PROVIDER REIMBURSEMENT REVIEW BOARD
HEARING DECISION

2006-D34

PROVIDERS
St. David's 89-92 Related Organization
Purchased Services Group
Austin, Texas

Provider Nos. 45-4069 and 45-3038

vs.

INTERMEDIARY
Blue Cross Blue Shield Association/
Trailblazer Health Enterprises, LLC

DATE OF HEARING
September 29, 2005

Cost Reporting Periods Ended
December 31, 1989 through
December 31, 1992

CASE NO. 95-0315G

INDEX

ISSUE:

Whether the Intermediary's denial of the Providers' request for an exception to the related organization principle for calendar years 1989 through 1992 was proper.

MEDICARE STATUTORY AND REGULATORY BACKGROUND:

The Medicare program was established to provide health insurance to the aged and disabled. 42 U.S.C. §§1395-1395cc. The Centers for Medicare and Medicaid Services (CMS), formerly the Health Care Financing Administration (HCFA), is the operating component of the Department of Health and Human Services (DHHS) charged with administering the Medicare program. CMS' payment and audit functions under the Medicare program are contracted out to insurance companies known as fiscal intermediaries. Fiscal intermediaries determine payment amounts due the providers under Medicare law and under interpretive guidelines published by CMS. See, 42 U.S.C. §1395h, 42 C.F.R. §§413.20(b) and 413.24(b).

At the close of its fiscal year, a provider must submit a cost report to the fiscal intermediary showing the costs it incurred during the fiscal year and the proportion of those costs to be allocated to Medicare. 42 C.F.R. §413.20. The fiscal intermediary reviews the cost report, determines the total amount of Medicare reimbursement due the provider and issues the provider a Notice of Program Reimbursement (NPR). 42 C.F.R. §405.1803. A provider dissatisfied with the intermediary's final determination of total reimbursement may file an appeal with the Provider Reimbursement Review Board (Board) within 180 days of the issuance of the NPR. 42 U.S.C. §1395oo(a); 42 C.F.R. §405.1835.

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

St. David's Health Care System (SDHCS) is an affiliated group comprised of various entities, including the following three hospitals located in Austin, Texas: St. David's Hospital (SDH), St. David's Pavilion (SDP), and St. David's Rehabilitation Center (SDRC). SDH is a general hospital which opened in 1924 and was certified for Medicare participation in 1966. SDP is a psychiatric specialty hospital. SDRC is a rehabilitation specialty hospital. Both SDP and SDRC began operations in the fall of 1989.[1] The related party adjustments to the cost reports of SDP and SDRC are the subject of this appeal.

SDP and SDRC (collectively, the Providers) have appealed the disallowance of certain costs by their fiscal intermediary, Trailblazer Health Enterprises, LLC (Intermediary). The costs at issue are for ancillary services obtained by SDP and SDRC from SDH that the Intermediary disallowed on the basis of the related party principle, set forth at 42 C.F.R. §413.17. As initially filed, the appeal involved a wide range of ancillary services furnished by SDH to the Providers for the entire 1989 – 1996 time period. Prior to the hearing, however, the parties executed an administrative resolution which narrowed the

[1] Transcript (Tr) at 45; Exhibit P-20.

appeal to adjustments made to the Providers' 1989 – 1992 cost reports for the following ancillary services: radiology, laboratory, physical therapy, electrocardiology (EKG), and emergency room.[2]

For the ancillary services at issue purchased from SDH, the Providers were charged SDH's usual and customary charge. These full charges were claimed by the Providers on their Medicare cost report because the Providers contend that the Intermediary should have applied the exception to the related organization principle as set forth at 42 C.F.R. Section 413.17(d), PRM (Provider Reimbursement Manual) CMS-Pub. 15-1 §1010. The Intermediary's adjustments reduced SDH's charges to cost by applying a departmental cost to charge ratio, in effect denying the Provider's claim for a related organization exception.

Other pertinent facts are as follows:

(1) SDH, SDP and SDRC were separately incorporated under Texas law.

(2) Each Provider maintained its own accounting records, general ledgers and financial statements.

(3) Each Provider filed separate IRS tax returns.

(4) Each Provider had separate business licenses.

(5) The estimated reimbursement effect of the Intermediary's denial of the Providers' claim of the related organization principle exception was approximately $7.7 million.

The Providers appealed the Intermediary's adjustments to the Board pursuant to 42 C.F.R. §§405.1835-405.1841. The appeal met the jurisdictional requirements of those regulations. The Providers were represented by Glenn P. Hendrix, Esquire, of Arnall Golden Gregory LLP. The Intermediary was represented by Bernard M. Talbert, Esquire, Associate General Counsel, Blue Cross Blue Shield Association.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

After considering the Medicare law and program instructions, the evidence submitted, and the parties' contentions, the Board finds and concludes that the "purchase" of services by SDP and SDRC from SDH does not meet the criterion for an exception to the related organization principle at 42 C.F.R. §413.17 (d). The Providers' allowable costs are limited to the costs actually incurred by the related party (SDH) to provide the radiology, laboratory, physical therapy, EKG and emergency room services purchased for patients of SDP and SDRC.

[2] See Administrative Resolution, Exhibit P-54.

42 C.F.R. §413.17 (d) allows an exception to the related organization principle when all of the following criteria are met:

> (d) Exception. (1) An exception is provided to this general principle if the provider demonstrates by convincing evidence to the satisfaction of the fiscal intermediary (or, if the provider has not nominated a fiscal intermediary, CMS) that –
> (i) The supplying organization is a bona fide separate organization;
> (ii) A substantial part of its business activity of the type carried on with the provider is transacted with others than the provider and organizations related to the supplier by common ownership or control and there is an open, competitive market for the type of services, facilities, or supplies furnished by the organization;
> (iii) The services, facilities, or supplies are those that commonly are obtained by institutions such as the provider from other organizations and are not a basic element of patient care ordinarily furnished directly to patients by such institutions; and
> (iv) The charge to the provider is in line with the charge for such services, facilities, or supplies in the open market and no more than the charge made under comparable circumstances to others by the organization for such services, facilities, or supplies.

If any one of these criterion are not met, the exception to the related organization principle would not apply. The provider is then limited to the cost incurred by the related party for a service furnished. In examining the facts and arguments provided by both the Providers and the Intermediary, the Board finds that the Providers failed to meet at least two of the four criteria.

Regarding the first criterion, the Board finds that SDP and SDRC are legitimate, bona fide separate organizations. As the Providers have argued, each organization was separately incorporated under appropriate state laws. Each had its own accounting system and ledgers and filed separate tax returns. This is clear evidence of a bona fide separate organization. Thus, the Board finds that the Providers met this requirement.

The second criterion under 42 C.F.R. Section 413.17(d) (1) (ii) has two requirements. The first requirement is that a substantial part of its business be carried on with others than the provider. The Providers argue that "sales of ancillary services" to SDP and SDRC were insubstantial when compared to the volume of ancillary services provided by SDH to its own patients.[3] Thus, they conclude that a substantial part of SDH's ancillary services are supplied to others than SDP and SDRC and organizations related to SDH.[4] The Board finds that SDH essentially provided services to its own patients, including the patients in its related organizations (SDP and SDRC). The regulation at 42 C.F.R. §413.17(d)(1)(ii) requires that a substantial part of the supplying organization's business activity (SDH in this case) be transacted with others than the provider and organizations

[3] See Provider's Post-Hearing Brief p.21.
[4] Id.

related to the supplier. Clearly, the regulation requires the supplier to deal with other organizations, while in reality, SDH only provided services to its own patients and those of its related organizations (SDP and SDRC).

The second criterion of 42 C.F.R. §41317(d)(1)(ii) is that there is an open and competitive market for the type of services furnished by the supplying organization. The Board finds that the Providers' arguments that such a market exists because SDH deals with the general public, i.e., those individuals who choose to receive services from SDH on an outpatient basis, is flawed. SDH is only dealing with its own patients, regardless of whether they are inpatients or outpatients. SDH is not supplying services to other organizations such as HMOs or health insurance companies, and there is nothing in the record to indicate that SDH attempted to market its services to other organizations.

The third criterion of the related party exception is that services that are obtained by institutions such as the Providers from other organizations be services which are commonly obtained and are not a basic element of patient care ordinarily furnished directly to patients by such institutions. The Board finds physical therapy, radiology and laboratory services to be essential services that would be expected to be furnished by rehabilitation and/or psychiatric facilities. The Provider thus failed to meet this requirement.

The fourth criterion concerns comparable charges for services in an open market. Since the Providers were required to satisfy all four of the related party exception criteria for their charges to qualify for an exception, and they have not satisfied criteria two and three, the relevance of the fourth requirement is moot and will not be addressed by the Board.

DECISION AND ORDER:

The Providers failed to satisfy two of the related party exception criteria of 42 C.F.R. §413.17(d). The Intermediary's denial of the Providers' request for an exception to the related organization principle for calendar years 1989 through 1992 was proper.

BOARD MEMBERS PARTICIPATING:

Suzanne Cochran, Esquire
Gary B. Blodgett, D.D.S.
Elaine Crews Powell, C.P.A.
Anjali Mulchandani-West
Yvette C. Hayes

FOR THE BOARD:

DATE: July 20, 2006

Suzanne Cochran
Chairperson