House of Representatives

Post Office Box 2910
Austin, Texas 78768-2910
(512) 463-0744
FAX (512) 463-5896

District Office

5039 Reed Road
Houston, Texas 77033
(713) 731-2400
FAX (713) 731-0172

RON WILSON
State Representative District 131

2763

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OPINION COMMITTEE

April 3, 2002

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The Honorable John Cornyn
Office of the Attorney General
209 W. 14th Street
P.O. Box 12548
Austin, Texas 78711-2548

FILE # ML-42557-02
I.D. # 42557

Dear Attorney General Cornyn:

The purpose of this letter is to request an Attorney General's opinion concerning whether and to what extent the Texas Department of Insurance is authorized by law to conduct a regulatory examination of a physician organization that contracts with a health maintenance organization (HMO) to provide only medical services that the organization's physicians are professionally licensed to provide, in exchange for a predetermined payment on a prospective basis. It is our understanding that the Department has interpreted Articles 1.15, 20A.17 and 20A.18C of the Texas Insurance Code as authorizing the Department to initiate and conduct an examination of a physician organization certified by the Texas State Board of Medical Examiners (commonly known as "5.01(a) organizations"), for the purpose of inquiring into contract-performance and financial condition matters on which the physician organization has not been given the prior notice, response and cure opportunities afforded by the Texas HMO Act to "delegated networks" that contract with HMOs.

It appears that the Department has recently begun relying on statutory provisions authorizing examination of HMOs, licensed HMO administrators and "delegated networks" to schedule examinations of the books and operations of physician organizations, to review a wide array of information (including confidential financial information) and procedures regarding the processing, adjudication and payment of claims. (A copy of a recent Department examination notice, directed to a 5.01(a) as well as to Department-licensed HMOs and administrators, is enclosed.) The 5.01(a) the Department now proposes to examine is not an entity that is licensed to perform claims processing functions or other non-medical services on behalf of the HMO. Therefore, the

Department's direct examination authority under applicable law properly extends only to HMOs, and to any licensed third-party administrators ("TPAs") or other entities who are performing HMO or TPA services that are regulated by the Department, and does not extend to physician organizations that do not hold a license or certificate of authority granted by the Department, and who provide or arrange only for medical services.

In connection with these "examinations," physician organizations are being asked to provide the Department's examiners with office space, telephones, modem lines for computers, access to copy and fax machines and computers, security clearance, passwords and parking passes for the physicians' business office, at the expense of the physician organization. Such an intrusion into a physician organization would not only be costly to the organization, but would be very disruptive to the primary function performed by such physician organizations, which is the provision of medical services to patients. The Department is without statutory authority to require the 5.01(a) organization to submit to such an examination, for the reasons that follow.

(a) **Physician Exemption.** There is a distinction between the Department's authority over physician organizations that accept financial risk under HMO contracts to provide ***comprehensive health care services*** (*i.e.,* hospital care, medical care, prescription drug benefits), and physician organizations that accept financial risk under HMO contracts only for ***medical services*** they are professionally licensed to provide. The Department's interpretation of its examination authority ignores the Texas Legislature's enactment of a clear statutory exemption from Department supervision for physicians engaged in the practice of medicine. Article 20A.26(f)(1) of the Texas Insurance Code provides, in pertinent part: "This Act shall not be applicable to . . . any physician, so long as that physician is engaged in the delivery of care that is within the definition of medical care . . . ." Under Article 20A.02, "physician" includes a 5.01(a) organization. The Texas HMO Act, therefore, does not apply to 5.01(a) organizations engaged in the delivery of medical care only.

The reason for this exemption is obvious: physicians, including physician practice groups, 5.01(a) organizations, and other physician organizations whose principal professional and business purpose is the provision of medical care to patients and related medical service management and administration, are, as a matter of sound public policy, subject principally to professional licensing requirements and medical practice standards established and administered by the Texas State Board of Medical Examiners, not the Texas Department of Insurance. Article 20A.02 makes it clear that the Legislature did not intend to give the Department any authority to regulate the practice of medicine, and did intend, through express exemption, to insulate physicians and physician organizations from the intensive and comprehensive financial and market regulation to which licensed insurers and health maintenance organizations are subject under the Insurance Code.

The Department's efforts to take a more active role in monitoring certain intermediary organizations is to be encouraged. The recent failures of Med Select in the Dallas/Ft. Worth area, North American Medical Management in Houston, and Quantum in San Antonio, are a legitimate regulatory concern. However those IPAs are distinguishable in that they accepted financial risk for hospital, pharmacy and other services outside the scope of their medical licenses. The Department must recognize that, unlike those failed IPAs, some intermediary organizations are simply physician organizations that accept financial risk under HMO contracts under which the organizations provide, arrange for, and administer only medical services they are professionally licensed to provide, and

are not themselves providing the non-medical HMO services and functions that are subject to direct financial and operational regulation and supervision by the Department.

(b) **Scope of the Department's Examination Authority.** Under the statutes cited in the enclosed notice of examination, the Department has limited examination authority over entities not subject to licensing by the Department. The relevant examination statutes provide:

(i) Article 1.15 of the Texas Insurance Code requires the Department to examine at least once every three years each Texas "carrier." "Carrier" as used here clearly refers to insurance companies (*see, e.g.*, Article 1.04A: "In making *examinations of any insurance organization* as provided by law, the department . . . ."). Article 1.15 is made applicable to HMOs by Article 20A.17(c). Department examination authority under Article 1.15 includes the ability to "visit and examine" carriers (*i.e.*, insurers or HMOs), but not physician organizations.

(ii) The Department also has authority under Article 20A.17 of the Texas HMO Act to examine HMOs at least once every three years. This authority includes the authority to examine books and records of physicians related to HMO quality of care concerns. The Department's limited Article 20A.17 authority to examine physician books and records does not include authority to examine into the processing, adjudication and payment of provider claims for HMO-covered services provided to HMO members, which is the stated purpose of the 5.01(a) examination recently noticed by the Department.

(iii) Article 20A.18C of the Texas Insurance Code, amended last legislative session, gives the Department more direct examination authority over "delegated entities," as more fully discussed below. The Department's examination authority, however, applies only to contracts entered into or renewed on or after January 1, 2002 and, therefore, to date, has had little application.

(c) **Delegated Networks/Delegated Entities.** The Department has interpreted Article 20A.18C of the Texas Insurance Code, as currently applicable to contracts entered into or renewed prior to January 1, 2002 as giving the Department direct examination authority over physician organizations. The Department's interpretation, however, ignores the Article 20A.18C definition of "delegated network," which encompasses only an entity that not only undertakes: (i) to arrange for medical care on a prepaid basis, but also (ii) "performs on behalf of the health maintenance organization any function regulated by" the HMO Act. The functions regulated by the HMO Act, such as utilization review and claim processing and payment, are "regulated" by the HMO Act in that they may be performed only by entities licensed by the Department to perform those functions. Many, if not most, physician organizations do not hold the requisite license to perform, and do not themselves perform, "delegated functions," although they may contract with licensed entities who do.

Department authority to regulate "delegated networks" under Article 20A.18C is a secondary, dependent authority that derives entirely from the Department's authority to regulate HMOs and

other Department-licensed entities. Under Article 20A.18C, HMOs are charged with monitoring the entities to which they may delegate their functional responsibilities under the HMO Act. HMOs are required to execute a written delegation agreement with each delegated network, and to monitor the delegated network to ensure that HMO functions delegated or assigned to the entity are performed in full compliance with all applicable statutory and regulatory requirements. The HMO is required to seek Department intervention *if* a delegated network is not operating in accordance with the delegation agreement, or is operating in a condition that renders the continuance of its business hazardous to HMO enrollees. Article 20A.18C expressly requires HMOs to provide the delegated network with notice and an opportunity to respond and correct any perceived deficiencies in its performance of delegated functions, prior to intervention by the Department in the operations of the delegated network. It appears that neither the Department nor the HMOs are adhering to the prescribed process for "examining" 501(a) organizations under Article 20A.18C, as currently applicable. Even if certain physician organizations are within the definition of "delegated network" in Article 20A.18C, the Department has no authority to intervene in their operations or affairs unless and until the Article 20A.18C prescribed notice and cure process has been followed, and there remain noticed, uncured "deficiencies" that provide a reasonable basis for Department intervention.

The enclosed examination notice directed to a 5.01(a) organization identifies "processing, adjudication and payment of claims" as the primary purpose of the examination, and references receipt of third party complaints and a request for intervention from an HMO, Aetna U.S. Healthcare of Texas, Inc. The referenced request for intervention from Aetna (copy enclosed) is a limited request for Department assistance in obtaining certain financial statements from the 5.01(a) organization, which in no way gives notice of or suggests any alleged deficiency related to processing, adjudication and payment of claims, or to any third-party complaint. Thus, the examination the Department proposes to conduct is not related to or justified by any alleged deficiency of which the 5.01(a) has been given notice or opportunity to cure. Applicable law does not authorize such a Department examination of a 5.01(a).

House Bill 2828, enacted in 2001 but applicable only to contracts entered or renewed on or after January 1, 2002, contains amendments to Article 20A.18C that prospectively will expand the Department's examination authority over entities to which HMOs delegate regulated functions. That Act changes the term "delegated network" to "delegated entity," expands the definition of the term to include an entity that, in addition to arranging for medical care for HMO enrollees also "accepts responsibility to perform" a Department-regulated HMO Act function. As amended, Article 20A.18C will permit the Commissioner to examine at any time any information the Commissioner reasonably believes is relevant to a delegated entity's financial solvency, or its ability to perform delegated functions. The recent amendments, however, do not apply to current, unrenewed contracts (such as the HMO/physician organization contract that is the basis for the attached Department examination notice). And those as-yet-inapplicable amendments make it clear that current law does not authorize an unpredicated Department examination of an entity that does not itself perform a delegated function.

(d) **Reserve Requirements.** With respect to the enclosed examination notice, the Department is asking a physician organization to disclose its confidential financial information,

including copies of monthly bank statements and information regarding reserves. It is our understanding that the Department has never previously sought to obtain such sensitive, confidential information from physicians, and I do not believe it has the authority to do so. There is no statutory financial reserve requirement imposed on physician organizations, such as the 5.01(a) targeted for examination here, who are "at risk" (that is, who are financially obligated by contract to perform, for the agreed-upon compensation) only the medical services they are professionally licensed to provide to their patients.

House Bill 2828, in addition to amending Article 20A.18C as described above, also added Article 20A.18D to the Texas Insurance Code. New Article 20A.18D requires a delegated network (an entity that assumes financial risk for more than only medical care) to establish reserves adequate to cover only the services for which the entity is at risk that are not within the scope of the network's professional license. A physician organization that accepts risk only for medical services is not legally required to establish reserves. Thus, even if the recent amendments were applicable to the 5.01(a) targeted by the Department for examination (they are not), the Department's examination authority under those amendments cannot be read to reach information pertaining to statutory solvency and operational requirements to which the 5.01(a) is not even subject.

In attempting to intervene in the affairs of a physician organization, to conduct a broad examination of its functions and operations (including matters, such as capitalization and reserves, that the Department has no authority to regulate), and without satisfying the applicable subject-matter, notice, and opportunity to cure requirements that are substantive and procedural prerequisites to Department intervention in contract-performance issues between the HMO and the physician organization, the Department is simply overreaching its authority.

In light of the significant regulatory issues involved, and their potential for affecting the provision of heath care by physician organizations that contract with HMOs, this matter greatly affects the public interest, and is a proper subject for resolution by you under section 402.042(a) of the Texas Government Code. I therefore respectfully request your opinion regarding (i) the statutory authority of the Commissioner of Insurance to conduct a regulatory examination of a physician organization that provides only medical services that the organization's physicians are professionally licensed to provide in exchange for a predetermined payment on a prospective basis from an HMO; (ii) whether or not an HMO's provision of notice and an opportunity to respond and cure deficiencies is a condition precedent to Department intervention with respect to contracts entered into prior to January 1, 2002 that have not been renewed; and (iii) whether a physician organization that accepts risk only for medical services is legally required to establish reserves under Texas law.

(i) **Does the Commissioner of Insurance have authority under Articles 1.15, 20A.17 or 20A.18C of the Texas Insurance Code to conduct a regulatory examination of a physician organization that, under a contract with a health maintenance organization, provides only medical services that the organization's physicians are professionally licensed to provide in exchange for a predetermined payment on a prospective basis?**

(ii) **With respect to the Department's intervention authority under Article 20A.18C of the Texas Insurance Code as it applies to contracts between an HMO and delegated network entered into prior to January 1, 2002 that have not been renewed:**

(a) Is an HMO required to provide notice to a delegated network identifying specific deficiencies under a monitoring plan ("Notice of Deficiencies") and an opportunity to respond and cure the specific deficiencies identified by the HMO as a condition precedent to the Department's intervention authority?

(b) Does the Department have authority to examine delegated networks with respect to matters that have either not been identified in the Notice of Deficiencies, or have been identified but cured by the delegated network, following an HMO's request for intervention by the Department?

(iii) **Is a physician organization that accepts risk only for medical services legally required to establish reserves under Texas law?**

I am apprising the Texas Department of Insurance of this request by sending a copy of this letter to Commissioner Montemayor. Thank you for you assistance in the matter.

Very truly yours,

Ron

Ron Wilson
Chairman
Committee on Licensing and Administrative Procedures
Texas House of Representatives

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