CENTERS FOR MEDICARE AND MEDICAID SERVICES

Decision of the Administrator

In the case of:	**Claim for:**
Southcrest Hospital	**Provider Reimbursement Determination for Periods**
Provider	**Ending: 12/31/03, 12/31/04 and 12/31/05**
vs.	
Wisconsin Physicians Service	**Review of:**
	PRRB Dec. No. 2010-D44
Intermediary	**Dated: September 15, 2010**

This case is before the Administrator, Centers for Medicare & Medicaid Services (CMS), for review of the decision of the Provider Reimbursement Review Board (Board). The review is during the 60-day period in § 1878(f)(1) of the Social Security Act (Act), as amended (42 USC 1395oo(f)). The parties were notified of the Administrator's intention to review the Board's decision. The Provider submitted comments, requesting that the Administrator affirm the Board's decision. The Intermediary and the CMS' Center for Medicare (CM) also submitted comments, requesting reversal of the Board's decision. Accordingly, this case is now before the Administrator for final agency review.

ISSUE AND BOARD'S DECISION

The issue is whether the Provider as a new provider is entitled to capital "hold-harmless" payment methodology under the capital prospective payment system (PPS) beyond the 10-year transition period.

The Board held that the Intermediary's refusal to reimburse the Provider for capital-related costs under the hold-harmless methodology for the cost years at issue was improper. Based upon the Provider's status as a new provider during the transition period and the fact that the Provider's hospital-specific rate (HSR) for the periods in dispute exceeded the Federal rate, the Board ruled that the Provider was entitled to

payment under the hold-harmless methodology outlined at 42 C.F.R. § 412.324(b) for up to eight years beyond the end of the transition period. The Board stated that it could find no support in the statute, or regulation, for the Intermediary's contention that a provider must be paid under the hold-harmless methodology prior to the end of the 1991-2001 transition period to continue to receive such treatment after 2001. Accordingly, the Board instructed the Intermediary to amend, if necessary, the Provider's fiscal years ending (FYs) 2003, 2004 and 2005 cost reports to reflect the hold-harmless methodology.

SUMMARY OF COMMENTS

The Intermediary commented requesting that the Administrator review and reverse the Board's decision. The Intermediary argued that the Provider was not entitled to the hold-harmless methodology outlined at 42 C.F.R. § 412.324(b), because the Provider was never paid under the hold-harmless methodology during the transition period. The Intermediary argued that payment under the hold-harmless methodology was a pre-requisite to continuing the methodology after the close of the ten-year transition period. In this case, the Provider's third cost reporting period (January 1, 2002) began after the close of the ten-year transition period (October 1, 1991 through October 1, 2001); therefore, there was no "third year through the remainder of the transition period" for this hospital. Since the Provider was never paid under the hold-harmless methodology prior to the end of the 10-year transition period, the Provider does not qualify for hold-harmless payments after the capital PPS transition period.

The CM commented requesting that the Administrator reverse the Board's decision. The CM noted that the regulations at 42 C.F.R. § 412.324 are titled "Determination of Transition Period Payment Rates for Capital-Related Costs" which dictate payment during the capital PPS transition period for cost reporting periods beginning on or after October 1, 1991 to cost reporting periods beginning before October 1, 2001. Furthermore, the regulations at 42 C.F.R. § 412.324(b)(2) state that "for the third year through the *remainder of the transition period,….*" CM noted that the transition period ended September 31, 2001 and that the Provider's third year began well after the end of the 10-year transition period. Since the transition period was over well before the Provider's third year began, there was no "remainder." Therefore, the Provider was not eligible for hold-harmless payments. 42 C.F.R. § 412.324(b)(3) does not apply.

Finally, CM noted that the intent of the transition period was to provide hospitals, previously paid under a reasonable cost-based system, a smooth transition to the fully prospective payment system for capital related costs. As such, it would be contrary to the purpose of the transition period and contrary to the plain language of

the regulations that a hospital should be paid under the hold-harmless methodology after the end of the transition period. There are no provisions in the regulation for payments under the hold-harmless methodology to begin for discharges occurring in cost reporting periods beginning on or after October 1, 2001.

The Provider commented requesting that the Administrator affirm the Board's decision. The Provider stated that the Board's decision tracks the language of the applicable regulation almost verbatim and to apply any other interpretation would be erroneous. In addition, the Provider cited *HealthEast Woodwinds Hospital v. Leavitt*, Civ. Action No. 08-4526 (D. Minn. May 2009), as support that the Administrator should affirm the Board's decision. In *HealthEast Woodwinds Hospital v. Leavitt*, the Federal District Court for the District of Minnesota held that the plain language of § 412.324(b)(2)&(3) compelled CMS to reimburse that hospital under the hold harmless payment methodology.

DISCUSSION

The entire record, which was furnished by the Board, has been examined, including all correspondence, position papers, and exhibits. The Administrator has reviewed the Board's decision. All comments received timely are included in the record and have been considered.

Section 1861(v)(1)(A) of the Social Security Act (Act) establishes that Medicare pays for the reasonable cost of furnishing covered services to program beneficiaries, subject to certain limitations. This section of the Act also defines reasonable cost as "the cost actually incurred; excluding therefrom any part of incurred cost found to be unnecessary in the efficient delivery of needed health services." The Act further authorizes the Secretary to promulgate regulations establishing the methods to be used and the items to be included in determining such costs. Consistent with the statute, the regulation at 42 C.F.R. § 413.9 states that all payments to providers of services must be based on the reasonable cost of services covered under Medicare and related to the care of beneficiaries.

Reasonable costs include capital-related costs. Consistent with the Secretary's rulemaking authority, the Secretary promulgated the regulation at 42 C.F.R. §413.130, which lists capital-related costs that are reimbursable under Medicare. Capital-related costs under Medicare include depreciation, interest, taxes, insurance, and similar expenses (defined further in 42 C.F.R. § 413.130) for plant and fixed equipment, and for movable equipment.

Title VI of the Social Security Amendments of 1983[1] added §1886(d) to the Act and established the inpatient prospective payment system (IPPS) for reimbursement of inpatient hospital services provided to Medicare beneficiaries. Under this system, hospitals are reimbursed their inpatient operating costs on the basis of prospectively determined national and regional rates for each discharge according to a list of diagnosis-related groups. Reimbursement under the prospective payment rate is limited to inpatient operating costs. The Social Security Amendments of 1983[2] amended subsection (a)(4) of §1886 of the Act to add a last sentence which specifies that the term "operating costs of inpatient hospital services" does not include "capital-related costs (as defined by the Secretary for periods before October 1, 1986)....)" That provision was subsequently amended until finally, §4006(b) of Omnibus Budget Reconciliation Act (OBRA) 1987 revised §1886(g)(1) of the Act to require the Secretary to establish a prospective payment system for the capital-related costs of IPPS hospitals for cost reporting periods beginning in Federal fiscal year (FFY) 1992.

Under the statue, the Secretary has broad authority in establishing and implementing the capital prospective payment system. The general capital PPS provisions include the regulation at 42 C.F.R. § 412.300, which sets out the scope of the subpart M and the definition of a “new” hospital at paragraph (b) as “a hospital that has not operated (under prior or present ownership) for less than three years.”

The regulation at 42 C.F.R. § 412.302 sets forth an introduction to the capital costs and explains the definition of “new” and “old” capital costs for purposes of the capital PPS, stating with respect to “old capital” that:

> (b) *Old capital costs.* Except as provided in paragraph (c) of this section with respect to capital obligations that qualify for recognition as old capital, old capital costs are allowable capital-related costs for land and depreciable assets that were put in use for patient care on or before December 31, 1990. <u>However, for a new hospital as defined in §412.300(b), old capital costs are defined as those allowable capital-related costs for land and depreciable assets that were put in use for patient care on or before the later of December 31, 1990 or the last day of the hospital's base year cost reporting period under §412.328(a)(2).</u> (Emphasis added.)

The regulation at 42 C.F.R. 412.304 explained that:

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[1] Pub. L. 98-21.

[2] Section 601(a) (2) of Pub. L. 98-21.

(a) *General rule*. As described in §412.312 through § 412.370, effective with cost reporting periods beginning on or after October 1, 1991, CMS pays an amount determined under the capital prospective payment system for each inpatient hospital discharge as defined in Sec. 412.4. This amount is in addition to the amount payable under the prospective payment system for inpatient hospital operating costs as determined under subpart D of this part.
(b) *Cost reporting periods beginning on or after October 1, 1991 and before October 1, 2001.* For cost reporting periods beginning on or after October 1, 1991 and before October 1, 2001, the capital payment amount is based on either a combination of payments for old capital costs and new capital costs or a fully prospective rate, as determined under § 412.324 through § 412.348.
(c) *Cost reporting periods beginning on or after October 1, 2001—*
(1) General. Except as provided in paragraph (c)(2) of this section, for cost reporting periods beginning on or after October 1, 2001, the capital payment amount is based solely on the Federal rate determined under § 412.308(a) and (b) and updated under § 412.308(c).
(2) *Payment to new hospitals*. For cost reporting periods beginning on or after October 1, 2002—
(i) A new hospital, as defined under § 412.300(b), is paid 85 percent of its allowable Medicare inpatient hospital capital-related costs through its cost report ending at least 2 years after the hospital accepts its first patient, unless the new hospital elects to be paid under the capital prospective payment system based on 100 percent of the Federal rate.
(A) If the new hospital elects to be paid based on 100 percent of the Federal rate, the new hospital must submit a written request to the fiscal intermediary by the later of December 1, 2002 or 60 days before the beginning of its cost reporting period.
(B) Once a new hospital elects to be paid based on 100 percent of the Federal rate, it may not revert to payment at 85 percent of its allowable Medicare inpatient hospital capital-related costs.
(ii) For the third year and subsequent years, the hospital is paid based on the Federal rate as described under § 412.312.
(d) Interim payments. Interim payments are made to the hospital as provided in § 412.116.

To ease the transition of existing hospitals from reasonable cost reimbursement of capital costs to the inclusion of capital payments under a capital inpatient prospective payment system, the Secretary promulgated regulations which established a transition period for cost reporting periods beginning on, or after,

October 1, 1991 and before October 1, 2001) to allow these hospital to adjust to the new system.[3] During the transition period, hospitals with a hospital specific rate (HSR) below the Federal rate were paid a blended percentage of their own capital cost (which decreased) and the Federal prospective rate (which increased) for each year during the transition period.[4] Hospitals with a base period HSR greater than the Federal rate were paid under the hold-harmless methodology.[5] Hospitals paid under the hold-harmless methodology received the higher of: (1) a blended payment of 85 percent of reasonable cost for "old capital" plus an amount for new capital based on a portion of the Federal rate; or (2) a payment based on 100 percent of the adjusted Federal rate.[6] At the end of the ten-year period, hospitals would be paid solely on the Federal prospective rate.[7] The regulation from 42 C.F.R. §412.234, through 412.352 is set forth as "DETERMINATION OF TRANSITION PERIOD PAYMENT RATES FOR CAPITAL-RELATED COSTS" The regulation at 412.324 lays out the general description of the transition period payment methodologies.

> § 412.324 *General description.*
> (a) *Hospitals under Medicare in FY 1991*. <u>During the ten-year transition period, payments to a hospital with a hospital-specific rate below the Federal rate are based on the fully prospective payment methodology under § 412.340 or for a hospital with a hospital-specific rate above the Federal rate, the hold harmless payment methodology under §412.344.</u>
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> (b) *New hospitals*. (1) A new hospital, as defined under §412.300(b), is paid 85 percent of its allowable Medicare inpatient hospital capital-related costs through its cost reporting period ending at least 2 years after the hospital accepts its first patient.

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[3] 56 Fed. Reg. at 43,358 (Aug. 30, 1991). <u>See</u> <u>also</u> 42 C.F.R. § 412.304.
[4] 56 Fed. Reg. at 43,359-60 (Aug. 30, 1991). <u>See</u> <u>also</u> 42 C.F.R. § 412.324.
[5] 56 Fed. Reg. at 43,359-60 (Aug. 30, 1991). <u>See</u> <u>also</u> 42 C.F.R. § 412.344. (§412.344 Hold-harmless payment methodology. (a) General. A hospital paid under the hold-harmless payment methodology receives a payment per discharge based on the higher of: (1) 85 percent of reasonable costs for old capital costs (100 percent for sole community hospitals) plus an amount for new capital costs based on a proportion of the Federal rate. The proportion is equal to the ratio of the hospital's Medicare inpatient costs for new capital to total Medicare inpatient capital costs; or (2) 100 percent of the Federal rate.")
[6] 66 Fed. Reg. 39,910, 39,911 (Aug. 1, 2001). <u>See</u> <u>also</u> 42 C.F.R. § 412.344.
[7] <u>Id</u>.

> (2) For the third year through the remainder of the transition period, the hospital is paid based on the fully prospective payment methodology or the hold-harmless payment methodology using the base period determined under § 412.328(a)(2).
>
> (3) If the hospital is paid under the hold-harmless methodology described in §412.344, the hold-harmless payment for old capital costs described in §412.344(a)(1) is payable for up to and including 8 years and may continue beyond the first cost reporting period beginning on or after October 1, 2000. (Emphasis added).

Thus, during the transition period, the regulation at 42 C.F.R. §412.324(b) allowed new hospitals to be paid 85 percent of its allowable Medicare capital costs through its cost reporting period ending at least 2 years after the hospital accepts its first patient. For the third year, "through the remainder of the transition period", the hospital may be paid based on a hold harmless methodology. Only if the hospital is paid under the hold harmless methodology during the transition period may the new hospital continue to be paid under the hold harmless methodology payable up to and including 8 years and may continue beyond the first cost reporting period beginning on or after October 1, 2000.

For cost reporting periods beginning on, or after, the transition period (beginning on or after October 1, 2001), capital PPS payments are generally based solely on the Federal rate for hospitals. The regulation does not provide for a hold harmless payment for the first time after the end of the transition period.

Recognizing that there were no provisions for "new hospitals" that began operation after the close of the transition period (October 1, 2001), the Secretary promulgated a new regulation extending the two-year exemption from capital PPS for new providers for cost reporting periods beginning on or after October 1, 2002.[8] Under 42 C.F.R. 412.304(c)(2), the Secretary proposed to pay "new hospitals" 85 percent of their reasonable cost during their first two-years of operation, unless they elected to received payment based on 100 percent of the Federal rate. However, effective with their third year of operation, the new hospital is paid based on the Federal rate.[9]

This policy with respect to new hospital that treated its first patient during the transition period was again reiterated in the preamble to the final capital PPS rule

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[8] 67 Fed. Reg. 50,100-50,101 (Aug. 1, 2002); See also 42 C.F.R. 412.304(c)(2).
[9] Id.

promulgated in 2001 at the end of the transition period.[10] The Secretary explained, with respect to "new hospitals", that:

> Hospitals that are defined as "new" for the purposes of capital payments during the transition period (see § 412.300(b)) will continue to be paid according to the applicable payment methodology outlined in § 412.324. During the transition period, new hospitals are exempt from the prospective payment system for their first 2 years of operation and are paid 85 percent of their reasonable capital-related costs during that period. The hospital's first 12 month cost reporting period…beginning at least 1 year after the hospital accepts its first patient, serves as the hospital's base period. Those base year costs qualify as old capital and are used to establish its hospital-specific rate used to determine its payment methodology under the capital prospective payment system. Effective with the third year of operation and through the reminder of the transition period, the hospital will be paid under either the fully prospective methodology or the hold-harmless methodology. If the fully prospective methodology is applicable, the hospital is paid using the appropriate transition blend of its hospital-specific rate and the Federal rate for that fiscal year until the conclusion of the transition period, at which time the hospital will be paid based on 100 percent of the Federal rate. If the hold-harmless methodology is applicable, the hospital will receive hold-harmless payment for assets in use during the base period for 8 years, which may extend beyond the 10-year transition period. (Emphasis added.)

In this case, the Provider is a 180-bed, short-term acute care hospital located in Tulsa, Oklahoma. The Provider was certified for Medicare participation in June of 1999.[11] The Provider qualified as a new hospital pursuant to 42 C.F.R. § 412.300(b) and was paid 85 percent of its capital costs for its cost reporting periods ending December 31, 2000 and December 31, 2001.[12] This Provider selected a calendar year as their basis for reporting under Medicare, thus, their full two-year period began January 1, 2000 and ended December 31 2001. Due to error, from January 1, 2002 through June 18, 2003 the Provider was paid base upon the "hold-harmless" reimbursement for capital related costs.[13] A determination was made not to correct

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[10] 66 Fed. Reg. 39,910, 39,911 (Aug. 1, 2001).

[11] See Intermediary's Supplemental Position Paper at 3.

[12] Id. This Provider selected a calendar year as their basis for reporting under Medicare, thus their full two-year period began January 1, 2000 and ended December 31 2001.

[13] See Provider's Exhibit P-1. Id. P-2.

the error though reopening but rather, by letter dated March 26, 2004, the Intermediary informed the Provider that commencing with all claims processed on and after June 19, 2003, the Provider would be paid capital payments based on the 100 percent Federal rate payment methodology. As of June 19, 2003, the Intermediary began paying the Provider based on 100 percent of the Federal rate for capital costs under capital PPS, rather than the hold-harmless methodology. The Provider appealed the Intermediary's determination.

Applying the foregoing provisions to the facts of this case, the Administrator finds that, the Provider is not entitled to the hold-harmless provision described at 42 C.F.R. §412.324(b)(3). The Administrator finds that 42 C.F.R. § 412.324(b)(3), requires that a hospital must have been paid <u>during the transition period</u> under the hold-harmless methodology in order to receive that benefit at the close of the transition period for up to eight years and beyond the end of the transition period. The regulation at 42 C.F.R. § 412.324(b) states at paragraph (2) that: "For the <u>third year through the remainder of the transition period</u>, the hospital is paid based on the fully prospective payment methodology[[14]] or the hold-harmless payment methodology using the base period determined under §412.328(a)(2)." (Emphasis added.) Thus, the subsequent paragraph (3) is referring to hold harmless payments made during the transition period when it states that: "<u>If the hospital is paid under the hold-harmless methodology</u>…, the hold-harmless payment for old capital costs …. is payable for up to and including 8 years and <u>may continue beyond the first cost reporting period beginning on or after October 1, **2000**</u>." (Emphasis added.) As a rule, a hospital is only paid under the hold harmless methodology starting during the transition period. Consequently, only where a new hospital receives payment under the hold harmless methodology during the transition period may it continue to be paid on that basis in accordance with 412.324(b)(3).

In addition, the transition period ends with cost reporting periods beginning on or after October 1, 2001. However, that the regulation at paragraph (c) requires a hospital to receive the hold harmless payment in the last year of the transition period for paragraph (c) to apply is also evident when it states that the hospital's hold harmless payments may continue "beyond the first cost reporting period beginning <u>on or after October 1, **2000**</u>." (Emphasis added.) The cost reporting period beginning

[14] § 412.340 "Fully prospective payment methodology. A hospital paid under the fully prospective payment methodology receives a payment per discharge based on a proportion of the hospital-specific rate and the Federal rate…."

on or after October 1, **2000**, is the last year of the transition period and, notably, not after the end of the transition period.[15]

In this case, the record shows that the Provider began operations in June of 1999, within the initial transition period of October 1, 1991 through October 1, 2001 as set forth at 42 C.F.R. § 412.304(b). The record shows that the Provider qualified as a "new hospital" pursuant to 42 C.F.R. § 412.300(b) and was treated as a "new hospital" (i.e., paid 85 percent of its capital-related cost) for purposes of capital-related reimbursement during the Provider's first two cost reporting periods ending December 31, 2000, and 2001. The record further shows that the Provider's third cost reporting period, the period January 1, 2002 through December 31, 2002, began after the close of the transition period, which ended September 30, 2001. The record shows that the Provider was never paid under the hold harmless provision during the transition period.[16] Consequently, as the Provider was never paid, during the transition period (cost reporting periods beginning on or after October 1, 1991 and before October 1, 2001), under the hold-harmless methodology, the Administrator finds that the Provider is not entitled to receive hold-harmless payments for its cost years involved in this case.

The final rule for capital PPS was implemented August 1, 1991. The Secretary explained the general purpose of the "hold harmless" payment, stating that:

> Before implementing full Federal rate payments for hospital inpatient capital-related expenditures, we proposed to provide for a 10-year transition period to allow hospitals adequate time to adjust to the new payment system. We proposed that the transition period for all hospitals subject to the prospective payment system would commence with the hospital's first cost reporting period beginning on or after October 1, 1991, and extend through the hospital's last cost reporting period beginning before October 1, 2001. Payments during the transition period would vary among hospitals, generally depending on the relationship between their hospital-specific rate and the Federal rate. 56 Fed. Reg. 43358, 43385 (Aug 1, 1991) (Emphasis added.)

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[15] The specificity in requiring the hold harmless payment to be made in the last year of the transition period would also eliminate new hospitals that elected to be paid under the Federal rate for that period as the regulation does not allow a hospital to revert to payment at 85 percent of its allowable capital-related costs.

[16] The Administrator notes that the Provider was erroneously paid under the hold-harmless methodology from January 1, 2002 through June 18, 2003. See P-1 (Intermediary March 26, 2004 letter), P-2, P-9 (CMS' March 5, 2004 letter).

For established hospitals, the hold harmless payment was for “old capital” that generally consisted of capital assets purchased prior to the implementation of the capital PPS in 1991. Such was not the case for new hospitals. The “hold harmless” payment for new hospitals was made up of “old capital” for allowable capital-related costs for land and depreciable assets that were put in use for patient care on or before the later of December 31, 1990 or the last day of the hospital's base year cost reporting period under §412.328(a)(2). The Secretary determined that new hospitals that began operation in the transition period (or after the end of the transition period) and did not receive a hold harmless payment during the transition period were not in the same situation as new hospitals that had begun operation and received hold harmless payments during the transition period.

The Secretary's rule allowing certain new hospitals the hold harmless payment beyond the transition period recognized that new hospitals and the underlying capital acquisitions generally are planned years before they are first put into use and operation.[17] Thus, these new hospitals that accepted their first patients and received hold harmless payment during the transition period had less opportunity to adjust to the capital PPS methodology before the end of the transition period. Conversely, those new hospitals that accepted their first patients at the end of the transition period, or after the transition period, and did not receive a hold harmless payment during the transition period, would have had the opportunity to adjust to the impact of capital PPS (implemented in 1991) before the end of the transition period. Consistent with the general purposes and provisions of the hold harmless methodology and the transition period, there are no provisions in the regulation for payments under the hold harmless methodology to begin for the first time for discharges occurring in cost reporting periods beginning on or after October 1, 2001. To do so, would be counter to the purpose of the transition period (to allow hospitals a reasonable amount of time to ‘adjust” to the new payment system) and the need to fully implement capital PPS.

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[17] For example, as an analogy, the Secretary recognized the time lapse between committing to capital acquisitions and putting that capital acquisition into use with respect to established hospitals. Regarding obligated capital for established hospital, hospitals were allowed up to four years before the obligated capital asset had to be put in use before October 1, 1994.) The Secretary stated that: “We are requiring that the capital asset be put in use before October 1, 1994 because we believe that our recognition of obligated capital should not be open-ended and that the September 30, 1994 deadline provides sufficient time for completion of projects which were committed by December 31, 1990.”

Accordingly, the Administrator finds that this Provider, as it did not receive the hold harmless payment during the transition period, did not qualify for the hold harmless payment for the cost years involved in this case.

DECISION

The decision of the Board is reversed in accordance with the foregoing opinion.

THIS CONSTITUTES THE FINAL ADMINISTRATIVE DECISION OF THE SECRETARY OF HEALTH AND HUMAN SERVICES

Date: 11/9/2010 /s/

Marilyn Tavenner
Principal Deputy Administrator and Chief Operating Officer
Centers for Medicare & Medicaid Services