 2006 showed little difference in cost weights compared to CY 2007. Medicare cost reports from hospital-based ESRD providers were not used to construct the proposed ESRDB market basket because data from independent ESRD facilities tend to better reflect the actual cost structure faced by the ESRD facility itself, and are not influenced by the allocation of overhead over the entire institution, as can be the case with hospital-based providers. This approach is consistent with our standard methodology used in the development of other market baskets, particularly those used for updating the skilled nursing facility PPS and home health PPS.

Cost Category Weights

Using Worksheets A, A2, and B from the CY 2007 Medicare cost reports, we first computed cost shares for nine major expenditure categories: Wages and Salaries,

Employee Benefits for direct patient care, Pharmaceuticals, Supplies, Laboratory Services, Blood Products, Administrative and General and Other (A&O), Housekeeping and Operations, and Capital-Related costs. Edits were applied to include only cost reports that had total costs greater than zero. In order to reduce potential distortions from outliers in the calculation of the cost weights for the major expenditure categories, cost values for each category less than the 5th percentile or greater than the 95th percentile were excluded from the computations. The resulting data set included information from approximately 3,572 independent ESRD facilities' cost reports from an available pool of 3,970 cost reports. Expenditures for the nine cost categories as a proportion of total expenditures are shown in Table 38.

Table 38
Initial 2007-Based End-Stage Renal Disease Bundled Rate
Major Cost Categories and Weights Determined from the
Medicare Cost Reports

Expense Category	CY 2007-Based Weights
Wages and Salaries	25.106%
Benefits for Direct Patient Care	5.076%
Pharmaceuticals	28.775%
Blood products	0.043%
Supplies	9.409%
Laboratory Services	0.330%
Housekeeping and Operations	3.353%
Administrative and General, and Other	17.847%
Capital-Related Costs	10.061%
Total	100.000%

Note: Totals may not sum to 100 due to rounding

Some costs that are required to be included in the ESRD bundled payment are not reported on the Medicare cost report. As a result, we supplemented Medicare cost report data with expenditure estimates for various ESRD-related drugs currently covered by Medicare Part D, as well as with additional lab expenses. The estimates for both of the aforementioned expenditures were provided by KECC. There are also costs that are reported on the Medicare cost report, but are not included in the ESRD bundled payment. As a result, we removed the expenses related to vaccine costs from total expenditures since these are excluded from the ESRD bundled payment, but reported on the Medicare cost report.

We are proposing to expand the expenditure categories developed from the Medicare cost reports to allow for a more detailed expenditure decomposition. To expand these cost categories, BES data were used as the Medicare cost reports do not collect detailed information on the items in question. Those categories include: benefits for all employees, professional fees, telephone, utilities, and all other services. We chose to separately break out these categories to more accurately reflect changes in ESRD facility costs. We describe below how the initially computed categories and weights were modified to yield the

final ESRDB market basket expenditure categories and weights presented in this proposed rule.

Wages and Salaries

The weight for wages and salaries for direct patient care that was initially computed was derived from Worksheet B of the Medicare cost report. However, because Worksheet B only includes direct patient care salaries, it was necessary to derive a methodology to include all salaries, not just direct patient care salaries, in order to calculate the appropriate market basket cost weight. This was accomplished in the following steps.

- 1) From the trial balance of the cost report (Worksheet A), we computed the ratio of salaries to total costs in each cost center. The cost centers for which we calculated this ratio were drugs, housekeeping and operations, A&O, supplies, blood and blood products, laboratories, capital-related machinery, and EPO.
- 2) We then multiplied the ratios computed in step 1 by the total costs for each corresponding cost center from Worksheet B. This provided us with an estimate

of non-direct patient care salaries for each cost center.

- 3) The estimated non-direct patient care salaries for each of the cost centers on Worksheet B estimated in step 2 were subsequently summed and added to the direct patient care salary figure (resulting in a new total salaries figure).
- 4) The estimated non-direct patient care salaries (see step 2) were then subtracted from their respective cost categories to avoid double-counting their values in the total costs.

As a result of this process, we moved from an estimated Wages and Salaries cost weight of 20.965 percent (as estimated using only direct patient care salaries as a percent of total costs found on the Medicare cost report) to a weight of 25.106 percent (capturing both direct and non-direct patient care salaries and, again, dividing that by total costs found on the Medicare cost report), as seen in Table 38.

When we add the expenditures related to lab expenses that were previously paid for under the Medicare fee schedule and not included in the Medicare cost report and the ESRD-related drug expenditures currently covered under Part D that were not included in the Medicare cost report,

and remove the estimated vaccine costs that are to be paid outside of the bundle, then the cost weight for the Wages and Salaries category falls to 22.798 percent.

The final adjustment made to this category is to include contract labor costs. These costs appear on the Medicare cost report, however, they are embedded in the Administrative and General and Other category and cannot be disentangled using the Medicare cost reports alone. To move the appropriate expenses from the A&O category to Wages and Salaries, we used data from the BES. We first summed total contract labor costs in the survey. We then took 80 percent of that figure and added it to Wages and Salaries. At the same time, we subtracted that same amount from A&O. The 80 percent figure that was used was determined by taking salaries as a percentage of total compensation (excluding contract labor). The resulting cost weight for Wages and Salaries increases to 24.516 percent.

Benefits

The Benefits weight was derived from the 2002 BES data aged forward to 2007 as a benefit share for all employees is not available from the ESRD Medicare cost report. The cost report only reflects benefits for direct patient care. In order to include the benefits related to non-direct

patient care, we estimated this marginal increase from the BES Benefits weight. This resulted in a Benefits weight that was 0.672 percentage point larger (5.748 vs.5.076) than the Benefits weight for direct patient care calculated directly from the cost reports. To avoid double-counting and to ensure all of the market basket weights still totaled 100 percent, we removed this additional 0.672 percentage point for Benefits from Pharmaceuticals, Biological Products, Administrative and General and Other, Supplies, Laboratory Services, Housekeeping and Operations, and the Capital-related Machinery components. This calculation reapportions the benefits expense for each of these categories using a method similar to the method used for distributing non-direct patient care salaries as described above.

The final adjustment made to this category is to include contract labor costs. Once again, these costs appear on the Medicare cost report, however, they are embedded in the Administrative and General and Other category and cannot be disentangled using the Medicare cost report alone. To move the appropriate expenses from the A&O category to Benefits, we followed the same methodology used to apportion contract labor wages and salaries noted immediately above. For Benefits, we applied the remaining

20 percent of total contract labor costs, as estimated using the BES, and included that in the Benefits cost weight. At the same time, we subtracted that same amount from A&O. The 20 percent figure that was used was determined by summing direct patient care benefits (as estimated using the Medicare cost report) and non-direct patient care benefits (as estimated using the BES) and taking that sum as a percentage of total compensation (excluding contract labor). The resulting cost weight for Benefits increases to 6.177 percent.

Utilities

We developed a weight for Utility expenses using the 2002 BES data, as utilities are not separately identified on the Medicare cost report. We aged the 2002 utility expenditures to 2007. We then disaggregated the Utilities category to reflect three subcategories: Electricity, Fuel (natural gas), and Water and Sewerage. We computed the ratio of each BES category to the total BES operating expenses. We then applied each ratio to the total operating expense percentage share as calculated from the cost reports, including the additions of ESRD-related drugs currently covered under Part D and additional lab expenses, to estimate the ESRD facility weight for each utility expenditure category. These amounts were then deducted

from the share of the combined Operation & Maintenance of Plant and Housekeeping cost category, where the expenses are included on the Medicare cost report (but cannot be separately identified). The resulting Electricity, Fuel (Natural Gas), and Water and Sewerage ESRDB market basket weights are 0.586, 0.111, and 0.483 percent, respectively, yielding a combined Utilities cost weight of 1.180 percent.

Pharmaceuticals

The proposed ESRDB market basket includes expenditures for all drugs, including separately billable drugs and ESRD-related drugs currently covered under Medicare Part D. We were able to calculate an expenditure weight for pharmaceuticals directly from the Drugs cost center on Worksheet B plus the expenditures of EPO which are reported on worksheet A2 of the Medicare cost reports. Vaccine expenditures, which are mandated as separately reimbursable, were excluded when calculating this cost weight. Section 1842(o)(1)(A)(iv) of the Act requires that influenza, pneumococcal, and hepatitis B vaccines described in subparagraph (A) or (B) of section 1861(s)(10) of the Act be paid based on 95 percent of average wholesale price (AWP) of the drug. Since these drugs are excluded from other prospective payment systems, we exclude them from the proposed ESRDB market basket, as well. We estimate that

expenditures for these three vaccines are approximately 1 percent of the total Medicare-allowable payments for separately billable drugs. 2007 expenditures for ESRD-related drugs currently covered under Part D were added to cost report totals.

Finally, to avoid double-counting, the weight for the Pharmaceuticals category was reduced to exclude the estimated share of non-direct patient care salaries and benefits associated with the Drugs and Epoetin cost centers. This resulted in a proposed ESRDB market basket weight for Pharmaceuticals of 30.743 percent. EPO expenditures accounted for 19.351 percentage points of the Pharmaceuticals weight, ESRD-related drugs currently covered under Part D accounted for 4.681 percentage points of the Pharmaceuticals weight, and all other drugs accounted for the remaining 6.710 percentage points of the Pharmaceuticals weight.

Blood Products

We calculated the weight for Blood Products in the ESRDB market basket using the separately billable expenditure amounts for the Whole Blood and Packed Red Blood Cells cost center on Worksheet A of the Medicare cost report. We then added the expenditures for A&O for Whole Blood and Packed Red Blood Cells from Worksheet B to the

net expenses from worksheet A to arrive at a total expenditure amount for Blood Products. This total was divided by total expenses to derive a weight for the Blood Products component in the bundled rate market basket. Similar to other expenditure category adjustments, we reduced the computed weight to exclude non-direct patient care salaries and benefits associated with the Blood cost centers. The proposed adjusted Blood Products market basket weight is 0.035 percent.

Supplies

We calculated the weight for Supplies included in the bundled rate using the reimbursable and separately billable expenditure amounts for the Supplies cost center on Worksheet B of the Medicare cost report. Supplies that are separately billable are reported as a separate line item on the cost reports and were also included. This total was divided by total expenses to derive a weight for the Supplies component in the ESRDB market basket. The computed weight for this category was reduced by the non-direct patient care salaries and benefits associated with the Supplies cost center. The resulting proposed market basket weight for Supplies is 8.543 percent.

Laboratory Services

We calculated the weight for Laboratory Services included in the bundled rate using the reimbursable and separately billable expenditure amounts for the Laboratory cost center on Worksheet B of the Medicare cost report. The cost report expenditures do not include laboratory services paid for under the Medicare fee schedule, only facility-furnished laboratory tests. Since a large majority of laboratory tests are paid via the fee schedule, we adjusted the laboratory fees upward. The inflation factor was computed from the ratio of ESRD facility Medicare laboratory payment data to the other facility Medicare laboratory payment data. This provides a measure of the extent to which laboratory services fall under the Medicare fee schedule. For 2007, we increased the laboratory expenditures by a factor of 16.298, as estimated by KECC. The weight for this category was similarly reduced by the non-direct patient care salaries and benefits associated with the Laboratory cost center. The resulting proposed market basket weight for Laboratory Services is 4.875 percent.

Housekeeping and Operations

We developed a market basket weight for this category using data from Worksheet A of the Medicare cost reports. Worksheet B combines the capital-related costs for

buildings and fixtures with the Operation and Maintenance of Plant (Operations) and Housekeeping cost centers, so we were unable to calculate a weight directly from Worksheet B. We separated these expenses from capital-related costs because we believe housekeeping and operations expenditures, such as janitorial and building services costs, are largely service-related and would be more appropriately proxied by a service-related price index. To avoid double-counting, we subtracted from the Housekeeping and Operations weight the utilities proportion described above, as well as the non-direct patient care salaries and benefits share associated with the Operations and Housekeeping cost center. The resulting proposed market basket weight for Housekeeping and Operations is 1.766 percent.

Administrative and General and Other (A&O)

We computed the proportion of total A&O expenditures using the A&O cost center data from Worksheet B of the Medicare cost reports minus the A&O expenditures related to the Blood Products category. As described above, we exclude contract labor from this cost category and apportion these costs to the salary and benefits cost weights. Similar to other expenditure category adjustments, we then reduced the computed weight to exclude

salaries and benefits associated with the A&O cost center. The resulting A&O cost weight is 13.617 percent. This A&O cost weight is then fully apportioned to derive detailed cost weights for Professional Fees, Telephone, All Other Labor-related Services, and All Other Nonlabor-related Services.

Professional Fees

A separate weight for Professional Fees was developed using the 2002 BES data aged to 2007. Professional fees include fees associated with the following: advertising, accounting, bookkeeping, legal, management, consulting, administrative, and other professional services fees. To estimate professional fees, we first calculated the ratio of BES professional fees to a total of administrative and other expenses from BES. We applied this ratio to the A&O total cost weight to estimate the proportion of ESRD facility professional fees. The resulting weight is 1.692 percent. This proposed cost weight is then separated into Labor-related Professional Fees (1.478 percent) and Nonlabor-related Professional Fees (0.214 percent), which is described in more detail below.

Telephone

Because telephone service expenses are not separately identified on the Medicare cost report, we developed a

Telephone Services weight using the 2002 BES expenses aged to 2007. We estimated a ratio of telephone services expenses to total administrative and other expenses from BES. We applied this ratio to the total A&O cost weight to estimate the proportion of ESRD facility telephone expenses. The resulting proposed market basket cost weight for Telephone Services is 0.590 percent.

All Other Labor-related Services

A separate weight for All Other Labor-related Services was developed using the 2002 BES data aged to 2007. All other labor-related services include repair and maintenance fees. We estimated a ratio of all other labor-related services expenses to total administrative and other expenses from BES. We applied this ratio to the total A&O cost weight to estimate the cost weight for ESRD facility All Other Labor-related Services. The resulting proposed market basket cost weight is 1.163 percent.

All Other Nonlabor-related Services

A separate weight for All Other Nonlabor-related Services was developed using the 2002 BES data aged to 2007. Non labor-related services include insurance, transportation, shipping, warehousing, printing, data processing services, and all other operating expenses not otherwise classified. We estimated a ratio of all other

nonlabor-related services expenses to total administrative and other expenses from BES. We applied this ratio to the total A&O cost weight to estimate the cost weight for ESRD facility All Other Nonlabor-related Services. The resulting proposed market basket cost weight is 10.172 percent.

Capital

We developed a market basket weight for the Capital category using data from Worksheet B of the Medicare cost reports. Capital-related costs include depreciation and lease expense for buildings, fixtures, movable equipment, property taxes, insurance, the costs of capital improvements, and maintenance expense for buildings, fixtures, and machinery. Because housekeeping and operations costs are included in the Worksheet B cost center for Buildings and Fixtures capital-related expense, we excluded these costs and developed a separate expenditure category as noted above. Similar to the methodology used for other market basket cost categories with a salaries component, we computed a share for non-direct patient care salaries and benefits associated with the Capital-related Machinery cost center. We used Worksheet B to develop two capital-related cost categories, one for Buildings and Fixtures, and one for Machinery. We

reasoned this was particularly important given the critical role played by dialysis machines. Likewise, because price changes associated with Buildings and Fixtures could move differently than those associated with Machinery, we felt that separate price proxies would be more appropriate to track price changes for the different capital-related categories over time. The resulting proposed market basket weights for Capital-related Buildings and Equipment and Capital-related Machinery are 6.653 and 1.894 percent, respectively.

Table 39 lists all of the expenditure categories in the ESRDB market basket and their corresponding CY 2007 cost weights and proxies, as developed in accordance with the methodology described above.

Table 39
ESRDB Market Basket Cost Categories, Price Proxies, and Cost Weights

Cost	Price/Wage	ESRDB Market Basket
Category	Variable	CY 2007 Weights
		(Percent)
Total Compensation		30.693
Wages and Salaries	ECI- Health Care and Social Assistance (Civilian)	24.516
Employee Benefits	ECI- Benefits Health Care and Social Assistance (Civilian)	6.177
Utilities		1.180
Electricity	PPI - Commercial Electric Power	0.586
Natural Gas	PPI - Commercial Natural Gas	0.111
Water and Sewerage	CPI - Water & Sewerage	0.483
All Other Materials		44.196

Pharmaceuticals	PPI - Prescription Drugs	30.743
Blood Products	PPI – Blood and Organ Banks	0.035
Supplies	PPI- Medical, surgical, and personal aid devices	8.543
Laboratories	PPI- Medical Laboratories	4.875
All Other Services		15.383
Telephone	CPI - Telephone Services	0.590
Housekeeping and Operations	PPI - Building, cleaning, and maintenance	1.766
Labor-Related		2.641
Professional fees Labor-Related	ECI - Compensation Professional and Related (Priv)	1.478
All Other Labor-Related Services	ECI - Compensation Service Occupations (Priv.)	1.163
Nonlabor-Related		10.386
Professional fees Nonlabor-Related	ECI- Compensation Professional and Related (Priv.)	0.214
All Other Nonlabor-Related Services	CPI - All items less food and energy	10.172
Capital Costs		8.547
Capital Related-Building and Equipment	CPI – Residential Rent	6.653
Capital Related-Machinery	PPI-Electrical Machinery and Equipment	1.894

Price Proxies

Once we determined the proposed CY 2007 ESRDB market basket expenditure categories and weights, appropriate wage and price series or proxies were selected to measure the rate of price change for each category. All of the proxies are based on BLS data, and are grouped into one of the following three BLS categories:

PPIs—PPIs measure changes in the prices producers receive for their outputs. PPIs are the preferable price proxies for goods and services that ESRD facilities purchase as

inputs in producing dialysis services, since these facilities generally make purchases in the wholesale market. The PPIs that we use measure price change at the final stage of production.

CPIs—CPIs measure changes in the prices of final goods and services purchased by the typical consumer. Because these indexes may not reflect the prices faced by a producer, we used CPIs only if an appropriate PPI was not available, or if the expenditure more closely resembled a retail rather than wholesale purchase. For example, we used the CPI for telephone services as a proxy for the Telephone cost category because there is no corresponding PPI, and we reasoned that commercial and residential rates change similarly.

ECIs—ECIs measure the rate of change in employee wage rates and employer costs for employee benefits per hour worked. They are fixed-weight indexes that strictly measure changes in wages and benefits per hour, and are not affected by shifts in employment mix.

We evaluated the price proxies using the criteria of reliability, timeliness, availability, and relevance. Reliability indicates that the index is based on valid statistical methods and has low sampling variability. Timeliness implies that the proxy is published regularly,

preferably at least once a quarter. Availability means that the proxy is publicly available. Finally, relevance means that the proxy is applicable and representative of the cost category weight to which it is applied. The CPIs, PPIs, and ECIs we propose to use meet these criteria.

Wages and Salaries

We propose to use the ECI (Wages and Salaries) for Health Care and Social Assistance Workers (Civilian) as the measure of price growth for Wages and Salaries in the ESRDB market basket. We feel that this price proxy most closely reflects both the types of occupations employed by ESRD facilities, and the competitive nature of the dialysis and health services labor markets.

Benefits

We propose to use the ECI for Employee Benefits for Health Care and Social Assistance Workers (Civilian) as the measure of price growth for Benefits in the ESRDB market basket. We selected this price proxy because it most accurately represents the labor conditions associated with ESRD facilities' employee benefit costs, similar to our finding for wages and salaries.

Professional Fees

We propose to use the ECI (Compensation) for Professional and Related Occupations (Private) as the proxy

for professional fees. We selected this price proxy because it includes occupations such as lawyers, accountants, and bookkeepers that are represented in this cost category.

Utilities

We propose to use the PPI for Commercial Electric Power and the PPI for Commercial Natural Gas as the proxies for the Electricity and Natural Gas cost categories, respectively. We propose to use the CPI for Water and sewerage as the price proxy for the water and sewerage cost category.

Capital-related - Building and Equipment

We propose to use the CPI for Residential Rent as the price proxy for the Capital-related Building and Equipment cost category. As described earlier, this cost category includes building and fixtures, leased buildings, fixed equipment, and moveable equipment. Because machine equipment, particularly dialysis machines, is reflected in a separate cost category, the bulk of the expenditures captured here are for building and fixed equipment. Thus, we would prefer to have a proxy that captures the price change associated with this type of capital expense. While there can sometimes be differences in the price levels for residential and commercial rent, we believe the CPI for

Residential Rent approximates the change in the underlying costs associated with ESRD facilities' capital costs such as depreciation, interest, taxes, and other capital costs. Given the lack of an ESRD-specific proxy for capital costs, we believe that the CPI for Residential Rent represents an adequate proxy for the changes in capital costs facing ESRD facilities.

Capital-related - Machinery

We propose to use the PPI for Electrical Machinery and Equipment as the price proxy for the Capital-related Machinery cost category. This PPI includes dialysis machines, which are a significant component of machine equipment costs reported by ESRD facilities. Therefore, we believe that this price proxy is the best measure of the price growth of this cost category.

Pharmaceuticals

ESRD facilities use a variety of drugs during dialysis treatment including EPO which is currently a separately billable drug and accounts for the majority of ESRD facility drug expenses. We pay for erythropoietic agents to treat chronic anemia in ESRD patients. At present, Epogen[®] and Aranesp[®] (both manufactured by a single supplier) are two of the prevailing erythropoietic drugs available to treat anemia in ESRD patients. Medicare is

the dominant purchaser of EPO since it is mainly used to treat kidney dialysis patients.

For the proposed ESRDB market basket, we propose to use the PPI for Prescription Drugs as the price proxy for the Pharmaceuticals category. We propose the use of this proxy for a variety of reasons. First, all of the market baskets that we produce include price proxies that are intended to reflect the efficient average price increase associated with the purchase of the particular input category. Accordingly, we have chosen to proxy the Pharmaceuticals cost category in the proposed ESRD market basket, which includes the mix of all prescription drugs purchased by dialysis facilities, by the PPI for Prescription Drugs because it reflects price changes associated with the average mix of all pharmaceuticals in the overall economy. Second, we anticipate the price changes associated with the assortment of drugs administered in ESRD facilities should, over time, be similar to the average prescription drug price changes observed across the entire economy. Finally, this price series was chosen as it is both publicly available and regularly published.

Blood Products

We propose to use the industry PPI for Blood and Organ Banks as the price proxy for this cost category. This is the price proxy that we recently proposed to use in the 2006-based inpatient hospital market basket (74 FR 24157).

Supplies

We propose to use the commodity-based PPI for Medical, Surgical, and Personal Aid Devices as a proxy for changes in ESRD supply prices. Many of the supplies used in dialysis are included in this PPI, such as dialyzers, catheters, I.V. equipment, syringes, and other general medical supplies used in dialysis treatment.

Laboratory Services

We propose to use the PPI for Medical Laboratories as the price proxy for the ESRD Laboratory Services cost category. Most of the laboratory tests used in dialysis are blood chemistry tests (a covered component of the medical labs PPI). Additionally, some ESRD facilities are using diagnostic imaging services to monitor patient site access, and the points where waste exchange takes place (also a covered component of the medical labs PPI).

Telephone

We propose to use the CPI for Telephone Services as the price proxy for the Telephone cost category. This

index is used as the price proxy for Telephone Services in other market baskets produced by CMS.

Housekeeping and Operations

We propose to use the PPI for Building Cleaning and Maintenance Services as the price proxy for the Housekeeping and Operations cost category. This PPI includes housekeeping, janitorial, and maintenance (excluding repairs) services, and is representative of the types of costs included in this cost category.

All Other Labor-related Services

We propose to use the ECI (compensation) for Service Occupations (Private) as the price proxy for the All Other Labor-related Services cost category. This category includes expenses related to repair services. We feel that the service occupations most accurately reflect the costs for these types of repair and maintenance services purchased by ESRD facilities.

All Other Nonlabor-related Services

We propose to use the CPI for All Items Less Food and Energy as the price proxy for the All Other Nonlabor-related Services cost category. This category includes costs such as data processing, purchasing, taxes, home office costs, and malpractice costs. The costs represented in this category are diverse and are primarily associated

with the purchase of services. These costs are best represented by a general measure of inflation such as the CPI for All Items Less Food and Energy. Food and energy are excluded from the index to remove the volatility associated with those items. Additionally, energy prices are already captured in the utility price proxies.

ESRDB Market Basket Increases

The proposed ESRDB market basket reflects the combination of weights and proxies discussed above. Table 40 contains the forecasted rate of growth for CY 2009 through CY 2019 for the ESRDB market basket. Over this time period, the ESRDB market basket average increase is projected to be 2.7 percent.

**Table 40
Forecast of the 2007-Based ESRD Bundled Rate Market basket
Percent Change, 2009 through 2019**

Cy beginning January 1st	ESRDB
CY2009	3.4
CY2010	2.3
CY2011	2.5
CY2012	2.6
CY2013	2.6
CY2014	2.7
CY2015	2.7
CY2016	2.7
CY2017	2.7
CY2018	2.7
CY2019	2.7

Note: These percent changes do not reflect the -1 percentage point update in the market basket as mandated by MIPPA.

Source: 2009 2nd Quarter Forecast from IHS Global Insight

ESRD Labor-Related Share

The labor-related share of a market basket is determined by identifying the national average proportion of operating costs that are related to, influenced by, or vary with the local labor market. The labor-related share is typically the sum of Wages and Salaries, Benefits, Professional Fees, Labor-related Services, and a portion of the Capital share from a given market basket.

We used the 2007-based ESRDB market basket costs to determine the proposed labor-related share for ESRD facilities under a bundled system. Under the proposed ESRDB market basket, the labor-related share for ESRD facilities is 38.160 percent; as shown in Table 41 below. These figures represent the sum of Wages and Salaries, Benefits, Housekeeping and Operations, All Other Labor-related Services, 87 percent of the weight for Professional Fees (details discussed below), and 46 percent of the weight for Capital-related Building and Equipment expenses (details discussed below).

Table 41 - ESRDB Market Baskets Labor-Related

Share Cost Category	2007-based ESRDB Labor-Related Share (Percent)
Wages	24.516
Benefits	6.177
Housekeeping and operations	1.766

All other labor-related services	1.163
Professional fees labor-related	1.478
Capital labor-related	3.060
Total	38.160

The labor-related share for Professional Fees (87 percent) reflects the proportion of ESRD facilities' professional fees expenses that we believe varies with local labor market. We recently conducted a survey of ESRD facilities to better understand the proportion of contracted professional services that ESRD facilities typically purchase outside of their local labor market. These purchased professional services include functions such as accounting and auditing, management consulting, engineering, and legal services. Based on the survey results, we determined that, on average, 87 percent of professional services are purchased from local firms and 13 percent are purchased from businesses located outside of the ESRD's local labor market. Thus, we are proposing to include 87 percent of the cost weight for Professional Fees in the labor-related share.

The labor-related share for capital-related expenses (46 percent of ESRD facilities' adjusted Capital-related Building and Equipment expenses) reflects the proportion of ESRD facilities' capital-related expenses that we believe

varies with local labor market wages. Capital-related expenses are affected in some proportion by variations in local labor market costs (such as construction worker wages) that are reflected in the price of the capital asset. However, many other inputs that determine capital costs are not related to local labor market costs, such as interest rates. The 46-percent figure is based on regressions run for the inpatient hospital capital PPS in 1991 (56 FR 43375). We use a similar methodology to calculate capital-related expenses for the labor-related shares for rehabilitation facilities (70 FR 30233), psychiatric facilities, long-term care facilities, and skilled nursing facilities (66 FR 39585).

XIII. Proposed Implementation for the ESRD PPS

A. Transition Period

Section 1881(b)(14) of the Act replaces the current basic case-mix adjusted composite payment system with a case-mix adjusted bundled prospective payment system, or the ESRD PPS, for Medicare outpatient ESRD facilities beginning January 1, 2011. Section 1881(b)(14)(E)(i) of the Act requires the Secretary to provide "a four-year phase-in" of the payments under the ESRD PPS for renal dialysis services furnished on or after January 1, 2011. Although the statute uses the term "phase-in", other Medicare payment systems use the term "transition" to describe the timeframe during which payments are based on a blend of the payment rates under the prior payment system and the new payment system. For purposes of this ESRD PPS proposed rule, we will use the term "transition" to describe this timeframe. Section 1881(b)(14)(E)(i) of the Act further requires that the transition occur "in equal increments," with payments under the ESRD PPS "fully implemented for renal dialysis services furnished on or after January 1, 2014." In addition, section 1881(b)(14)(E)(ii) of the Act permits an ESRD facility to make a one-time election to be excluded from the transition from the current basic case-mix adjusted composite payment