CENTERS FOR MEDICARE AND MEDICAID SERVICES

Decision of the Administrator

In the case of:	Claim for:
ARTHUR G. JAMES CANCER HOSPITAL **Provider** **vs.** **BLUECROSS/BLUE SHIELD ASSOCIATION/AMINASTAR FEDERAL- OHIO** **Intermediary**	**Reimbursement Determination for Cost Reporting Periods ending: 06/30/1996 and 06/30/98** **Review of:** **PRRB Dec. No. 2005-D39** **Dated: May 11, 2005**

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 Provider submitted comments, requesting reversal of the Board's decision. The parties were notified of the Administrator's intention to review the Board's decision. The Provider submitted further comments. Accordingly, this case is now before the Administrator for final agency review.

ISSUE AND BOARD DECISION

The issue was whether the Intermediary's adjustment to disallow the interest paid to Ohio State University Hospitals (OSUH) was proper.

The Board held that the Intermediary properly disallowed the amounts claimed by the Provider as interest expense. The Board determined that the Provider and OSUH were not separate entities but separate divisions of the same entity. The Board found that the loan between the Provider and OSUH was an inter-entity transaction with no

separate borrower or lender. The interest expense between divisions of the same entity are not reasonable and necessary under 42 CFR 413.153(c).

In finding that the Provider and OSUH were separate divisions of the same entity, the Board cited Ohio Revised Code §3335.10 which places general supervision of the University's property and control of all the University's expenses under the supervision of the Board of Trustees of the Ohio State University. Further, the Board noted the affidavits of the Treasurer of the Ohio State University which indicated that the Provider and OSUH were operating units of the University. Finally, the Board stated that activities between the entities were controlled by the financial polices of the University and interest income and interest expenses were charged through a system under the direct supervision of the Treasurer of the University.

COMMENTS

The Provider submitted comments requesting that the Administrator reverse the Board's decision. The Provider argued that the Board erred in recognizing a distinction between an "inter-entity transaction" and a related-party transaction for purposes of determining whether a particular provider is eligible for an exception to the general interest expense rules. The Provider maintained that it is a separate provider for Medicare purposes and a separate state teaching medical facility that is responsible for earning its own revenue and incurring its own costs.

The Provider noted that it was legally unable to acquire operating funds with any third-party lender because the Ohio Constitution forbids a State institution from borrowing money from any independent, third-party sources. See Ohio Constitution Art. VII § 3. Accordingly, the Provider was only permitted to enter into loan agreements with OSUH or the University. The University policy also required the Provider to operate in an economically self-sufficient manner. Thus, in need of funding for its operating costs, the Provider argued it had no choice but to enter into a loan agreement with another institution legally considered part of the University.

In addition, Provider noted that Trustees of Indiana University v. United States, 618 F.2d 736 (Ct. Cl.1980) and the interest expense exception in 42 C.F.R. § 413.153(c)(2) for providers operated by religious orders. The Provider argued that the Board improperly failed to address the precedential effect of Indiana University case on Provider's claim for reimbursement of the interest expense incurred under the loan from OSUH. The Provider pointed out that in the Indiana University case, the court established a common law exception to the related party interest expense rule for interest incurred by a State university hospital under a loan from the university. It specifically held that where a nonprofit hospital affiliated with a State university and

prohibited by State law from borrowing from outside the university, a loan between the hospital and the university that is entered into at less that the current rate of interest is not subject to the general prohibition against reimbursement of related-party interest.

The Provider contended that the facts of the instant appeal are virtually identical to those in Indiana University. Similar to this case, the Indiana University Hospitals were State teaching hospitals which had no separate legal identity from Indiana University. In addition, like the Provider, Indiana University Hospitals received no money from the State for their operations. In addition, similar to the Ohio Constitution, the Indiana Constitution prohibited the university and the hospitals from incurring a debt to an independent third-party lender. Thus, the Provider asserted that the holding in Indiana University is controlling in this case and, therefore, the interest expense claimed by Provider should be allowed.

Finally, the Provider argued that the exception in 42 CFR 413.153(c)(2), which authorizes reimbursement of a provider operated by a religious order for interest expense paid to the religious order, renders the regulation unconstitutional. The Provider asserted that, to the extent the regulation creates an exception to the related-party interest rule for a provider operated by a religious order, while denying reimbursement of identical interest expenses for a similarly situated provider operated by a State university, the regulation violates the First Amendment to the United States Constitution. Thus, the Provider concluded that denying the interest expenses in this case, while permitting reimbursement of interest payments by similarly situated providers operated by religious orders under the exception in 42 C.F.R. §413.153(c)(2), would be unconstitutional.

DISCUSSION

The entire record, which was furnished by the Board, has been examined, including all correspondence, position papers, and exhibits.[1] 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 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

[1] Case No. 02-1243 involving the Provider's appeal of its 1998 cost year has been consolidated with the case and the record in Case No. 99-2779 for the 1996 cost year.

actually incurred, excluding therefrom any part of incurred cost found to be unnecessary in the efficient delivery of needed health services."

The foregoing principles are reflected and further explained in the Medicare regulations. The regulations establish at 42 CFR 413.9 that the determination of reasonable cost must be based on costs related to the care of Medicare beneficiaries. If the provider's costs include amounts not related to patient care, or costs that are specifically not reimbursable under the program, those costs will not be paid by the Medicare program. Further, the regulations at 42 CFR 413.9(b) provide that "reasonable cost" of any services must be determined in accordance with regulations establishing the method or methods to be used, and the items to be included.

Section 1815(a) of the Act also states that no payment shall be made to any provider unless it has furnished such information as the Secretary may require in order to determine the amounts due the provider. In the determination of reasonable costs, the regulation, at 42 CFR 413.20, require that providers maintain sufficient financial records and statistical data for proper determination of costs payable under the program, including the extent to which there is any common ownership or control between the provider and other organizations.

Consistent with the foregoing principle, the regulation at 42 CFR 413.24 sets forth the requirement that cost data and cost finding be adequate. That regulation provides, at subsection (c) that:

> Adequate cost information must be obtained from the provider's records to support payments made for services furnished to beneficiaries. The requirement of adequacy of data implies that the data be accurate and in sufficient detail to accomplish the purposes for which it is intended.

Reasonable costs include operating costs and capital-related costs. Consistent with the Secretary's rulemaking authority, the Secretary promulgated 42 CFR §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 CFR §413.130) for plant and fixed equipment, and for movable equipment.

In addition, the regulation, at 42 CFR 413.153(a)(1), provides that necessary and proper interest on both current and capital indebtedness is an allowable cost. The regulation, at (b)(2), explains that, *inter alia*, "necessary" requires that interest be:

> (i) Incurred on a loan made to satisfy a financial need of the provider. Loans that result in excess funds or investments would not be considered necessary
>
> (ii) Incurred on a loan made for a purpose reasonably related to patient care; and
>
> (iii) Be reduced by investment income except if such income is from gifts and grants, whether restricted or unrestricted, and that are held separate and not commingled with other funds…

In addition, the regulation at (b)(3) explains that "proper" requires that interest be:

> (i) Incurred at a rate not in excess of what a prudent borrower would have to pay in the money market existing at the time the loan was made; and
>
> (ii) Paid to a lender not related through control or ownership, or personal relationship to the borrowing organization.

In addition, paragraph (c) specifically provides that:

> Except as described in paragraph (c)(2) of this section to be allowable, interest expense must be incurred on indebtedness established with lenders…. not related through control, ownership or personnel relationship to the borrower…. If the owner uses his own funds in a business, it is reasonable to treat the funds as invested funds or capital, rather than borrowed funds.

With respect to whether parties will be considered related, the regulations at 42 CFR 413.17, state, in pertinent part:

> (b) *Definitions.* (1) *Related to the provider*. Related to the provider means that the provider to a significant extent is associated or affiliated with or has control of or is controlled by the organization furnishing the services, facilities, or supplies.
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> (2) *Common ownership*. Common ownership exists if an individual or individuals possess significant ownership or equity in the provider and the institution or organization serving the provider.

> (3) *Control*. Control exists if an individual or an organization has the power, directly or indirectly, significantly to influence or direct the actions or policies or an organization or institution.

Consistent with the foregoing regulations, section 1000 of the Provider Reimbursement Manuel (PRM) further explains that the purposes of the related organization principle is to avoid the payment of a profit factor to the provider through the related organization, and to avoid payment of artificially inflated costs. In the determination of a related organization's costs, section 1005 of the PRM states that the related organization's costs include all reasonable costs, direct and indirect, incurred in the furnishing of services, facilities, and supplies to the provider, with the intent to treat the costs incurred by the supplier as if they were incurred by the provider itself, and specifically directs that the provider must make available adequate documentation to support the costs incurred by the related organization.

The record reflects that the Provider is a freestanding cancer hospital and exempt from the prospective payment system for purposes of their inpatient operating costs and inpatient related capital costs. In 1992, the Provider borrowed $31,125,000 from OSUH pursuant to a memorandum of understanding executed by OSUH, the Provider and Ohio State University.[2] A portion of the loan was designated for capital expenditures of $7,125,000 to be repaid over three years with no interest. A portion of the loan was designated for operating expenditures of $24,000,000 to be paid over a 12-year period with interest accruing from July 1, 1992. The average interest rate charged to the Provider for FYE 1996 was 5.69 percent.[3]

As acknowledged by the Provider, the Provider and OSUH are not separate legal entities. Rather, the Provider and OSUH are operating units of Ohio State University.[4] The Provider argued that, although it is a separate department within the University, as is OSUH, it differs from typical departments in that the University does not simply allocate money to the Provider. Instead, the Provider must borrow funds from the University. In addition, the Provider stated that it is precluded by State law from borrowing from an outside source. Accordingly, the Provider claimed that it is entitled to an exception to the related party principle.

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[2] Intermediary's Position Paper, Exhibit I-1.

[3] Provider's Position Paper, p. 3. The interest rate for FYE 1998 was not indicated in this position paper.

[4] Provider's Position Paper, Exhibit P-17, p. 2.

Applying these facts to the foregoing law and regulations, the Administrator finds the Provider and OSUH are both associated with and affiliated to Ohio State University, as separate operating units of the Ohio State University. In addition, Ohio State University was a party to the loan agreement. All of the entities are State institutions. Thus, regardless of how the Provider characterized its relationship to OSHU, the related party principle applies. Accordingly, as the Provider and the lender are related parties for Medicare reimbursement purposes, the associated interest expense is not allowable. The Administrator also notes that the case cited by the Provider, Trustees of Indiana University v. United States, 618 F.2d 736 (Ct. Cl. 1980), is not binding in the circuit in which the Provider is located and, thus, is not controlling in this case.

DECISION

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

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

Date: 7/11/05

/s/
Leslie V. Norwalk, Esq.
Deputy Administrator
Centers for Medicare & Medicaid Services