PROVIDER REIMBURSEMENT REVIEW BOARD
HEARING DECISION

2000-D78

PROVIDER -
Intercounty THC 96 H/O Key Emp/ Rel Int Group
Los Angeles, CA

Provider Nos. 05-7470, 55-7643 & 55-7625

vs.

INTERMEDIARY -
Blue Cross and Blue Shield Association/
Wellmark Blue Cross and Blue Shield

DATE OF HEARING-
June 15, 2000

Cost Reporting Period Ended -
March 31, 1996

CASE NO. 98-2068G

INDEX

	Page No.
Issue	**2**
Statement of the Case and Procedural History	**2**
Provider's Contentions	**3**
Intermediary's Contentions	**5**
Citation of Law, Regulations & Program Instructions	**9**
Findings of Fact, Conclusions of Law and Discussion	**10**
Decision and Order	**11**

ISSUE:

Was the Intermediary=s disallowance of interest expense was proper?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

Intercounty Total Health Care (AProvider@) is a free standing for-profit home health agency located in Los Angeles, California. The Provider is a member of the Intercounty chain and is serviced by a home office operated out of the same Los Angeles office.[1] On May 16,1994, the Provider signed a factoring agreement with Advanced Medical Funding, Inc. (AAMF@) related to its accounts receivable.[2] On November 16, 1995, an amended agreement between the Provider and AMF was signed.[3] In its home office cost report, the Provider submitted $36,578 in interest expense as a result of the factoring agreement with AMF.[4] As the home office entity was not formed until November 30, 1995 (the Intercounty chain components use the fiscal year from 4/1/95 through 3/31/96), a portion of the interest expense related to this factoring arrangement was also included on the Medicare cost report for provider number 05-7470, the Intercounty chain's Los Angeles provider.[5] It is the Provider=s position that the interest expense resulted from a loan with AMF. Wellmark Blue Cross and Blue Shield (AIntermediary@), however, disallowed the full amount of $36,578 claimed for interest expense since it believes that the agreement was in fact a sale of the Provider=s accounts receivable rather than a loan.[6]

The Provider appealed the Intermediary=s adjustment to the Provider Reimbursement Review Board (ABoard@) pursuant to 42 C.F.R. '' 405.1835-.1841, and has met the jurisdictional requirements of those regulations. The amount of Medicare reimbursement in controversy is $32,920.[7]

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1 Intermediary Position Paper at 3.

2 Intermediary Exhibit I-5, Provider Exhibit P-2.

3 Intermediary Position Paper at 9, See Intermediary Exhibit I-6.

4 Intermediary Position Paper at 8.

5 Provider=s Position Paper at 6 indicates that the Intermediary eliminated $15, 871 in interest expense. See Intermediary Exhibit 1-4 for this audit adjustment and work papers related to this adjustment.

6 Intermediary Position Paper at 9.

7 Intermediary Position Paper at 5, Provider Position Paper at 6 indicates that the reimbursement effect is approximately $14,000.

The Provider was represented by Mickey Bond, of Gentner and Company. The Intermediary was represented by Bernard M. Talbert, Associate Counsel, Blue Cross and Blue Shield Association.

PROVIDER=S CONTENTIONS:

It is the Provider=s position that during the fiscal year under appeal, the incurred interest expense at issue in this case related to a loan from AMF. The Provider contends that AMF used its accounts receivable as collateral. The Provider believes that the Intermediary's sole basis for the disallowed interest expense relates to wording found in a section of the contract between AMF and the Provider entitled ASale of Accounts@. The Provider contends that based on this wording, the Intermediary believed that the accounts receivables were sold and that a loan with interest payments did not take place.[8]

The Provider refers to the Medicare Intermediary Manual, Part 3, (HCFA Pub. 13-3) ' 3488 which addresses a provider's right to payment.[9] The above section states in part that:

> Payment is considered to be made directly to an ineligible person or organization if that person or organization can convert the payment to its own use and control without the payment first passing through the control of the Provider. . .

HCFA Pub. 13-3 ' 3488 Emphasis added.

The Provider contends that the manual reference above is not applicable in the instant case, therefore, the Intermediary=s claim that the Provider sold its accounts receivable or assigned its rights to payment is incorrect.[10]

The Provider admits that certain sections of the contract with AMF are not particularly well worded, however, it takes the position that the ASale of Accounts@ section is not reflective of the arrangement between the parties.[11] In fact, the Provider argues that most of the contract is worded in the context of a loan with interest payments [California case law, which controls according to paragraph 48 of the contract, requires that contracts be interpreted Aas a whole, with each clause lending meaning to the others.@ Titan Corp. v. Aetna Cas. & Sur. Co., 22 Cal., App. 4th 457, 473-74 (Cal. Ct. App. 1994)].

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[8] Provider Position Paper at 6.

[9] See Provider Exhibit P-3.

[10] Provider Position Paper at 6-7.

[11] Provider Position Paper at 7.

In support of its argument that the contract is worded in the context of a loan rather than a sale, the Provider points to the following sections of the contract (Provider=s Exhibit P-2):

<u>Paragraph 7</u>- The Provider contends that the entire agreement between the parties is referred to as a security agreement, which the Provider believes means Aan agreement that creates or provides for a security interest.@ The Provider contends that this makes sense because the accounts receivable act as collateral for the loan made by AMF to the Provider.[12]

<u>Paragraphs 19-20</u> The Provider contends that these sections of the contract clearly set forth a loan arrangement with AMF lending up to 70 percent of the net amount of receivables and the Provider paying a 3.5 percent factoring or interest payment.

<u>Paragraph 26</u> The Provider points out that at the end of this paragraph, the contract once again speaks in terms of a security interest in all receivables until all Aobligations@ have been paid.

<u>Paragraph 5</u> AObligations@ are defined in this paragraph as Aall loans, interest, advances, debts, liabilities . . . owing by [the Provider].......@

<u>Paragraphs 23-24</u> These paragraphs describe what occurs when the amounts loaned are greater than the amounts providing the basis for the security interest, i.e., an Aover advance.@ Further, paragraph 24 refers to Afunds for advance@, which the Provider believes clearly refers to an advance of money, i.e., a loan.

As additional support of its contention that the contract represents a loan arrangement (rather than a sale), the Provider refers to the last paragraph on page five of the contract which requires the Provider to pay AMF Ainterest or factoring fee, under Paragraph 18@ and refers to Ainterest payable pursuant to Paragraph 19. . . .@ Moreover, in paragraph 31 (b) , the Provider contends that the contract requires it to pay AMF upon termination an amount equal to Ainterest at the rate provided herein calculated on the average principal balance of the Loans outstanding during the six months immediately preceding the date of termination......@. The Provider notes that further down in the same paragraph, the contract states:

> Notwithstanding any termination of this Loan Agreement, all of our security interests in all of the Collateral and all of the terms and provisions of this Loan Agreement shall continue in full force and effect until all Obligations have [sic]paid and performed in full.

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[12] Provider Position Paper at 7.

Additionally, Paragraph 31 (c) states that A[u]pon mutual agreement between borrower and lender we will terminate with no penalties and fees.@

The Provider contends that the above-quoted contract provisions, when read together, show that this agreement, although it contains loose language in one or two isolated spots about a Asale@ of receivables, was truly a loan agreement. The Provider further contends that other provisions of the contract directly support its contention that the contract represents a loan arrangement with the accounts receivable providing a collateral or security interest for that loan. Moreover, the Provider argues that it maintained control over the accounts receivable, because even in the case of a default, AMF only retained a security interest in the accounts receivable.[13]

Most importantly, the Provider points out that its actual experience with AMF shows that it was making interest payments on a loan.[14] The Provider contends it received the advance, monitored the daily loan balance, the daily collateral balance, and the total monthly interest payment referred to as a Aservice charge.@ (The service charge is the monthly interest rate of 3.5 percent). The Provider believes that its practice of making interest payments to AMF is an important tool in shedding light on the contract between the Provider and AMF. As the Supreme Court of California has said, A[w]ords are but an imperfect medium to convey thought and intention. When the parties to a contract perform under it and demonstrate by their conduct that they knew what they were talking about, the courts should enforce that intent.@ Crestview Cemetery Ass'n v. Dieden, 54 Cal. 2d 744, 754 (1960).

In summary, it is the Provider=s position that most of the actual language of the contract and the parties= conduct in executing the contract fully support that AMF loaned money to the Provider. The Provider believes that it maintained control of its accounts receivable pursuant to HCFA Pub. 13-3 ' 3488, and therefore, it did not enter an agreement to sell its receivables.

INTERMEDIARY=S CONTENTIONS:

The Intermediary disallowed the interest expense related to this sale of receivables in accordance with HCFA Pub. 15-1 ' 219 which states, in pertinent part,

> [i]n accounts receivable financing, the intermediary must first determine if the arrangement represents a sale of receivables or if it is a loan. If it is a loan, the interest incurred on the loan is an allowable expense if it is necessary and proper.. .The interest on the loan is the discount on the

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13 Provider Position Paper at 8, Paragraph 26 of contract.

14 Provider Position Paper at 8.

> advance on the receivables (e.g., 10 percent where a provider receives 90 cents on the dollar).
>
> If the intermediary determines that the arrangement is a sale, the costs associated with the sale are not allowable expenses. The provider has opted to receive payment prior to collection on the accounts.

Id. (Emphasis added)

It is the Intermediary=s position that this manual section specifies that interest expense related to factoring arrangements, which qualify as a sale is not allowable.[15] The Intermediary acknowledging that the manual is silent as to what constitutes a sale of accounts receivable, however, points out that the Foreward section of HCFA Pub. 15-1, states, in pertinent part:

> For any cost situation that is not covered by the manual's guidelines and policies, generally accepted accounting principles should be applied.

Therefore, the Intermediary asserts that generally accepted accounting principles (AGAAP@) must be consulted in order to determine if the Provider's arrangement qualifies as a sale or a loan.[16] The Intermediary contends that the Financial Accounting Standards Board issued FAS 77 to address accounts receivable factoring transactions occurring before December 31,1996.[17] The Intermediary further contends that FAS 77 requires that a transfer of a receivable that is subject to recourse must be reported as a sale if the following conditions are met:

1. The seller unequivocally surrenders to the buyer the control of the future economic benefits of the receivables.

2. The seller's remaining obligations to the buyer under the recourse provision of the transfer agreement must be subject to reasonable estimation on the date of the sale of the receivables.

3. The seller cannot be required to repurchase the receivables from the buyer except in accordance with the recourse provision of the transfer agreement.

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[15] Intermediary Position Paper at 9.

[16] Id.

[17] See Intermediary Exhibit I-7.

It is the Intermediary's opinion that the factoring agreements (May 16, 1994 agreement and November 16,1995 amended agreement) between the Provider and AMF qualify as sales agreements as both agreements meet the criteria for a sale according to GAAP. The Intermediary addresses each of the agreements separately, below.[18]

<u>May 16. 1994 Agreement-(Intermediary Exhibit I-5</u>)

1. The Intermediary refers to Page 3 of this agreement, paragraph 13 under ASale of Accounts@ which states Awe shall accept to purchase such invoices outright, in which case, you grant us a full and clear bill of sale of said invoices@.

   The Intermediary contends that this section of the contract explicitly states that the agreement is for a sale of receivables. The agreement is for an outright purchase in which AMF is granted a full and clear bill of sale. Therefore, the Intermediary believes that the Provider has agreed to unequivocally surrender to the buyer the control of the future economic benefit of these receivables. In other words, the Provider would have no right to the future use of the receivables. Also, the Intermediary points to Paragraph 32 on page 8, under ACovenant Not To Assign@ which further states that A[d]uring the term of this Agreement, you agree not to sell, assign, or otherwise encumber the Receivables to anyone except us.@ It is the Intermediary=s position that this reiterates that the Provider has surrendered control of the future economic benefit of the receivables to AMF. Therefore, the Intermediary contends that the agreement meets the first criterion for a sale as defined under FAS 77.

2. The Intermediary contends that the amount of bad debts, related cost of collection and repossession, repayments and validity of receivables can all be reasonably estimated by the Provider. In support of this contention, the Intermediary asserts that the Provider's Medicare utilization for the current period was approximately 90 percent, therefore, the majority of the receivables sold were from a reliable payer source, which indicates that bad debts, cost of collection, and so forth, could be very easily estimated. Therefore, the Intermediary contends that the agreement meets the second FAS 77 criterion.

3. The Intermediary asserts that there is no provision in the agreement for the Provider to repurchase the receivables from AMF, aside from the recourse provisions. Therefore, the agreement meets the third criterion of FAS 77, as well.

Based on the above analysis, The Intermediary contends that the first agreement signed by the Provider meets all three of the FAS 77 criteria for a sale, therefore, the Intermediary believes that all transactions

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[18] <u>See</u> Intermediary Position Paper at 10-12.

made under this agreement must be treated as such. The interest expense related to these transactions is nonallowable for Medicare purposes.

<u>November 16, 1995 Agreement-(Intermediary Exhibit I-6</u>)

1. The Intermediary refers to Section 5.03 (b) and (d) on page 9 of this agreement, which states that, Athe Receivables, shall belong to AMF and shall be immediately transmitted by Client to AMF@ and A[c]lient shall have no right and agrees not to commingle with its own funds or to use, divert or withhold any of the proceeds of any collections. Except as otherwise provided herein, Client hereby divests itself of all dominion over the Receivables and the proceeds thereof and collection received thereon.@ It is the Intermediary=s position that the language in this latest agreement demonstrates that Provider has surrendered control of the receivables to AMF.

   Additionally, the Intermediary notes that Section 9.03 (d) on page 15 states AAMF shall have the right, but shall not be obligated, to sell and deliver any or all Receivables and any or all other Collateral at a public or private sale, for cash, upon credit, or otherwise at such prices and upon such terms as AMF in its sole discretion deems advisable.@ Because AMF has the right to sell the receivables to a third party at its sole discretion, the Intermediary contends that it is clear that the Provider has surrendered all control of the future economic benefit of the receivables to AMF. Therefore, the Intermediary contends this agreement meets the first criteria of FAS 77.

2. As noted under the May 16, 1994 agreement, above, approximately 90 percent of the Provider's receivables are from Medicare. Since the receivables are from a reliable payer source, bad debts, cost of collection, and so forth, could be very easily estimated. Therefore, the agreement meets the second FAS 77 criterion.

3. The Intermediary contends that there is no provision in the agreement for the Provider to repurchase the receivables from AMF aside from the recourse provisions. Therefore, the Provider meets the third criterion of FAS 77, as well.

The Intermediary contends that since this second agreement between the Provider and AMF also meets all three criteria of FAS 77, all transactions made under this agreement must also be accounted for as a sale. Accordingly, it follows that the interest expense related from these transactions is nonallowable for Medicare purposes.

The Intermediary acknowledges the Provider=s position that its agreement with AMF constituted a loan even though the words ASale of Accounts@ were used. The Intermediary, however, rejects the Provider=s argument that HCFA Pub. 13-3 ' 3488 supports the Provider=s position. The Intermediary asserts that this manual section deals with the assignment of a provider's right to payment and instructs

the intermediary in what situations payment may be made to a party other than the provider.[19] The Intermediary contends that this manual section does not deal with accounts receivable factoring agreements or the allowability of related costs. Therefore, the Intermediary believes that HCFA Pub. 13-3 ' 3488 is not pertinent to this issue.

The Intermediary also addresses the Provider=s argument that the agreement was a loan because terms such as Asecurity interest@, Ainterest@ and Acollateral@ were used. The Intermediary contends that the inclusion of these terms in the agreement does not automatically qualify the agreement as a loan.[20]

The Intermediary asserts that the Provider has not addressed Program instructions and GAAP which actually deal with the allowability of this type of cost. The Intermediary contends that the substance of the agreements with AMF falls under GAAP's definition of a sale of accounts receivable and that consequently, the Program instructions dictate that the cost is nonallowable.

The Intermediary also refers to a recent decision by the HCFA Administrator which further supports its disallowance of interest expense. The Intermediary points out that the HCFA Administrator reversed the Board in, Barton Creek Health Care, Inc., v. Blue Cross and Blue Shield Association et al, .PRRB Dec. No. 98-D53, May 21, 1998, Medicare & Medicaid Guide (CCH) & 46,334, rev=d HCFA Admin., July 17, 1998, Medicare & Medicaid Guide (CCH) & 80,062 (Intermediary Exhibit I-8) and ruled that the provider failed to meet its burden of proof that the claimed interest expense was necessary and proper.

Accordingly, the Intermediary contends that if the Board determines the agreement in this case is in fact a Aloan@ and not a Asale@ of receivables, it is the Intermediary's position that the Provider must furnish the appropriate documentation to support that the loan was necessary, proper, and related to patient care.[21]

The Intermediary contends that its adjustment to disallow interest expense associated with the accounts receivable factoring agreement was made in accordance with Medicare instructions and GAAP. The Intermediary requests that the Board affirm its adjustment

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19 Intermediary Position Paper at 12.

20 Intermediary Position Paper at 12.

21 Intermediary Position Paper at 8.

CITATION OF LAW, REGULATIONS AND PROGRAM INSTRUCTIONS:

1. Regulations - 42 C.F.R.:

'' 405.1835-.1841 - Board Jurisdiction

2. Program Instructions-Provider Reimbursement Manual, Part I (HCFA Pub. 15-1):

Foreward Section - Page I

' 219 - Accounts Receivable Financing

3. Medicare Intermediary Manual, Part 3 (HCFA Pub. 13-3):

' 3488 - Assignment of Provider=s Right to Payment

4. Case Law:

Barton Creek Health Care, Inc., v. Blue Cross and Blue Shield Association et al, PRRB Dec. No. 98-D53, May 21, 1998, Medicare & Medicaid Guide (CCH) **&** 46,334, rev=d HCFA Admin. July, 17, 1998, Medicare & Medicaid Guide (CCH) **&** 80,062.

Titan Corp. v. Aetna Cas. & Sur. Co., 22 Cal., App. 4th 457 (Cal. Ct. App. 1994).

Crestview Cemetery Assn. v. Dieden, 54 Cal. 2d 744 (1960).

5. Other:

Financial Accounting Standards Board- Summary of Statement No. 77-Reporting by Transferors for Transfers of Receivables with Recourse (Issued 12/83).

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

The Board, after consideration of the facts, parties= contentions, evidence presented, and an analysis of the controlling laws, regulations, and pertinent Generally Accepted Accounting Principles (GAAP) finds and concludes that both of the Provider=s agreements with AMF were in fact a sale of its accounts receivable (rather than a loan), and accordingly, was correctly treated as such by the Intermediary. The Provider argued in its brief that although the agreement is not particularly well worded to support its contention that the transaction constituted a loan, when the agreement is looked at in its entirety, most of the agreement is worded in the context of a loan with interest payments. It is the Intermediary=s position

that the agreements with AMF were really a sale of the Provider=s accounts receivable. The Intermediary=s primary argument is that the substance of the agreements with AMF falls under GAAP's definition of a sale of accounts receivable and that consequently, the Program instructions dictate that the cost is nonallowable. Alternatively, the Intermediary argued that even if the Board found that the agreement constitutes a loan, the Provider failed to document its need for a loan and the resulting interest payments.

The Board finds that there were actually two agreements in existence with AMF during the fiscal year at issue. The original agreement, signed with AMF on May 16, 1994, was in existence at the beginning of the fiscal year. The Provider subsequently amended this agreement on November 16, 1995. The Board reviewed these two agreements using GAAP criteria under FAS 77, which was issued by the Financial Accounting Standards Board.[22] FAS 77 requires that a transfer of a receivable that is subject to recourse must be reported as a sale if the following conditions are met:

1. The seller surrenders to the buyer the control of the future economic benefits of the receivables.

2. The transferor can reasonably estimate its obligation under the recourse provisions.

3. The transferee cannot return the receivables to the transferor except in accordance with the recourse provision of the transfer agreement.

Based on its review of both agreements, the Board concludes that the agreements meet all three criteria of FAS 77, and consequently qualify as sales agreements. Having reached this conclusion, the Board finds there is no need to comment on the Intermediary=s alternative argument that the Provider failed to adequately document the need for a loan.[23]

The Board acknowledges the Provider=s comments that certain sections of the agreements speak to a loan, however, the Board is not persuaded that these sections could lead to a conclusion that the agreements were bona fide loan agreements.

The Board further notes the Provider=s reference to HCFA Pub 13-3 ' 3488, does not apply to this case.

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[22] See Intermediary Exhibit I-7.

[23] Intermediary Exhibit I-8.

DECISION AND ORDER:

The Board finds that the subject agreements in this case constituted sales of accounts receivables rather than loans. The Intermediary=s adjustment is affirmed.

Board Members Participating:

Irvin W. Kues
Henry C. Wessman, Esquire
Martin W. Hoover, Jr., Esquire
Charles R. Barker
Stanley J. Sokolove

Date of Decision: August 22, 2000

FOR THE BOARD:

Irvin W. Kues
Chairman

Schedule of Providers in Group
PRRB Case No. 98-2068G

Provider No	Provider name
05-7470	InterCounty-Los Angeles
55-7643	InterCounty-Stockton
55-7625	InterCounty-San Diego