



April 27, 2010

The Honorable Kathleen Sebelius
Secretary of Health and Human Services
200 Independence Avenue, SW
Washington, DC 20201

Dear Madam Secretary,

When we met with you earlier this year, we appreciated your willingness to address the needs of California for additional federal assistance. Like many other states, we are facing unprecedented fiscal challenges that threaten the funding for many of our critical safety-net programs. Your leadership in approving the application of the American Recovery and Reinvestment Act (ARRA) Federal Medical Assistance Percentages (FMAP) to the Medicare Part D “clawback” formula gave our state a much-appreciated \$670 million. However, as our July 1 fiscal year deadline approaches, our state’s ongoing multibillion-dollar deficit requires us to continue working with our federal partners to resolve some of these funding challenges.

The state’s current fiscal situation poses another fundamental challenge as we begin the effort to implement national health reform. California must maintain and strengthen its core health care infrastructure for the successful implementation of federal health reform.

The state is seeking approval from the Centers of Medicare and Medicaid Services (CMS) for the following issues.

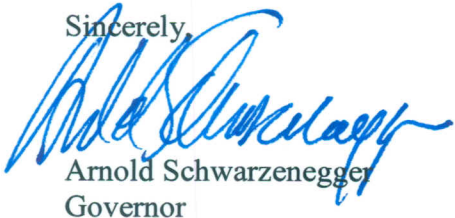
- **Medicaid 1115 Waiver**. California seeks to partner with the federal government to negotiate a new Medicaid 1115 waiver. The demonstration project would build on the state’s existing safety net and provide the necessary foundation for implementing health reform. Specifically, the waiver proposal would: expand coverage to uninsured adults up to 200 percent of federal poverty level through existing local coverage initiatives; coordinate Medi-Cal health care to seniors and persons with disabilities and other populations with high-cost, complex health needs; and strengthen funding to critical safety net hospitals by providing more – and more flexible – funding. The waiver will provide a critical bridge that enables the state to build on its existing health care delivery system and implement health reform over the next three years. To achieve these objectives, the state is requesting an additional \$2 billion per year for each of the five years of the waiver.

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- **Hospital Quality Assurance Fee.** In 2009, California enacted legislation to authorize a new quality assurance fee on hospitals. This fee would leverage approximately \$2 billion in new federal funds, and allow the state to pay supplemental Medi-Cal payments for inpatient and outpatient hospital services. The additional funding will provide critically needed assistance for both public and private hospitals that serve a disproportionate number of uninsured and Medi-Cal patients. In addition, Governor Schwarzenegger's 2010-11 budget assumes \$560 million for children's health care under the legislation.
- **State Match for Existing Waiver and Enhanced ARRA.** CMS has tentatively approved \$783.8 million in safety net care pool funding relating to unexpended funds from the state's existing 1115 waiver (\$360 million), as well as enhanced ARRA funding (\$423.8 million). These funds are needed to reduce the budget shortfall in the state's current fiscal year. However, CMS has not yet approved the state's plan for drawing down the new federal funds through the use of specific Certified Public Expenditures.
- **Medicare Part D Clawback Methodology.** Currently, CMS uses 2003 expenditure data to set the baseline for the clawback payments and considers states' calendar year 2003 expenses on a cash basis. As a result, even though California was in the process of implementing multiple aggressive prescription drug cost-containment programs, including aggressive supplemental drug rebates and a significant change in the reimbursement paid to pharmacy providers, all of which occurred after 2003, the federal government has not given credit for these savings to the state. An adjustment to this formula would result in \$75 million savings annually and approximately \$360 million savings if applied retroactively to the initiation of the Part D benefit.

Again, we appreciate the active involvement you and your staff have had with California and the meaningful steps you've already taken to provide our state much-needed resources for programs that serve millions of Californians.

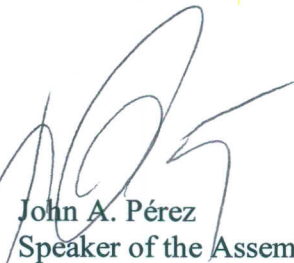
Sincerely,



Arnold Schwarzenegger
Governor



Darrell Steinberg
Senate President



John A. Pérez
Speaker of the Assembly

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