The Use of Surety Bonds in Health Care

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Publications

Ohio State Auditor David Yost has noted that Ohio has millions of dollars of unpaid obligations owed by Medicaid providers and has proposed the use of surety bonds to address the problem. Based on recent reports, auditors have identified over $33 million in alleged overpayments to more than 120 providers. Further analysis of a portion of those claims showed that only about 10% of the outstanding balances have been collected. Thus, Mr. Yost proposed the use of surety bonds as a means to recover some of these overpayments and to minimize the problem in the future. Introduced by Senators Lehner and Eklund, Senate Bill 218 is still pending before the Ohio Legislature at the time of this article's publication.

What is a Surety Bond?

Most people have little understanding of what a surety bond covers, how it is structured, how it operates, or why it is used instead of insurance. Indeed, the vast majority of experienced attorneys can have lengthy and successful careers and never deal with a surety bond. But surety bonds have been used to facilitate commerce for thousands of years. The concept of suretyship is referenced in the Code of Hammurabi, is found in the Old Testament, was an element of Roman civil law, was included in the English common law, and was even an integral element of the Magna Carta.

Suretyship is not a form of insurance. Instead, suretyship involves no transfer of risk and provides that one party (the surety) agrees to answer for the debts or obligations of another (the principal). The party in whose favor the bond runs is called the obligee. Since under a surety bond the surety agrees to answer for the debts of another, the bond must be in writing to comply with the requirements of the statute of frauds. (The statute of frauds is a legal concept that requires certain types of contracts to be executed in writing. The precise form of the Statute of Frauds varies between jurisdictions.)

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Surety bonds are commonly used to provide a second and alternative source of recovery for the failure of one entity to comply with its contractual, statutory or regulatory obligations. Surety bonds are often used in public construction at the federal level under the Miller Act or at the state level in what are known as "Little Miller Acts." The bonds envisioned by Ohio Auditor Yost, however, would be best characterized as commercial surety bonds. These bonds are provided to assure that the principal, which typically is engaged in a particular business, fulfills its obligations imposed by governing statutes or applicable regulations. In this context, the federal government and many states impose obligations to provide these surety bonds on certain providers of health care goods and services.

Targeting Medicare and Medicaid Fraud

On January 20, 1998, Sally K. Richardson, Director, Center for Medicaid and State Operations for the Department of Health and Human Services, issued a letter regarding the implementation of the Balance of Budget Act (BBA) of 1997. The letter was one of a series of communications that targeted fraud and abuse in Medicaid and Medicare programs. A proposed regulation had been published in the federal register in January 1998 as a final rule and the agency solicited comments on the rule. This proposed rule addressed the use of surety bonds and capitalization requirements for Home Health Agencies (HHAs). Under this proposed regulation, HHAs were required to secure surety bonds to participate in Medicare and Medicaid programs, and a separate bond was required for each program. Under the Medicaid program, each HHA had to post a surety bond that was in the penal sum of $50,000 or 15% of the annual Medicaid payments made to the HHA by the Medicaid agency for services rendered. Under the Medicare program, the surety bond had to be in the penal sum of $50,000 or 15% of the annual amount paid by the HHA under the Medicare programs. There were also capitalization requirements imposed for participation in the programs.

States also required the posting of surety bonds by entities or individuals who wanted to become providers of goods or services

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under a variety of Medicaid programs. Those required to post a bond included physician groups, ambulance or transportation providers, home health agencies, and personal care assistance providers. The purpose of the bond is to assure that these providers who are accepting payment through Medicaid programs are operating their business in a proper manner and in full compliance with applicable federal or state statutes and regulations. The applicable terms of the Medicaid provider bond vary greatly as to the penal sum of the bond as well as regulations surrounding how the bonds are to be administered.

The premiums charged for the issuance of the bonds also vary greatly and may range from a total of 0.5% to 2% of the bond amount. For example, a $50,000 bond may require a premium as low as $250 or as high as $1,000 depending upon the financial stability of the principal seeking the bond.

Issuing the Bond and Determining its Terms

To issue the bonds, the surety typically conducts a financial review of the potential provider of the goods or services. The bond itself provides a financial guarantee that the business will fulfill its obligations according to the terms of the statutes or regulations governing the providers. Under these bonds, the government agency is deemed the obligee, the principal is the business that is providing the goods or services, and the surety is the carrier that underwrites the bond. For example, Florida requires the posting of such bonds under Florida statute § 409-907(7) of the Florida Agency for Healthcare Administration. The penal sum for the bond in Florida is set at $50,000.

Under the terms of the bond in Florida, the principal pledges that it will satisfy all requirements of the Florida statutes to render the particular services in a proper manner. Typically, the Florida Medicaid Provider Bond remains in effect for a period of one year. The bonds can be terminated by giving the required notice by certified mail, and the cancellation becomes effective sixty (60) days from the mailing of the notice. The surety can also cancel the bond by giving sixty (60) days' notice to the agency identified as the obligee under the bond. The posting of the bond is required for

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an entity to become eligible to provide the Medicaid services.

Since suretyship is not insurance, the carrier providing the bond typically secures a commitment from the principal and possibly personal indemnitors to indemnify the carrier in the event it must pay a claim under the terms of the bond. The principal is, and remains, the primary obligor to perform the services or provide the goods, and the surety becomes the secondary obligor. In this instance, suretyship is much more like a financial requirement that obligates the principal, as the primary obligor, to reimburse the surety in the event that any loss is sustained.

Surety Bonds for DMEPOS Providers and Pharmacies

Another context in which surety bonds may be required is for the providers of durable medical equipment, prosthetics, orthotics and supplies (DMEPOS). In order to enroll in the Medicare billing processes, a DMEPOS supplier must post a surety bond. The requirement to post these bonds was referenced in the January 2, 2009 posting of the final rule entitled "Medicare Program: Surety Bond Requirement for Suppliers of Durable Medical Equipment, Prosthetics, Orthotics and Supplies (DMEPOS)." Under § 4312(b) of the Balance Budget Act of 1997, suppliers of DMEPOS were required to post a surety bond in an amount not less than $50,000. The suppliers of DMEPOS who are properly registered must obtain a bond for each National Provider Identifier (NPI) and provide this information to the National Supplier Clearinghouse (NSC). A DMEPOS supplier bond must be obtained for each practice location. For example, an organization that operates as a DMEPOS supplier with ten (10) locations would be required to secure surety bonds totaling $500,000.

Pharmacies can also be enrolled as DMEPOS suppliers through the NSC. Pharmacies which bill for certain non-accredited products, including Epoetin, amino suppressive drugs, infusion drugs, nebulizer drugs, or oral anti-cancer drugs are also required to post a surety bond. Pharmacies that continue to participate in the Medicare programs as a DMEPOS supplier are required to post surety bonds.

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Sanctions are imposed for the failure to post the required surety bond. A supplier that has not provided the required surety bond for any length of time would be deemed "non-compliant." Once found to be non-compliant, Medicare billing privileges would be revoked for a period of time during which the supplier is and remains in non-compliance. The DMEPOS supplier would remain liable for items or services provided during any gap in compliance. If a gap in the bonding requirement remains, certain penalties can be imposed. For example, a supplier with one adverse legal action against them in 10 years preceding may be deemed a "high risk." For each such occurrence, the penal sum of the bond would increase at a rate of $50,000 per occurrence. Adverse actions would include the following:

- A Medicare imposed revocation of any Medicare billing privilege;
- Revocation or suspension of a license to provide health care by any state licensing authority;
- Revocation or suspension of a license by any accreditation organization;
- Conviction of a federal or state felony offense; or
- Exclusion or disbarment from participation in a federal or state health care program.

Under the terms of some surety bonds, the surety would be liable for unpaid claims, civil money penalties and assessments that occurred during the period of the bonds or any rider that supplements the bond. The total liability of the surety, is capped at the amount of the penal sum of the bond.

In September 2011, Donald M. Berwick, M.D., Administrator of the Centers for Medicare and Medicaid Services, received a report from Stuart Wright, Deputy Inspector General for Evaluation and Inspections regarding the use of surety bonds to recover overpayments made to suppliers of DMEPOS. In the report, Mr. Wright noted:

> "We found that CMS does not have finalized procedures for recovering DMEPOS overpayments through surety bonds. In

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addition, as of July 2011, no overpayments had been recovered through surety bonds since October 2, 2009, the date the surety bond requirement became effective for all suppliers. A full report, to be issued at a later date, will provide additional information on the number of DMEPOS suppliers that received overpayments, the amount of unrecovered overpayments, and the extent to which DMEPOS overpayments would have been recovered if CMS had sought collection through surety bonds."

In his report, Mr. Wright noted that Medicare's standards were "too weak" to effectively screen DMEPOS suppliers to enroll in the program. Mr. Wright further noted that the Office of the Inspector General had conducted site visits in Florida, observing that "nearly half" of the suppliers were not in compliance with basic supplier standards. The report also documented how the enrollment process for accredited suppliers had been changed in 2011 to require the use of surety bonds. In general, the report noted that "a surety bond enabled CMS to recover overpayments when other methods of collection are unsuccessful."

Pharmaceutical Dealer/Supplier Bonds

Another type of bond that may be required is a Pharmaceutical Dealer/Supplier Bond. These bonds are required for entities that are engaged in the wholesale distribution of prescription drugs. This would include companies that repackage or distribute drugs under private labels, manufactures drugs, provides warehouse services, or retail pharmacies that provides wholesale distribution services. Many states require that wholesale distributors obtain a pharmaceutical wholesale dealer surety bond to insure that the providers fully comply with state and federal laws regarding their operation. While the penal sum varies from state to state, many bonds must be at the level of $100,000. Arizona is one state that requires the posting of a Pharmaceutical Wholesaler Surety Bond. Under the Arizona Statute, the bond is required to guarantee compliance with the requirements of and payment of any penalties, fees and costs imposed by the Arizona State Board of Pharmacy.

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California is another state that requires the posting of a Pharmaceutical Wholesaler Surety Bond. These are required under § 4162 and § 4162.5 of the Business and Professional Code of California that requires an applicant seeking to perform as a Pharmacy Wholesaler to post a bond with the California State Board of Pharmacy.

Sample Requirements by State

Indiana

Indiana is a state that requires the posting of surety bonds for Medicaid transportation service providers. The bond insures that the transportation providers will comply with Indiana Code Section 12-15-11. The bond would guarantee that Medicaid recipients will be protected if the provider violates a law that causes damage to the service recipient. The recipients may file claims against the surety bond for reimbursement if they sustain damage as a result of the transportation provider's negligence. A transportation provider in Indiana is required to enroll with the Indiana Health Coverage Programs (the IHCP), and the application process requires the posting of the bond.

Texas

Texas requires the posting of a Medicaid bond. In Texas, Medicaid providers are obligated to obtain a Texas Medicaid bond in order to operate legally within the state. The requirements are set forth in Texas Administrative Code, Title 1, Part 15, Chapter 352, Rule § 352.15. The terms of the bond provide that the provider will operate lawfully and will not commit lawful fraud against the state as the payer for the services.

Ohio

Ohio requires the posting of a surety bond under certain circumstances. Ohio Revised Code § 1751.271 and Ohio Revised Code § 5111.17 outline the requirements for the posting of a performance bond by a Health Insuring Corporation to pay claims of contractual providers for covered health care services provided to Medicaid recipients. The language of the bond reads as follows:

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> "If the principal shall well and truly pay claims of contracted providers for covered health care services provided to Medicaid recipients, then this obligation shall be void; otherwise to remain in full force and effect."

While appearing antiquated, this wording is the standard language contained in a surety bond. Under the bond, the principal is required to fulfill its contractual obligations, and if the principal fails to do so, the surety may be obligated to perform.

As discussed above, surety bonds can be required at different stages and for different entities providing some form of health care services. For more information on how surety bonds operate in general or how a specific surety bond may apply to claimants, principals or sureties, please contact any member of Frost Brown Todd's Health Care Industry Team or the author of this article, David C. Olson (dolson@fbtlaw.com, 513.651.6905.)

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