

**PROVIDER REIMBURSEMENT REVIEW BOARD
DECISION
ON THE RECORD
2004-D20**

PROVIDER –
West Virginia University Hospital
Morgantown, WV

Provider No. 51-0001

vs.

INTERMEDIARY – Blue Cross Blue
Shield Association/ Trigon Blue Cross
and Blue Shield

DATE OF HEARING -
December 11, 2003

Cost Reporting Periods Ended
December 31, 1994, 1995 and 1996

CASE NOS. 98-1344
99-1718
00-2691

INDEX

	Page No.
Issue.....	2
Statement of the Case and Procedural History.....	2
Parties' Contentions.....	3
Findings of Fact, Conclusions of Law and Discussion.....	4
Decision and Order.....	5

ISSUE:

Was the Intermediary's adjustment to bond interest expense proper?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

West Virginia University Hospital ("Provider") is an acute care, not for profit teaching hospital located in Morgantown, West Virginia. On its December 31, 1994, 1995 and 1996 cost reports, the Provider claimed interest income on investments from an escrow account. Trigon Blue Cross and Blue Shield ("Intermediary") offset the interest income against the Provider's allowable bond interest expense. The Provider asserts that a portion of the interest income in the escrow account is attributable to funded depreciation and should not be subject to offset. The Provider filed timely appeals to the Provider Reimbursement Review Board ("Board") and has met the jurisdictional requirements of 42 C.F.R. §§405.1835-405.1845. The amount of Medicare reimbursement at issue for fiscal years 1994, 1995 and 1996, is \$354,000, \$342,000 and \$49,000, respectively.

The Medicare program reimburses interest expense on capital expenditures but requires that any interest expense be offset by any investment income in accordance with 42 C.F.R. §413.153(a) and (b). However, the interest expense offset is not required when interest income is derived from funded depreciation accounts, i.e., cash or other assets set aside to replace capital assets or for other capital purposes. In 1993, due to the availability of more favorable interest rates, the Provider carried out an advance refunding of outstanding bonds it had issued in 1986. On August 31, 1993, through a resolution of its board of directors, the Provider contributed \$25 million from its funded depreciation account toward the total amount necessary to advance refund the 1986 bonds.¹ The advance refunding was projected to save the Provider \$2.4 million per year.² The \$25 million of depreciation was combined with the proceeds from the 1993 debt issue to purchase zero coupon bonds and United States Treasury Notes and Strips. The investments were placed in an escrow account managed by One Valley Bank. The total amount initially invested was \$97,872,171.³ Thus, the funded depreciation portion of the total investment was 26 percent. The Provider believes that the 26 percent of interest income attributable to the funded depreciation portion of the escrow account should not be subject to offset.

The Intermediary, relying on guidance in Administrative Bulletin No. 1158, 88.01, dated May 31, 1988 (AB 1158), offset the entire income earned on the escrow account against bond interest.⁴

The Provider was represented by Carel T. Hedlund, Esquire, of Ober, Kaler, Grimes & Shriver. The Intermediary was represented by Bernard M. Talbert, Esquire, of the Blue Cross Blue Shield Association.

¹ Exhibit P-41 (1995).

² Exhibit P-42 (1995).

³ Exhibit P-44 (1995).

⁴ Exhibit I-7 (1994).

PARTIES' CONTENTIONS:

The Provider raises three challenges to the Intermediary's action: (1) funded depreciation funds maintain their character when used for appropriate purposes, including their transfer to another account for the purpose of debt liquidation; (2) the Intermediary's assumption that the funds were "from operations" was incorrect; and (3) that AB 1158 is inconsistent with other authorities.

Relying on prior Board cases, the Provider asserts that when funds designated as funded depreciation are transferred to an account established for an appropriate use of funded depreciation, the funds do not lose their character as funded depreciation. See Valley Hospital and Medical Center v. Aetna Life Insurance Company, PRRB Dec. No. 95-D5, October 17, 1994, Medicare & Medicaid Guide (CCH) ¶ 42,917 (Valley Hospital).⁵ The Provider points out that the escrow account was established for the purpose of capital debt liquidation, which is an appropriate purpose under CMS Pub. 15-1 §226. Thus, the \$25 million of funded depreciation transferred to the escrow account should continue to be treated as funded depreciation and should not be subject to offset against the Provider's allowable bond interest expense in accordance with 42 C.F.R. §413.153(b)(2)(iii) and CMS Pub. 15-1 §202.2.

The Provider also asserts that the commingling of funded depreciation funds with the funds from the 1993 borrowing used to refinance the 1986 bonds did not affect the characterization of the funds as funded depreciation. The commingling of funded depreciation with other funds is expressly permitted under CMS Pub. 15-1 §202.6. Furthermore, in response to a comment received by CMS requesting express authorization to pool funded depreciation with other investment funds, CMS stated that 42 C.F.R. §413.153(b)(2)(iii) has never prohibited the pooling of funded depreciation with other investment vehicles. 61 Fed. Reg. 63,740, 63,744 (December 2, 1996).⁶ In addition, there is no statute, regulation, or manual provision that prohibits this practice.

The Provider takes issue with the Intermediary's reference to the \$25 million as "from operations." The Provider agrees that interest on a provider's operational accounts would be subject to offset, but insists that it demonstrated that the funds came from funded depreciation and that the Intermediary conceded that the funds in this case were from funded depreciation and not from operations.⁷

The Intermediary acknowledges that documentation reviewed subsequent to its initial determination has shown that the \$25 million at issue in this case came from funded depreciation, but it nonetheless believes that interest earned from those funds must be offset pursuant to AB 1158. The Intermediary points out that the Provider has placed the funds in an escrow fund to advance refund a prior bond issue and that, according to AB 1158, funded depreciation funds placed with a trustee or escrow agent for the purpose of advance refunding of a debt are considered expended, and therefore not considered to be

⁵ Exhibit P-46.

⁶ Exhibit P-40 (1995).

⁷ See Intermediary Position Paper, Issue No. 3, Arguments (1994).

funded depreciation. The income earned on such funds must be offset along with the remaining income earned on the escrow funds. AB 1158 states the following about the use of existing funded depreciation for an advance refunding of debt by placing the funds in an irrevocable trust:

HCFA-Pub. 15-1, Section 226.C., states, “Funds are considered available unless committed, by virtue of contractual arrangements, to the acquisition of depreciable assets used to render patient care, or to other capital purposes.” Funds placed in an irrevocable trust for the purpose of an advance refunding of debt are considered expended for purposes of HCFA-Pub. 15-1, Section 226, and are not considered funded depreciation while in the hands of the trustee or escrow agent.

The Provider urges that Board not to rely on AB 1158 because the Board has recognized that an Administrative Bulletin is a document prepared by the Blue Cross Association and is not a CMS authority or an authority that is binding on the Board. See Woodland Park Hospital v. Blue Cross and Blue Shield Association/ Blue Cross and Blue Shield of Oregon, PRRB Dec. No. 91-D30, March 10, 1998, Medicare & Medicaid Guide (CCH) ¶ 41,332.⁸ More importantly, the Provider contends that AB 1158 is contrary to the HCFA Administrator’s decision in Robert Parker Hospital v. Blue Cross and Blue Shield Association/Blue Cross of Western Pennsylvania, HCFA Admin. Dec., March 10, 1998, Medicare & Medicaid Guide (CCH) ¶ 46,455 (Robert Parker).⁹ See also Valley Hospital, *supra*. Thus, the CMS Administrator recognized that where funded depreciation is placed in a trust account to advance refund bonds, it is protected from interest income offset.

The Provider contends that because it has properly set aside funds for funded depreciation and properly used them for capital purposes, interest income earned on these funds should not be subject to offset.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

The Board, after consideration of the Medicare law and guidelines, the parties’ contentions and evidence presented, finds and concludes as follows:

The underlying transaction in this case is the Provider’s transfer of funds to an escrow account in order to advance refund bonds. The Board finds that a portion of the funds used by the Provider to establish the escrow account were from funds designated by the Provider’s board of directors as funded depreciation. The action to fund depreciation was approved by the Provider’s board of directors, the fund was clearly designated as funded depreciation, and ultimately, the funds were transferred to an account established for an appropriate use of funded depreciation in accordance with CMS Pub. 15-1 §226: capital debt liquidation. Therefore, the Board finds that the interest earned on the \$25 million in funded depreciation should not be subject to offset against the Provider’s allowable bond interest expense.

⁸ Exhibit P-52 (1995).

⁹ Exhibit P-53 (1995).

The Board notes that the Intermediary relied upon AB 1158, which indicates that funds transferred to an irrevocable trust for advance refunding were no longer considered funded depreciation. The Board does not believe that this interpretation is supported by either the regulations or manual provisions. In addition, the Board agrees with the Provider that case law does not support this outcome. See Valley Hospital and Robert Parker, supra. The facts in both cases are similar to the instant case in that those two providers created an escrow account to advance refund bonds and transferred funds from funded depreciation accounts into the escrow accounts. In both cases, it was found that the funds from funded depreciation accounts did not lose their character as funded depreciation and were protected from interest offset. The Board concludes that the same holding should apply to this case.

DECISION AND ORDER:

The Board finds that interest income resulting from the transfer of funds from the Provider's funded depreciation account to an escrow account for advance refunding of debt should not be subject to offset. The Intermediary's adjustment is reversed.

Board Members Participating:

Suzanne Cochran, Esquire
Martin W. Hoover, Jr., Esquire
Gary B. Blodgett, D.D.S.
Elaine Crews Powell, CPA

DATE: April 30, 2004

FOR THE BOARD:

Suzanne Cochran, Esquire
Chairman