

# PROVIDER REIMBURSEMENT REVIEW BOARD HEARING DECISION

99-D43

**PROVIDER** -O'Connor Hospital  
San Jose, California

**DATE OF HEARING-**  
April 10, 1998

Provider No. 05-0153

**vs.**

Cost Reporting Period Ended -  
June 30, 1985

**INTERMEDIARY** -Blue Cross and  
Blue  
Shield Association/Blue Cross of  
California

**CASE NO.** 89-0910

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**ISSUE:**

Was the Health Care Financing Administration's ("HCFA") refusal to exclude the Campbell alcohol and chemical dependency recovery unit from the prospective payment system ("PPS") because it did not meet applicable State licensure law proper?

**STATEMENT OF THE CASE AND PROCEDURAL HISTORY:**

The issue in this appeal arises from HCFA's denial of O'Connor Hospital's ("Provider") request for an exclusion from the Medicare program's PPS for its alcohol and chemical dependency treatment unit for the fiscal year ended June 30, 1985. In the interest of facilitating the presentation of this issue before the Provider Reimbursement Review Board ("Board"), the Provider and the Blue Cross and Blue Shield Association/Blue Cross of California ("Intermediary") entered into the following "Statement of Stipulated Facts":

1. O'Connor Hospital ("O'Connor"), located in San Jose, California, is licensed as a general, acute care hospital with approximately 350 beds. In 1978, O'Connor acquired Campbell Hospital, located in Campbell, California, and renamed it O'Connor Hospital at Campbell ("Campbell"). Campbell is approximately 4 miles from O'Connor.
2. At the time of the acquisition, Campbell was licensed by the California Department of Health Services ("CDHS") as a general, acute care hospital with 48 medical/surgical beds. Campbell continued with the same licensure after acquisition.
3. As State licensed general, acute care hospitals, Medicare certified O'Connor and Campbell as meeting the conditions for participation in the Medicare program. From the time of acquisition through the cost year at issue, O'Connor and Campbell filed one cost report with the Medicare program under one provider number. O'Connor and Campbell received reimbursement from Medicare for covered services furnished to beneficiaries during the cost years prior to and during the cost year at issue.
4. Shortly after acquisition, Campbell began to provide alcohol and chemical dependency services.
5. In the process of providing alcohol and chemical dependency recovery services at Campbell, O'Connor notified CDHS that Campbell was providing alcohol and chemical dependency recovery services. See Provider's Exhibit P-3. The State of California reimbursed O'Connor for chemical dependency services furnished at Campbell.

6. From the time of acquisition, the amount of chemical dependency recovery services furnished at Campbell continued to grow. During the cost year at issue, Campbell provided chemical dependency recovery services in all of its licensed beds.
7. On January 24, 1984, O'Connor submitted a request to the Health Care Financing Administration's ("HCFA") Region IX office asking that Campbell be excluded from the Medicare prospective payment system as a distinct part alcohol/drug unit.
8. On June 28, 1984, O'Connor's request was denied by HCFA's Region IX office based on its findings that "[t]he unit is not approved by the State licensing agency." See Provider's Exhibit P-5.
9. Effective August 15, 1984, O'Connor and Campbell were issued a consolidated licensure as a general, acute care hospital.
10. In January 1985, CDHS scheduled a survey of Campbell's chemical dependency recovery service. See Provider's Exhibit P-11. This notice stated that upon approving the program as a chemical dependency recovery service, CDHS would issue a consolidated license for O'Connor and Campbell with O'Connor becoming a 395 bed general, acute care hospital with a 38 bed chemical dependency recovery supplemental service.
11. Effective January 15, 1985, CDHS issued O'Connor and Campbell a consolidated license that designated 38 medical/surgical beds for chemical dependency recovery services.

The Provider appealed HCFA's denial of its PPS exclusion request to the Board, and has met the jurisdictional requirements of 42 C.F.R. §§ 405.1835 - .1841. The estimated amount of Medicare reimbursement in controversy is approximately \$162,000. The Provider was represented by Jeffrey G. Micklos, Esquire, of Foley & Lardner. The Intermediary's representative was Bernard M. Talbert, Esquire, of the Blue Cross and Blue Shield Association.

#### PROVIDER'S CONTENTIONS:

The Provider contends that there is no basis for HCFA's denial of its PPS exclusion request under the controlling law and regulations. Effective for cost reporting periods beginning on or after October 1, 1983, Congress enacted the PPS for inpatient hospital services as set forth in 42 U.S.C. § 1395ww(d)(1)(A). The Medicare statute at 42 U.S.C. § 1395ww(d)(1)(B) provides for the exclusion of certain hospitals from the PPS, including psychiatric, rehabilitation and long term hospitals, as well as psychiatric and rehabilitation units that are a

distinct part of the hospital. For the cost reporting period at issue, the regulations at 42 C.F.R. § 405.471 (c)(3) (1984) provided for the exclusion of alcohol and drug treatment hospitals from the PPS.<sup>1</sup> In order to be excluded from the PPS, an alcohol and drug treatment hospital had to meet a number of requirements that were specifically set forth in 42 C.F.R. § 405.471 (c)(3). Alcohol and drug units are also excluded from the PPS if they meet the requirements under 42 C.F.R. § 405.471 (c)(4). It is the Provider's position that HCFA improperly determined that its distinct part alcohol/drug unit failed to meet applicable State licensure laws, as required under 42 C.F.R. § 405.471 (c)(4)(i)(E).

The Provider contends that HCFA's denial of its PPS exclusion request is improper and should be reversed. HCFA's denial was based on its finding that the Campbell unit is "not approved by the State licensing agency."<sup>2</sup> However, the Provider asserts that it met applicable State licensing requirements because the State of California implicitly approved the Campbell unit to provide chemical dependency recovery services prior to the cost reporting period at issue. Moreover, California laws allows the Provider to continue providing chemical dependency recovery services at the Campbell unit until surveyed and evaluated by the State agency for supplemental service approval. Finally, in denying the PPS exclusion request, HCFA overstepped its regulatory authority by looking behind the State's licensing requirements to find that required "approvals" were not present.

The Provider contends that the Campbell unit met all applicable State licensing requirements on the first day of the cost reporting period. HCFA's denial is based on its finding that the Campbell unit was not "approved" by the State licensing agency to furnish chemical dependency recovery services. In reaching this decision, the Provider submits that HCFA went beyond the plain language of the applicable Medicare regulation and manual provision. The Provider acknowledges that California law recognizes chemical dependency recovery hospitals as a health facility requiring a distinct State license.<sup>3</sup> However, this chemical dependency recovery hospital licensing statute contains an exception for acute care hospitals that furnish chemical dependency recovery services in existing licensed hospital beds. Under this exception, a separate licensure is not required, but the hospital must obtain State approval to furnish these services as a supplemental service.

The Provider asserts that the Campbell unit met all necessary State approvals because the State of California implicitly approved Campbell to furnish chemical dependency recovery services. The State routinely inspected the Campbell unit with regard to its ongoing acute care licensure and was aware that chemical dependency recovery services were being

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<sup>1</sup> The Medicare regulations at 42 C.F.R. § 405.471 were subsequently redesignated as 42 C.F.R. § 412.20 to § 412.32.

<sup>2</sup> Provider Exhibit P-5.

<sup>3</sup> See Provider Exhibit P-8 (Cal. Health and Safety Code § 1250.3).

furnished at Campbell. After the enactment of the chemical dependency recovery hospital licensing statute in 1980, the State continued to inspect the Campbell unit and issue acute care licenses. At no time did the State inform the Provider that it was not approved to continue furnishing chemical dependency recovery services at the Campbell unit. Accordingly, the State implicitly approved O'Connor to furnish chemical dependency recovery services at Campbell. Moreover, the Provider asserts that, under California law, it was authorized to continue providing alcohol and drug rehabilitation services at the Campbell unit for which supplemental service approval became required until the State surveyed and evaluated those services. This grandfather clause advances public policy which recognizes that a provider is entitled to a continuity of operations during the implementation of a new regulatory scheme.

The Provider submits the public policy considerations underlying the grandfather clause apply in this case. The chemical dependency recovery hospital licensing statute was enacted in 1980. However, the regulations implementing this law were not promulgated until late December 1982. During the cost reporting period at issue, the State surveyed and evaluated the Provider's chemical dependency unit and granted the facility supplemental service approval to continue furnishing chemical dependency recovery services at the Campbell unit. Given the State's supplemental service approval requirements and the State's delay in performing the necessary evaluation, the Provider submits that HCFA cannot defend its denial merely on the fact that O'Connor's acute care license did not explicitly indicate it was approved to furnish these services at the Campbell unit. For the cost reporting period immediately following the fiscal period at issue here, HCFA granted the Provider an exclusion from the PPS for the Campbell drug and alcohol dependency unit. Moreover, under its PPS exclusion regulation, HCFA should not be allowed to selectively choose which State law provisions it wishes to apply. Instead, HCFA should be held to look to State licensure laws as a whole to recognize the interplay between the rules. This means that, for Medicare purposes, HCFA should recognize that California's regulatory grandfather clause constituted an approval for the Campbell unit. Accordingly, the Provider submits HCFA's denial should be reversed.

#### INTERMEDIARY'S CONTENTIONS:

The Intermediary contends that HCFA correctly applied the regulatory provisions of 42 C.F.R.

§ 405.463 and § 405.471 when it established the cost reporting period ending June 30, 1986 as the first full period that the Campbell unit was excludable from the Medicare program's PPS as a distinct part alcohol and chemical dependency treatment unit. The regulation at 42 C.F.R.

§ 405.463(b)<sup>4</sup> states the following:

(b) Cost-reporting periods subject to the rate of increase ceiling.

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<sup>4</sup>

Subsequently redesignated as 42 C.F.R. § 413.40(b).

(1) Base period. Each hospital’s initial ceiling will be based on allowable inpatient operating costs per case incurred in the 12-month cost reporting period immediately preceding the first cost reporting period subject to ceilings established under this section, . . .

42 C.F.R. § 405.463(b).

With respect to the general requirements which distinct part units must meet to be excluded from the PPS, the regulation at 42 C.F.R. § 405.471 (c) (4) states in part:

- (i) A distinct part unit must -
- . . .
- (E) Meet applicable State licensure laws; . . .

42 C.F.R. § 405.471 (c)(4)(i).

The Intermediary contends that the focal date for the factual examination and legal analysis of this case is July 1, 1984. That is the date that the Provider became subject to the Medicare program’s new PPS. If any component of the Provider was to be exempt from the PPS, the exemption had to be in place on that date. The fiscal period which began on July 1, 1984 and ended on June 30, 1985, was the Provider’s first year under the PPS. If the Campbell unit had been excluded from the PPS, Medicare payments would have been based on cost. Since an exception was not received prior to this time period, the Provider, including the Campbell unit, was paid under the PPS.

The license documentation in the record indicates that the Campbell unit was a separate 38-bed medical surgical hospital on July 1, 1984. On August 15, 1984, the CDHS issued a consolidated license which added the Campbell unit to the license of the Provider.<sup>5</sup> The costs associated with the 38-bed Campbell unit were included with the Provider’s adult and pediatric costs on a combined cost report filed for the two locations. The license designation necessary to meet the regulatory requirement of 42 C.F.R. § 405.471 (c)(4) was not issued until January 15, 1985.<sup>6</sup> It was at that time when a license was issued which specifically designated the 38 Campbell unit beds for chemical dependency recovery service (“CDRS”). This license was issued six and a half months after the start of the fiscal period for which the Provider is seeking the PPS exempt status.

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<sup>5</sup> See Provider Exhibit P-2, Page 1.

<sup>6</sup> See Provider Exhibit P-2, Page 2.

In its letter dated June 28, 1984, the HCFA Region IX office rejected the Provider’s exclusion request for failure to be properly licensed.<sup>7</sup> In a subsequent response to the Provider’s request for reconsideration, HCFA affirmed its prior decision, advising that a PPS exclusion must be granted prospectively (i.e. at the beginning of the fiscal year for which it is effective).<sup>8</sup> Again, the Intermediary emphasizes that the license designation necessary to meet the regulatory requirement was not issued until January 15, 1985.

The Intermediary argues that HCFA’s conclusion was appropriate under the relevant State statute. Section 1250.3 of the California Health and Safety codes identifies chemical dependency recovery services as a supplemental service.<sup>9</sup> Further, Title 22, § 70301 of the California statute requires specific approval by the CDHS for all supplemental services.<sup>10</sup> The designation of the CDRS as an approved supplemental service did not take place until January 15, 1985. HCFA determined that the supplemental service approval was an indispensable element of the California regulatory control over hospital activities. The fact that the Campbell unit may have been legally providing the service prior to State approval does not satisfy the requirements of 42 C.F.R.

§ 405.471 (c)(4)(i). The distinction the Provider is trying to extract between the concept of the license on one hand, and the approval of a supplemental service on the other hand, simply does not exist. The Intermediary concludes that HCFA correctly interpreted the California regulatory structure.

CITATION OF LAW, REGULATIONS, AND PROGRAM INSTRUCTIONS:

1. Law - 42 U.S.C.:

1395 ww(d) et seq. - Payment to Hospitals For Inpatient Hospital Services.

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

§ 405.463 - Ceiling on Rate of Hospital Cost Increases

Redesignated §413.40

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<sup>7</sup> See Intermediary Exhibit I-2. Page 2.

<sup>8</sup> See Intermediary Exhibits I-2, Page 1.

<sup>9</sup> See Provider Exhibit P-8, page marked 166.

<sup>10</sup> See Provider Exhibit P-9, Page marked 774.

- § 405.463(b) - Cost Reporting Periods Subject to the Rate of Increase Ceiling  
Redesignated § 413.40(b)
- § 405.471 - Hospitals and Hospital Services Subject to and Excluded from the Prospective Payment System  
Redesignated § 412.25
- § 405.471 (c) et seq. - Excluded Hospitals and Hospital Units  
Redesignated § 412.20 to § 412.32
- § § 405.1835 - .1841 - Board Jurisdiction

3. Other:

California Code of Regulations:

§ 70301 - Supplemental Service Approval Required

California Health and Safety Code:

§1250.3 - Chemical Dependency Recovery Hospital, et seq.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

The Board, after consideration of the facts, parties’ contentions, evidence presented, testimony elicited at the hearing, and post-hearing submissions, finds and concludes that HCFA’s denial of the Provider’s PPS exclusion request for the fiscal year ended June 30, 1985, was consistent with the regulatory requirements set forth in 42 C.F.R. § 405.463 and § 405.471.

The record shows that the 38 Campbell unit beds were not designated for chemical dependency recovery services until CDHS issued a revised license with an effective date of January 15, 1985.<sup>11</sup> Until the Provider received this license designation, it did not meet the regulatory requirements of 42 C.F.R. § 405.471(c)(4), which would have permitted Campbell to be classified as a distinct part unit. Since a PPS exclusion must be granted at the beginning of the fiscal year for which it is effective, the Provider cannot be granted an exclusion from

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<sup>11</sup> See Provider Exhibit P-2, Page 2.



the PPS for the fiscal year ended June 30, 1985. The Board finds that the Medicare regulations are clear on this matter, and that the Provider failed to comply with the regulatory requirements by not obtaining timely approval of these supplemental services from the State of California.

The Board finds that the record is void of any evidence which would indicate that the Provider attempted to meet the necessary State licensure requirements before the July 1, 1984 deadline. While the Provider could have taken action in a timely manner, the record shows that it was laggard in initiating the necessary action to assure compliance with the licensure requirements set forth in the Medicare regulations. It is the Board's conclusion that HCFA correctly interpreted and applied its regulatory requirements, and that the Provider cannot circumvent these requirements by its untimely performance.

DECISION AND ORDER:

HCFA properly refused to exclude the Campbell alcohol and chemical dependency recovery unit from the prospective payment system because it did not meet applicable State licensure law.

Board Members Participating:

Irvin W. Kues  
James G. Sleep  
Henry C. Wessman, Esq.  
Martin W. Hoover, Jr., Esq.  
Charles R. Barker

**Date of Decision:** May 04, 1999

For The Board:

Irvin W. Kues  
Chairman