PROVIDER REIMBURSEMENT REVIEW BOARD DECISION

2017-D19

PROVIDER–
Clarke County Hospital

Provider No.: 16-1348

vs.

MEDICARE CONTRACTOR –
Wisconsin Physicians Service

DATE OF HEARING –
May 5, 2015

Cost Reporting Periods Ended –
June 30, 2010, June 30, 2012 and
June 30, 2013

CASE NOs.: 14-3177, 14-1331 and
15-0165

INDEX

ISSUE

Whether the Medicare Administrative Contractor ("Medicare Contractor"),[1] Wisconsin Physicians Service ("WPS"), improperly disallowed certain home office costs claimed by the Provider, Clarke County Hospital ("Clarke"), on the grounds that it was not related to the entity that had furnished the services.[2]

DECISION

After considering the Medicare law and regulations, the parties' contentions, and the evidence submitted, the Board finds that Central Iowa Hospital Corporation ("Central Iowa" or "CIHC") is an organization related to Clarke within the meaning of Medicare "related organization" principles. Accordingly, the Board remands Clarke's cost reports for fiscal years 2010, 2012, and 2013 to the Medicare Contractor for audit, to determine if the costs incurred by Central Iowa, and included by Clarke on these cost reports as home office costs, are reasonable and necessary.

INTRODUCTION

Clarke is a 25-bed critical access hospital located in rural Iowa.[3] During the fiscal years in dispute, Clarke and Central Iowa[4] were parties to a Critical Access Hospital Network Agreement and a Hospital Management Agreement.[5] The cost reporting periods involved in these appeals are for Clarke's fiscal years ending 06/30/2010, 06/30/2012 and 06/30/2013. Clarke's assigned Medicare Contractor during the time at issue was WPS.

For each of the years at issue, Central Iowa filed a home office cost statement allocating costs to Clarke and certain other entities for which it provided management and administrative services.[6] In turn, Clarke claimed its share of Central Iowa's home office costs on its own Medicare cost reports.[7] On October 7, 2011 the Medicare Contractor issued a Notice of Program Reimbursement ("NPR") for Clarke's 6/30/2010 cost report reimbursing Clarke for Central Iowa's home office costs.[8] However, in February 2012, the Medicare Contractor reopened this cost report,[9] determined that Clarke and Central Iowa were not "related organizations" under Medicare rules, and consequently removed the

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[1] Medicare's payment and audit functions were historically contracted to organizations known as fiscal intermediaries ("FIs"). These functions are now contracted with organizations known as Medicare Administrative Contractors ("MACs"). The term "Medicare Contractor" refers to both FIs and MACs as relevant.

[2] The Medicare Contractor stated the issue to be whether the Provider is entitled to costs allocated from Central Iowa Hospital Corporation. *See* Transcript of Proceedings, *Clarke County Hospital v. Wisconsin Physicians Service* (May 5, 2015) at 12 [hereinafter *Tr.*].

[3] Provider's Revised Final Position Paper at Exhibit P-1.

[4] Central Iowa was part of Iowa Health System ("IHS"), a regional health care delivery system that directly owned and operated four hospitals. Provider's Revised Final Position Paper at 1.

[5] *See* Provider's Revised Final Position Paper at Exhibits P-37 and P-40.

[6] *See* Provider's Revised Final Position Paper at 8.

[7] *Id.* at 8.

[8] *Id.* at Exhibit P-3.

[9] *Id.* at Exhibit P-7.

home office allocations reported on Worksheet A-8-1 of Clarke's 6/30/2010 cost report. The Medicare Contractor did not remove the management fees reported on Worksheet A.[10] The Medicare Contractor issued a revised NPR on February 8, 2013 denying reimbursement for Central Iowa's costs in excess of the amounts paid to Central Iowa by Clarke.[11] The Medicare Contractor continued to disallow Clarke's reported home office costs for Clarke's cost reporting periods ending 06/30/2012 and 06/30/2013.[12]

Clarke disagreed with the Medicare Contractor's adjustments and timely appealed to the Board. As Clarke met all jurisdictional requirements for a hearing, the Board conducted a live hearing on May 5, 2015. Robert E. Mazer, Esq., at Baker, Donelson, Bearman, Caldwell & Berkowitz, P.C., represented Clarke. Robin Sanders of the BlueCross BlueShield Association represented the Medicare Contractor.[13]

STATEMENT OF THE FACTS

The management agreement between Clarke and Central Iowa provided, among other things, that Central Iowa would recruit the administrator/chief executive officer ("CEO") whose sole responsibility would be the effective and efficient operation of the hospital.[14] The CEO was a Central Iowa employee, reporting to the Clarke's Board of Trustees.[15] The Trustees and Central Iowa jointly evaluated the CEO's performance.[16] Similarly, the agreement provided that Central Iowa would recruit the chief financial officer ("CFO") to be responsible for the overall financial operations of the hospital. The CFO would be a Central Iowa employee reporting to Clarke's CEO.[17] Under the agreement, the parties would consult in other areas of Central Iowa's expertise and Clarke's needs, including: nursing, public and community relations, human resources, staff development, physician recruitment, purchasing, etc.[18]

Under the critical access hospital network agreement with Central Iowa,[19] Clarke could make referrals and transfer its patients to one of Central Iowa's facilities when an attending physician determined it to be necessary. The agreement also provided for credentialing assistance and quality assurance assistance.[20]

Federal regulations at 42 C.F.R. § 413.17 (2012) direct how Medicare handles costs for "related organizations." Section (a) of this regulation states the principle for related organization's costs as follows:

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[10] *See id.* at Exhibits P-18 and P-19.
[11] *See id.* at Exhibit P-19.
[12] *Id.* at Exhibits P-23 and P-30.
[13] Note that the Federal Specialized Services is now representing the Medicare Contractor.
[14] *See* Provider's Revised Final Position Paper at Exhibit P-37.
[15] *Id.* at Exhibit P-37, 2.
[16] *Id.*
[17] *Id.* at Exhibit P-37, 3–4.
[18] *Id.* at Exhibit P-37, 4.
[19] *See id.* at Exhibit P-40, 1.
[20] *Id.* at Exhibit P-40, 4–5.

> (a) *Principle*. . . . [C]osts applicable to services, facilities, and supplies furnished to the provider by organizations related to the provider by common ownership or control are included in the allowable cost of the provider at the cost to the related organization. However, such cost must not exceed the price of comparable services, facilities, or supplies that could be purchased elsewhere.

Section (b) of this regulation defines related organizations, in relevant part, as follows:

> (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.
>
> (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 of an organization or institutions.

CMS provides guidance on this regulation in the Provider Reimbursement Manual ('PRM") 15-1. Specifically, Chapter 10, § 1000 repeats the principle articulated in the regulation at §413.17(a)—that the costs furnished by related organizations are includable in the provider's allowable costs and that these costs cannot exceed the price of comparable services that could be purchased elsewhere—and adds:

> The purpose of this principle is two-fold: (1) to avoid the payment of a profit factor to the provider through the related organization (whether related by common ownership or control), and 2) to avoid payment of artificially inflated costs which may be generated from less than arm's-length bargaining.

The manual further explains the situation where a contract creates the related organization relationship in § 1011.1 which states:

> If a provider and a supplying organization are not related before the execution of a contract, but common ownership **or control** is created at the time of execution by any means, the supply contract will be treated as having been made between related organizations (emphasis added).

Finally, § 1004.3 defines the term "control" as follows:

> The term "control" includes any kind of control, whether or not it is legally enforceable and however it is exercisable or exercised. It is the reality of the control which is decisive, not its form or the mode of its exercise.

The parties dispute whether the above regulatory and manual guidance on related organizations supports the Medicare Contractor's adjustments to remove the amounts claimed by Clarke on its FY 2010, 2012 and 2013 cost reports, as related organization/home office costs from Central Iowa.

DISCUSSION, FINDINGS OF FACT, AND CONCLUSIONS OF LAW

The Medicare Contractor contends that the management agreement between Clarke and Central Iowa did not allow Clarke to claim Central Iowa's home office costs as a related organization.[21] The Medicare Contractor reasons that with respect to Clarke, the Board of Trustees is the governing body and is solely responsible for the policy making and direction of Clarke.[22] The Medicare Contractor points out that the management agreement states that Central Iowa "will be acting as an independent contractor"[23] and is not granted related party status through such an agreement.[24]

The Medicare Contractor argues that "the Board of Trustees is the governing body of the Hospital and is solely responsible for policy making and direction of the Hospital."[25] No Central Iowa employees serve on Clarke's Board of Trustees and, as a result, Central Iowa has no influence through these Trustees. The Medicare Contractor maintains that while the CEO, CFO and director of patient care services are employed by Central Iowa and may exert some influence over Clarke, their influence is primarily related to their job responsibilities in their respective positions and are solely responsible to carry out the policies as directed by the Trustees.[26] As such, the Medicare Contractor concludes that Central Iowa is not a related party, and it is necessary to limit Central Iowa's costs to the actual amounts incurred by Clarke.[27]

The Medicare Contractor relies on PRM 15-1 § 2135 which provides detailed guidance related to purchased management and administrative support services.[28] The Medicare Contractor asserts that Clarke has failed to document the costs and services associated

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[21] Medicare Contractor's Final Position Paper at 10.
[22] *Id.* at 8.
[23] Provider's Revised Final Position Paper at Exhibit P-37, 1.
[24] Medicare Contractor's Final Position Paper at 10.
[25] *Id.* at 8 (citing Hospital Management Agreement from Provider's Revised Position Paper at Exhibit P-37, 2).
[26] Medicare Contractor's Final Position Paper at 8–10.
[27] *Id.* at 17.
[28] *Id.* at 10.

with these contracts.[29] Specifically, the Medicare Contractor explains that Clarke has not submitted the documentation as required by § 2135.5 "a" through "f."[30] The Medicare Contractor maintains that, if the Board finds that Clarke and Central Iowa are related organizations, the cases must be remanded back to the Medicare Contractor for review to determine the extent to which the claimed home office costs are allowable.[31]

For its part, Clarke emphasizes Central Iowa's significant influence over both the operations and policies of the Hospital[32] and relies on CMS' related organization regulations which define the term "control" to mean "the power to directly or indirectly significantly to influence or direct the actions or policies of an organization."[33]

Further Clarke asserts that it is improper to raise before the Board new issues of whether the home office costs were incurred, were a reasonable amount, and were documented.[34] Clarke reasons that the Medicare Contractor accepted Central Iowa's home office cost statement reflecting both its home office costs and the allocation of such costs to Clarke, and the Medicare Contractor has not demonstrated that these home office costs were unreasonable.[35] Clarke argues that the regulations at 42 CFR § 405.1871(b)(5) do not provide for a remand to the Medicare Contractor to make a second determination on the claimed home office costs on a different basis.[36]

The Board finds that based on the evidence in the record and substantial testimony at the hearing, it is clear that Central Iowa had significant influence over the management staff, policies, and day-to-day operations of Clarke and controlled Clarke. Central Iowa employs Clarke's CEO, the CFO as well as other senior administrative officials who run the day-to-day operations of Clarke and are accountable to Central Iowa. The CEO of Clarke testified that Central Iowa had an influence on virtually everything he did.[37]

Clarke is a very small community hospital with a Board of Trustees who are community leaders with little, if any, background in healthcare. Central Iowa supplies experience and expertise required to manage a healthcare entity.[38] Clarke's CEO identified individuals to serve as Trustees[39] and that the Trustees would generally follow the recommendations of Central Iowa.[40] The CEO's testimony illustrated that the Trustees approved large numbers of new or revised policies in a single motion[41] and that Central Iowa guaranteed general

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[29] *See id.* at 7.
[30] *Id.* at 7.
[31] *Id.* at 17.
[32] *See* Provider's Post Hearing Brief and Proposed Findings of Fact and Conclusions of Law at 7–8 [hereinafter Provider's Post-Hearing Brief].
[33] 42 C.F.R. § 413.17(b)(3) (2016).
[34] Provider's Rebuttal to MAC Position Paper at 1–3.
[35] *Id.* at 12-13.
[36] Provider's Post Hearing Brief at 27.
[37] *Tr*. at 197.
[38] Provider's Post-Hearing Brief at 22–23; *Tr.* at 295-308.
[39] *Tr.* at 228–30.
[40] *Id.* at 238–40.
[41] *Id.* at 237–38; Provider's Revised Final Position Paper at Exhibit P-39, 61–62 and 159–60.

obligation bonds that Clarke issued allowing for a lower interest rate.[42] It also reflects collaboration between the managers at Clarke and the managers at Central Iowa.[43]

Medicare regulations and PRM 15-1 define the term "control" broadly and inclusively. Specifically, 42 C.F.R. § 413.17(b)(3) defines "control" as "the power, directly or indirectly, significantly to influence or direct the actions or policies." Similarly, the PRM 15-1 § 1004.3 defines "control" to include "any kind of control, whether or not it is legally enforceable and however it is exercisable or exercised." The Board concludes, based on the evidence in the record that Central Iowa exercised the power, directly or indirectly, to significantly influence the actions and policies of Clarke and they are, therefore, related parties as articulated by Medicare regulations and policies.

However, while the Board agrees that Clarke is a related party of Central Iowa under Medicare's rules, the Board does not agree that the Medicare Contractor, by simply accepting Central Iowa's home office cost statement, also accepted the reasonableness of the home office costs. The Board agrees with the Medicare Contractor that Medicare's reasonable cost principles apply to home office costs and concludes that a remand is necessary to determine the propriety of these costs.

The Board reviewed the Medicare Contractor's workpapers related to the home office adjustments and noted that these adjustments removed the Central Iowa's related organization home office costs *in toto* from Clarke's cost reports.[44] The Medicare Contractor stated that these amounts had not been reviewed as the providers were determined not to be related.[45] The Board finds that the Medicare Contractor's determinations did not accept the home office costs at issue but rather stated that amounts had not been reviewed.

The Board also finds that reasonable cost principles do apply to costs from home offices.[46] Specifically, Medicare regulations at 42 C.F.R. § 413.17(a) allow a provider to claim the cost of services provided by organizations related to the provider by common ownership or control, as long as these costs do not exceed the price of comparable services. The intent of this provision is to ensure that Medicare does not pay artificially inflated costs which may be generated from less than arm's length bargaining. Additionally, PRM 15-1, § 1005 allows that the "principles of reimbursement of provider costs described elsewhere in this manual will generally be followed in determining the reasonableness and allowability of the related organization's costs."

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[42] *Tr*. at 244–45.
[43] *Id*. at 246–47.
[44] *See* Provider's Revised Final Position Paper at Exhibits P-18, P-19, P-23, P-24, P-30, and P-31.
[45] *See* Medicare Contractor's Final Position Paper at Exhibit I-2, 26 (describing how the amounts were not reviewed, in a section entitled "Work Done," ¶5).
[46] As stated in PRM 15-1 § 2150, the Medicare program does not recognize home offices as Medicare providers and, as a result, does not directly reimburse home offices for their costs related to patient care. Rather, to the extent the home office furnishes services related to patient care to a provider, the reasonable costs of such services are includable in the provider's cost report and are reimbursable as part of the provider's costs.

Medicare regulations at 42 C.F.R. § 405.1871(b)(5) allow the Board to remand a case when a Medicare Contractor denies the relief the provider seeks based on procedural grounds or on the alleged failure to supply documentation. In this case, the Medicare Contractor asserts that Clarke failed to supply adequate documentation to support its claim that it was related to Central Iowa, and therefore, the Medicare Contractor denied the home office costs without further review of the costs. As the Medicare Contractor did not review the merits of the case, the Board concludes that a remand is appropriate.

DECISION AND ORDER

After considering the Medicare law and regulations, the parties' contentions, and the evidence submitted, the Board finds that Central Iowa is an organization related to Clarke within the meaning of Medicare "related organization" principles. Accordingly, the Board remands Clarke's cost reports for fiscal years 2010, 2012, and 2013 to the Medicare Contractor for audit, to determine if the costs incurred by Central Iowa, and included by Clarke on these cost reports as home office costs, are reasonable and necessary.

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DATE: July 11, 2017