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PUBLIC HEALTH AND HUMAN SERVICES



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October 13, 2005

To: John Chappuis  
Deputy Director

From: Russ Cater  
Chief Legal Counsel

Handwritten initials "RC" in black ink.

Subject: Children's Health Insurance Program

You have asked for my opinion as to (1) whether the Department of Public Health and Human Services (Department) is required to audit the actual administrative costs expended by an entity that contracts as an insurer for the Children's Health Insurance Program (CHIP). For the following reasons I have determined that it is not necessary to audit the actual costs.

You have also asked my opinion regarding other questions related to the "risk charge" and reconciliation to "actual" costs. My analysis of the first question related to the required audit will also provide a basis for my response to your other questions.

The Department is in the process of negotiating a contract with Blue Cross and Blue Shield (BCBS) for the provision of a group children's health insurance plan that meets the requirements of MCA 53-4-1001 et seq. BCBS has contracted with the Department to provide this insurance since its inception in 1999. The law relevant to CHIP was amended by the 2005 Montana Legislature when it passed SB 154. The pertinent provisions of the law, as amended, are as follows:

**"53-4-1007. (Temporary) Department may contract for services.**

(3) If the department of public health and human services contracts with an insurance company or other entity to administer the program as provided in subsection (2)(b) or (2)(c), not more than 12% of the contract payment may be used for administrative expenses, including:

- (a) direct and indirect expenses as specified in 33-22-1514;
- (b) risk charges; and
- (c) any applicable assessments, fees, and taxes.

(5) (a) An insurance company or other entity that contracts with the department

for a fully insured contract as provided in subsection (2)(b) shall calculate the surplus account balance at the end of each contract year and may retain an amount equal to 50% of the risk charge allowed under the contract. The remainder of the surplus balance must be deposited in the state special revenue account provided for in 53-4-1012.

(b) For the purposes of this subsection (5):

(i) "risk charge" means the percentage of the administrative expense allowed in the contract for assuming the risk;

(ii) "surplus account balance" means funds that remain after all claims and all administrative expenses have been paid for a claim period. (*Terminates on occurrence of contingency--sec. 15, Ch. 571, L. 1999; sec. 7, Ch. 565, L. 2005.*)"

[Emphasis added.]

Your question involving the audit of administrative expenses is also governed by MCA 18-1-118. This section provides as follows:

**"18-1-118. Access to records of contracting entities.** Money may not be spent by a state agency under a contract with a nonstate entity unless the contract contains a provision that allows the legislative auditor sufficient access to the records of the nonstate entity to determine whether the parties have complied with the terms of the contract. The access to records is necessary to carry out the functions provided for in Title 5, chapter 13. A state agency may terminate a contract, without incurring liability, for the refusal of a nonstate entity to allow access to records as required by this section." (Emphasis added.)

In order to determine if the CHIP contract complies with the terms of the contract and the law pertaining to the CHIP program (specifically MCA 53-4-1007(3) and (5) it is necessary to examine only the records for premiums paid, the number of eligible member months, and the actual health care claims that are paid by the contractor. An examination (or audit) of these records alone is sufficient to determine if the contractor has complied with the terms of the contract and with state law. For the reasons set forth in more detail below, it is not necessary to audit the actual administrative costs expended by the contractor to determine if the contractor has complied with the terms of the contract and the law.<sup>1</sup>

The Department, in determining an appropriate amount to be paid for the provision of a group children's health insurance plan, has split the actual premium into three categories. The first is an amount for coverage of anticipated claims that will be paid to health care providers for treating children eligible under the program. The second is a "risk charge"

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<sup>1</sup> For purposes of this opinion it is assumed that the statutes governing the Department's administration of CHIP are an implied term of the contract. See *Earts v. Chase Bank of Texas*, 2002 MT 249, 312 M 147, 59 P3d 384 (2002). Numerous references in the proposed and past contract are made to MCA 53-4-1001 et seq. In addition, section 10 of the contract specifically grants to the State of Montana, as required by MCA 18-1-118, access to the provider's records that are pertinent to the contract for purposes of an audit.

to cover unanticipated health care claims. The third category covers all other expenses, including direct and indirect expenses and applicable assessments, fees and taxes.

The Department and BCBS have not come to an agreement on the amount to be paid for category one, i.e., expected claims per member per month. But, the parties have come to an agreement on the costs associated with the second and third categories. Risk charges will be limited to 2% of the **contract payment** (premium) and the other charges in category three will be limited to 10% of the **contract payment** (premium). These amounts are stated in draft attachment 10 of the contract and attached to this memo for reference.

MCA 53-4-1007(3) limits administrative expenses to 12% of the **contract payment**. Categories two and three, as described above, are based upon a percentage of the contract payment. Simple addition of the percentage allowed for the risk charge (2%) and all other administrative expenses (10%) keeps the total charges within the limits of Montana law.

An argument has been made that the administrative expenses **actually expended** must be considered in determining the 12% limit. Or, that the 12% limit is a factor based upon the actual claims paid by the contractor for direct health care services. Or, that the 12% limit is a percentage to be determined after a determination of whether monies are to be repaid to the State as set forth in subsection (5) of MCA 53-4-1007. In order to reach these conclusions one would have to read into the statute words that are not contained therein.

It is a generally accepted principle of statutory construction that one must not insert words that may have been omitted. *State ex rel. Palmer v. Hart*, 201 M 526, 655 P2d 965, 39 St. Rep. 2277 (1982); *Skrukrud v. Gallatin Laundry Co., Inc.*, 171 M 217, 557 P2d 278 (1976); *Kadillak v. The Anaconda Co.*, 184 M 127, 602 P2d 147 (1979). In construing a statute, the court must find legislative intent from the plain meaning by reasonably and logically interpreting the statute as a whole without omitting or inserting anything or determining intent from a reading of only a part of the statute. *Gaub v. Milbank Ins. Co.*, 220 M 424, 715 P2d 443, 43 St. Rep. 497 (1986).

In order to reach a conclusion that the 12% administrative limit is based upon actual audited expenses one would be required to add the word **actual** to the subsection (3) provision of MCA 53-4-1007 wherein it is stated that "not more than 12% of the **contract payment** may be used for [actual] administrative expenses." (Emphasis added.) The language of the statute, however, is clear. The administrative expenses are limited to a percentage of the "contract payment". The contract payment is the total of the per member per month premium paid by the Department under the contract. In other words, it is the sum of the three categories described above.

The definition of "risk charge" as provided in MCA 53-4-1007(5) also supports the conclusion that the contract payment rather than the actual administrative expenses are the amounts to be considered in determining the 12% limit and the surplus balance. Risk

charge is defined as “the percentage of the administrative expense **allowed in the contract** for assuming the risk.” The words “allowed in the contract” can only mean the price negotiated at the time the contract was agreed upon, not the actual costs incurred or expended.

Even if the language was not clear or if it could be argued that it is ambiguous the Courts have indicated that deference should be given to the interpretation by the agency charged with administering the program. *St. v. Midland Materials Co.*, 204 M 65, 662 P2d 1322, 40 St. Rep. 666 (1983). In this instance, the Department has determined that the total premium paid per member per month, which comprises all three of the categories listed above, constitute the total contract payment.

An examination of the actual administrative expenses are also not necessary for a determination of compliance with MCA 53-4-1007(5) pertaining to the “surplus balance”. This section is set forth again as follows:

“(5) (a) An insurance company or other entity that contracts with the department for a fully insured contract as provided in subsection (2)(b) shall calculate the surplus account balance at the end of each contract year and may retain an amount equal to 50% of the risk charge allowed under the contract. The remainder of the surplus balance must be deposited in the state special revenue account provided for in 53-4-1012.

(b) For the purposes of this subsection (5):

(i) "risk charge" means the percentage of the administrative expense allowed in the contract for assuming the risk;

(ii) "surplus account balance" means funds that remain after all claims and all administrative expenses have been paid for a claim period.”

The most recent offer by the Department is for payment of a premium of \$122.01 per member per month. The estimated member months are 120, 760. This results in a total estimated dollar contract payment of \$14,733, 927. Based upon past experience the Department and BCBS have agreed that 2% of the premium should be allocated to the risk charge and 10% of the premium is allocated to other administrative expenses as explained above.

Let’s assume, for example, that \$15,000,000 is the total contract payments (or premiums) that are made for the contract year. And according to the contract allocation as set forth above 12% is the total allocated for administrative costs (which includes the risk charge). The following is a sample calculation that the State is entitled as a “remainder of the surplus balance [that] must be deposited in the state special revenue account” as provided in subsection 5. (These examples are the same that are used by the Department in a document that has been referred to as attachment 10 of the proposed CHIP contract.)

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Retention/Remainder Calculation Examples:

	<u>#1</u>	<u>#2</u>	<u>#3</u>
Total Premium	\$15,000,000	\$15,000,000	\$15,000,000
Less: Total Admin Fees	1,800,000	1,800,000	1,800,000
Less: Total Paid Claims	12,000,000	13,050,000	13,150,000
Account Balance	\$ 1,200,000 (Surplus)	\$ 150,000 (Surplus)	\$ 50,000 (Surplus)
Total Risk Charges	\$ 300,000	\$ 300,000	\$ 300,000
.5 times Risk Charges ***	\$ 150,000	\$ 150,000	\$ 150,000

(\*\*\* Note: This is only a calculation of the amount the Contractor may retain as provide in 53-7-1107(5). This is the Contractor's Retention Amount.)

Account Balance	\$ 1,200,000	\$ 150,000	\$ 50,000
Less: Contractor's Retention Amount	(\$ 150,000)	(\$ 150,000)	(\$ 150,000)
Department's Remainder Amount.	\$1,050,000	- 0 -	- 0 -
Cannot be less than zero			

The use of these examples helps explain the determination of the "risk charge", the "administrative expenses" (which includes the risk charges), the "surplus balance account" and the amount to be retained by the contractor as required by MCA 53-4-1007(5). As can be seen from this explanation, it is not necessary to audit the actual administrative costs expended by the contractor to determine if it has complied with the terms of the contract and applicable law.

(2) Does the Department have any claim to the risk charge or other administrative fees allocated in the contract?

For the following reasons I have determined that the Department does not have any claim to the risk charge or other administrative fees allocated in the contract.

Any claim that the Department may have to the risk charge and other administrative fees allocated in the contract is determined by the terms of the contract and any relevant laws that are an express or implied part of the contract. Under the CHIP contract, as proposed, a premium payment will be paid to BCBS based upon a per member per month premium (PMPM). (See contract section 5.) The current offer by the Department is for a premium payment of \$122.01 PMPM. This amount, as explained above, includes 2 % for the risk charge and 10% for other administrative costs. Under a health care indemnity contract as proposed, BCBS will be responsible for paying the costs of health care services as

outlined in attachment 1 of the contract. BCBS assumes the risk if the health care claims exceed the premium paid for the enrollee individually or in the aggregate.

Likewise, the Department does not have a claim to return of any risk charges or administrative expenses allocated under the contract. Attachment 10, section 4 specifically indicates that this contract "is not a cost based contract." It further goes on to state that the administrative expense fee "is not subject to retroactive adjustment or settlement ...". If claims or expenses do not exceed what was bargained for under the contract (\$122.01 PMPM) BCBS may keep the excess monies paid. Thus, there is no direct legal claim of the Department to the risk charges or administrative charges once they are paid under the contract.

The next part of the analysis of this question is to determine if the pertinent law can be interpreted to the contrary of the contract provisions. Attachment 10 does refer to the relevant provisions of the law, MCA 53-4-1007(5). This attachment to the contract does have a provision for determining if there is a "surplus account balance". (See attachment 10, section seven and eight.) MCA 53-4-1007(5) also provides a calculation for determining the amount of the surplus account balance that may be "equal to 50% of the risk charge allowed under the contract." But, this does not mean that the Department has a specific claim to the risk charge. Instead, it gives the Department the legal right to an amount of money based upon a calculation of the surplus account balance.

(3) Does the law pertaining to the CHIP require that the Department reconcile the administrative costs to 12% of the actual costs rather than the contract premium payment at year-end?

For the reasons I have stated with respect to question (1) it is my opinion that the law does not require reconciliation to actual administrative costs. MCA 53-4-1007 requires reconciliation to actual costs only with respect to the health claims paid on behalf of the CHIP recipients and the actual PMPM premium contract payment. I do not believe it is necessary to repeat that analysis.

I hope this opinion adequately answers your question. Please let me know if I can be of further assistance in this matter.