PROVIDER REIMBURSEMENT REVIEW BOARD
HEARING DECISION

ON-THE-RECORD
98-D35

PROVIDER -
Parkway Regional Medical Center
Miami, Florida

Provider No. 10-0114

vs.

INTERMEDIARY -
Blue Cross and Blue Shield Association/
Blue Cross and Blue Shield of Florida

DATE OF HEARING-
February 13, 1998

Cost Reporting Period Ended -
November 17, 1989

CASE NO. 93-2004

INDEX

ISSUE:

Does the recapture of depreciation due to the gain on the sale of depreciable assets have any effect on the Provider's equity capital for prior years?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

Parkway Regional Medical Center ("Provider") is a for profit hospital located in Miami, Florida. The Provider was sold effective on November 17, 1989. Blue Cross and Blue Shield of Florida ("Intermediary") recaptured certain depreciation expenses previously allowed because the sale resulted in a gain. The Intermediary did not recalculate the Provider's equity capital for the same prior years. The Provider filed a timely appeal with the Provider Reimbursement Review Board ("Board") pursuant to 42 C.F.R. §§ 405.1835-.1841 and has met the jurisdictional requirements of those regulations. The Medicare reimbursement effect exceeds $100,000.

The Provider has not disputed the Intermediary's determination that there was a gain on sale or that the depreciation expense should be recaptured to the extent of the applicable gain. Rather, the Provider maintains that the Intermediary should retroactively apply the recapture of depreciation to the computation of Medicare reimbursement of Return on Equity ("ROE").

The Provider was represented by Patric Hooper, Esquire, of Hooper, Lundy and Bookman, Inc. The Intermediary was represented by Bernard M. Talbert, Esquire, of the Blue Cross and Blue Shield Association.

PROVIDER'S CONTENTIONS:

The Provider contends that its equity capital should be adjusted for prior years for two reasons. The Provider contends that the Health Care Financing Administration ("HCFA") did not comply with the rulemaking requirements of the Administrative Procedure Act ("APA"), 5 U.S.C. § 553, in establishing the policy relied upon by the Intermediary until 1992, 57 Fed. Reg. 43906 (September 23, 1992), and therefore, the policy is not applicable to the transaction in this 1989 case. The Provider also contends that there is a basis for the retroactive reinstatement of equity capital in the Medicare regulations and manual, and notes previous Board decisions to that effect.

The Intermediary's position is that HCFA Pub. 15-1 § 130, as amended in August 1984, prohibits it from making any adjustment to the Provider's equity capital for prior years even though it has retroactively adjusted the Provider's allowable depreciation expense as a result of the gain on sale. Although the Provider challenges these provisions on substantive grounds, the Provider argues that the policy in the manual provision is invalid from a procedural standpoint. The Provider states that the policy constitutes a change in, or the

establishment of, a substantive Medicare policy which was not promulgated pursuant to the rule-making requirements of the APA until well after the 1989 transaction in this case.

The Provider points out that the original version of HCFA Pub. 15-1 § 130, before its amendment in 1984, did not prohibit an adjustment to a provider's equity capital for prior years when a gain or loss on the disposal of depreciable assets occurred. Similarly, the governing regulation, 42 C.F.R. § 413.134(f)(1), did not prohibit an adjustment to a provider's equity capital in the event of a gain or loss on the disposition of depreciable assets. In 1992, HCFA amended the Medicare regulation at 42 C.F.R. § 413.134(f)(1), 57 Fed. Reg. 43906 (September 23, 1992), to provide that a gain or loss on disposition of depreciable assets has no retroactive effect on a proprietary provider's equity capital for years prior to the disposition. The Provider asserts that the Secretary's realization that the 1984 amendment to HCFA Pub. 15-1 § 130 constituted a substantive change, and it was this realization that prompted her to amend the governing regulation in 1992 in order to meet the requirements of the APA.

The Provider observes that it is well-established that the Secretary may not change or establish substantive Medicare reimbursement policy without complying with the rulemaking requirements of the APA. In Mt. Diablo Hospital Medical Center v. Bowen, 860 F.2d 951 (9th Cir. 1988), the court invalidated the application of Medicare policy issued by manual provision because the policy was not enacted in accordance with the rule-making requirements of the APA. Also in Cedars-Sinai Medical Center v. Shalala, No. CV 95-2902 JGD (ex), (C.D. Ca April 8, 1996) Medicare and Medicaid Guide (CCH) ¶ 44,188, aff'd in part, rev'd and remanded in part, 125 F.3d. 765 (9th Cir. 1997), the court found that Medicare manual instructions were invalid and void because they constituted a change in existing policy and had not been issued in accordance with the APA.

The Provider notes that HCFA indicated that the 1984 change to HCFA Pub. 15-1 § 130 was a clarification of existing policy as opposed to a change or establishment of new policy. The Provider disputes this claim by noting that the policy was not applied retroactively. In the HCFA Administrator's decision in Northgate General Hospital v. Ætna Life Insurance Company, PRRB Case No. 94-D16, March 30,1994, Medicare and Medicaid Guide (CCH) ¶ 42,215, aff'd HCFA Administrator, June 3, 1994, Medicare and Medicaid Guide (CCH) ¶ 42,553 ("Northgate") the retroactive recalculation of a provider's return on equity on a transaction prior to the 1984 amendment of HCFA Pub. 15-1 § 130 was permitted. The Provider asserts that the Secretary may have remedied the procedural flaw with the 1992 regulation, but that the 1992 regulation may not be applied retroactively. The Provider cites Georgetown Hospital v. Sullivan, 488 U.S. 204 (1988), which holds that the Secretary does not have retroactive rule-making authority.

The Provider further notes that the Board has previously concluded that if depreciation of a provider's facility is recaptured, there should be a corresponding recalculation of the provider's ROE for the cost years in which such return has been calculated on the basis of a

depreciated value for the facility. See Deluxe Care Inn v. Ætna Life Insurance Company, PRRB Case No. 94-D32, April 28, 1994, Medicare and Medicaid Guide (CCH) ¶ 42,409, rev'd HCFA Administrator, June 24, 1994, Medicare and Medicaid Guide (CCH) ¶ 42,547 ("Deluxe Care"); Woodcliff Lake Manor Nursing Home, Inc. v. Ætna Life Insurance Co., PRRB Case No. 91-D28, March 21, 1991, Medicare and Medicaid Guide (CCH) ¶ 35,151, mod'd HCFA Administrator, May 17, 1991, Medicare and Medicaid Guide (CCH) ¶ 39,233 and Hassler Nursing Center v. Ætna Life Insurance Co., PRRB Case No. 89-D44, June 13, 1989, Medicare and Medicaid Guide (CCH)
¶ 37,917 mod'd HCFA Administrator, August 9, 1989, Medicare and Medicaid Guide (CCH) ¶ 37,990, aff'd Hassler Nursing Center v. Sullivan, CV 89-2770 (JHG) (D.D.C. October 10, 1991), Medicare and Medicaid Guide (CCH) ¶ 39631. In these cases, the Board expressly concluded that there is a basis for the retroactive restatement of equity capital in the Medicare regulations and in the manual, which refers to the adjustment required when accelerated depreciation is converted to straight line depreciation.

The Provider acknowledges that the HCFA Administrator has reversed each of these Board determinations and found that a "windfall" occurs if the provider's equity capital is adjusted. The Board however found there was no windfall. See Deluxe Care, Medicare and Medicaid Guide (CCH) ¶ 42,409, at 40,310. According to the Board, depreciation is, in effect, the lost usefulness of the provider's original cost of its investment in plant, property and equipment related to patient care. Id. Reimbursement for depreciation expense is reimbursement for an allowable cost which represents the lost usefulness of wasting away of the provider's investment and is not comparable to the reasonable rate of return on equity which is capitalized, invested, and used in the provision of patient care. Id. Under 42 C.F.R. § 413.157 (redesignated § 413.157), the ROE is paid in addition to the reasonable cost of covered services and thus, by recomputing the ROE, a provider is not receiving a windfall. Id.

In summary, the Provider contends that the 1984 policy prohibiting ROE recalculation was not a clarification but a substantive change which was not properly promulgated at the time of this transaction in the instant case. The Provider also contends that prior Board decisions that allowed recalculation of ROE were correct.

INTERMEDIARY'S CONTENTIONS:

The Intermediary contends that it did not allow a recalculation of ROE because the Medicare policy at HCFA Pub. 15-1 § 130 does not permit it. The Intermediary also points out that previous Board decisions cited by the Provider have been overturned by the HCFA Administrator.

The Intermediary refers to the following Medicare manual provision that addresses recomputation of ROE.

> Depreciable assets may be disposed of through sale, scrapping, trade-in, donation, exchange, demolition, abandonment or involuntary conversion such as condemnation, fire, theft, or other casualty. If disposal of a depreciable asset results in a gain or loss, adjustment is necessary in the provider's allowable cost. The amount of gain included in the determination of allowable cost is limited to the amount of depreciation previously included in allowable costs. The amount of loss to be included is limited to the undepreciated basis of the asset permitted under the program. When an asset has been retired from active service but is being held for standby or emergency services, depreciation may continue to be taken on such assets. In no case, however, can gain or loss be computed on the retired asset until the asset is actually disposed of. A gain or loss on disposal of depreciable assets has no effect on a proprietary provider's equity capital for prior years.

HCFA Pub. 15-1 § 130 (emphasis added).

The Intermediary indicates that since it is the Medicare program's policy not to recognize an effect on prior years' equity, ROE was not recalculated.

The Intermediary notes that the HCFA Administrator has overruled the Board in the three cases cited by the Provider. In Deluxe Care, the HCFA Administrator stated the following.

> [T]he Board ruled that, if depreciation of the Provider's facility is recaptured, then there should be a corresponding recalculation of its return on equity capital for the cost years in which such return had been calculated on the basis of a depreciated value for the facility . . .
>
> Medicare's return on equity capital does not reimburse a "cost"' in an accounting sense, i.e., it is not reimbursement of "an expenditure or outlay of cash, other property, capital stock, or services . . . ." The return on equity capital is an allowance for profit. The return is a percentage of the value of the equity capital. It is paid to providers only if they are organized and operated with the expectation of making a profit.
>
> Moreover, retroactive recalculation of the return on equity capital would give the provider a windfall, i.e., a duplicate payment of profit. During the period between reimbursement and recapture, the Provider already had free use of the funds which Medicare paid to reimburse for depreciation expense. The Provider also had the opportunity to invest those funds and earn a profit. Retroactive recalculation of a return on equity capital would require Medicare to pay a second return on those funds which Medicare had already paid to the Provider. In recapturing the depreciation expense, the Medicare program does not seek to recapture any of the profits earned by the Provider on the use of

these funds.

Deluxe Care, Medicare and Medicaid Guide (CCH) ¶ 42,547, at 41,193-4.

Since the program instruction precludes recalculation and previous Board decisions have been overruled, the Intermediary contends that the Provider request for recalculation should be denied.

CITATIONS OF LAWS, REGULATIONS AND PROGRAM INSTRUCTIONS:

1. Laws:

5 U.S.C. § 553	-	Administrative Procedure Act
42 U.S.C. § 1395x(v)(1)(A)	-	Reasonable Cost

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

§ 405.429 (redesignated § 413.157)	-	Return on Equity Capital of Proprietary Providers
§ 405.1835-.1841	-	Board Jurisdiction
§ 413.9	-	Cost Related to Patient Care
§ 413.134	-	Depreciation

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

§ 130	-	Disposal of Assets

Transmittal No. 313, August 1984.

4. Cases:

Cedar-Sinai Medical Center v. Shalala, No. CV 95-2902 JGD (ex), (W.D.C.D. of Ca., April 8, 1996, Medicare and Medicaid Guide (CCH) ¶ 44,188, aff'd in part, rev'd and remanded in part, 125 F.3d 765 (9th Cir. 1997).

Deluxe Care Inn v. Ætna Life Insurance Company, PRRB Case No. 94-D32, April 28, 1994, Medicare and Medicaid Guide (CCH) ¶ 42,409, mod'd HCFA Administrator, June 24, 1994, Medicare and Medicaid Guide (CCH) ¶ 42,547.

Georgetown Hospital v. Sullivan, 488 U.S. 204 (1988).

Guernsey Memorial Hospital v. Shalala, 115 S.Ct. 1232 (1995).

Hassler Nursing Center v. Ætna Life Insurance Co., PRRB Case No. 89-D44, June 13, 1989, Medicare and Medicaid Guide (CCH) ¶ 37,917 mod'd HCFA Administrator, August 9, 1989, Medicare and Medicaid Guide (CCH) ¶ 37,990, aff'd

Hassler Nursing Center v. Sullivan, CV 89-2770 (JHG) (D.D.C. October 10, 1991), Medicare and Medicaid Guide (CCH) ¶ 39,631.

Mt. Diablo Hospital District v. Bowen, 860 F.2d 951 (9th Cir. 1988).

Northgate General Hospital v. Ætna Life Insurance Company, PRRB Case No. 94-D16, March 30,1994, Medicare and Medicaid Guide (CCH) ¶ 42,215, aff'd HCFA Administrator, June 3, 1994, Medicare and Medicaid Guide (CCH) ¶ 42,553.

Woodcliff Lake Manor Nursing Home, Inc. v. Ætna Life Insurance Co., PRRB Case No. 91-D28, March 21, 1991, Medicare and Medicaid Guide (CCH) ¶ 35,151, mod'd HCFA Administrator, May 17, 1991, Medicare and Medicaid Guide (CCH) ¶ 39,233.

5. Other:

57 Fed. Reg. 43906 (September 23, 1992).

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

The Board finds that the regulations prior to 1992 did not address the issue of the effect of recapture of depreciation on ROE. In 1984, HCFA issued an interpretative rule in the manual that clarified its policy not to permit a retroactive adjustment of ROE on recapture of depreciation. In the transmittal No. 313 to the manual provisions it states that:

> [t]his section has been clarified by adding a sentence at the end which indicates a gain or loss on the disposal of depreciable assets has no effect on a proprietary provider's equity for prior years. The basis for this clarification is that if the gain or loss did not exist in prior years, it could not represent a change in equity prior to the year of disposal. Any other interpretation is contrary to the regulations at 42 C.F.R. § 405.415(d)(3) which indicate the effect on equity capital in the respective year caused by recovery of accelerated depreciation should be recognized and 42 C.F.R. § 405.415(f) which does not recognize any prior year effect on equity with respect to gains and losses on disposal of assets.

. . . .

> NOTE: Because there has been misunderstanding with respect to this policy, intermediaries will take appropriate steps to assure proper implementation of this policy with respect to all assets and facilities disposed of after the month of this issuance. Intermediaries should not initiate action to reopen prior cost reporting periods. However, adjustments may be made based on specific provider requests for prior cost reports which may still be reopened under 42 C.F.R. § 405.1885.

Transmittal No. 313, August 1984.

The Board finds that HCFA's issuance of HCFA Pub. 15-1 § 130 without following the APA notice and comment provisions does not invalidate that guideline. The Board finds that the Secretary has already indicated by regulation that there should be recapture of depreciation and that only reasonable costs shall be reimbursed. The changes to the manual instruction in Transmittal No. 313, which clarify that there will be no retroactive adjustment to ROE, is consistent with these provisions. See Hassler Nursing Center v. Sullivan, supra. The courts have also ruled that HCFA may utilize its manual to establish consistent policies without violation of the APA. See Guernsey Memorial Hospital v. Shalala, 115 S.Ct. 1232 (1995). Although the manual does not have the effect of law as would a regulation, it is still available to enunciate interpretive rules that are not inconsistent with a prior regulation or statute.

The Board notes that HCFA recognized in Transmittal No. 313, Note, that there was confusion prior to 1984 regarding its policy and that its would allow some providers to claim a retroactive ROE adjustment. See also Northgate, supra. The Board disagrees with the Provider's assertion that this is proof that the policy was a change or the establishment of a new substantive policy that had to be promulgated by APA notice and comment.

Since the Board finds that HCFA's 1984 clarifications to HCFA Pub. 15-1 § 130 did not violate the APA and that they were a reasonable interpretation of existing statutes and regulations, the Board finds that the evolving manual provisions which were clarified in 1984, should be applied in the instant case, which came after the 1984 revisions to the manual.

DECISION AND ORDER:

The Intermediary's refusal to recalculate the Provider's ROE was proper. The Intermediary's adjustments are affirmed.

Board Members Participating:

Irvin W. Kues
James G. Sleep
Henry C. Wessman, Esquire

Date of Decision: March 24, 1998

FOR THE BOARD:

Irvin W. Kues
Chairman