PROVIDER REIMBURSEMENT REVIEW BOARD
HEARING DECISION

2000-D50

PROVIDER -
West Virginia University Hospital
Morgantown, West Virginia

Provider No. 51-0001

vs.

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

DATE OF HEARING-
March 23 2000

Cost Reporting Period Ended -
December 31, 1992

CASE NO. 96-0918

INDEX

ISSUE:

Was the Intermediary=s adjustment reclassifying the depreciable assets as Anew@ capital proper?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

West Virginia University Hospital (AProvider@) is an acute-care, non-profit teaching hospital located in Morgantown, West Virginia. The Provider filed its cost report for FY 1992, claiming the cost of depreciation for twelve capital assets as Aold capital.@[1] The assets had a total cost of approximately $258,000 and the Provider had claimed approximately $42,600 in depreciation expenses for these assets.[2] Trigon Blue Cross and Blue Shield (AIntermediary@), however, reclassified the depreciation expense relating to these movable assets from the AOld Capital@ Cost Center to the "New Capital" Cost Center.[3] The basis for this adjustment, as reflected on the adjustment report, was the Intermediary's determination that it Ahas not considered all costs to be obligated.@[4]

The Provider appealed the Intermediary=s adjustment to the Provider Reimbursement Review Board (ABoard@) in a timely manner and has met the jurisdictional requirements of 42 C.F.R ''405.1835-.1841. The reimbursement effect of this adjustment is approximately $3,000.[5] The other issues in the original appeal have either been withdrawn or transferred to a group appeal. The Provider is represented by Carel T. Hedlund, of Ober, Kaler, Grimes & Shriver, P.C. The Intermediary is represented by Eileen Bradley, Esquire, of the Blue Cross and Blue Shield Association.

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1 Provider Position Paper at 3; Provider Exhibit P-1.

2 Id.

3 See Provider Exhibit P-2.

4 Id.

5 Provider Position Paper at 2.

Facts:

For the year ended December 31, 1992, the Provider was paid under the old/new blend hold harmless methodology of the prospective payment system (PPS) for capital related costs. Under this system, assets that were used for patient care purposes on or before December 31, 1990 are considered Aold@ assets, and assets that were put into patient care service after December 31, 1990 are considered Anew" assets. The capital related costs for Aold@ capital are treated differently than the capital related costs for "new" capital. Pursuant to 42 C.F.R. ' 412.302(c) (1991, 1992)[6] and Provider Reimbursement Manual, Part 1, (HCFA Pub. 15-1) ' 2807.3C., however, even if an asset is placed in use after December 31, 1990, it may nevertheless qualify as Aold@ capital if certain conditions are met. These assets are referred to as obligated capital. One of these conditions is that there had to be a binding enforceable agreement for the Provider to acquire the asset which was entered into on or before December 31, 1990. The agreement had to be in writing and had to obligate the Provider to proceed with the capital expenditure. In addition, the Provider had to timely submit the documentation to the Intermediary to support that there was a binding enforceable agreement.

The Intermediary acknowledges that the Provider did timely submit a listing of major moveable equipment that it believed met the criteria to be considered as obligated capital.[7] The Intermediary reviewed the listing and made a determination of the assets it believed met the criteria to be considered obligated capital. According to the Intermediary, many items included on the listing did not meet the criteria, therefore, it reclassified the capital related costs on these items from Aold@ capital to Anew@ capital. The assets in dispute are included in a schedule on Page 3 of the Provider=s Position Paper and at Exhibit 10 of the Intermediary=s Position Paper.

PROVIDER=S CONTENTIONS:

It is the Provider=s primary argument that prior to December 31, 1990, it entered into binding agreements to purchase the assets at issue, as evidenced by the written sales agreements entitled "Purchase Orders." The Provider contends that these assets thus qualify as "old" capital pursuant to 42 C.F.R. ' 412.302(c) (Provider Exhibit P-4) and HCFA Pub. 15-1 ' 2807.3C (Provider Exhibit P-3).

The Provider believes that the Intermediary based its adjustment on its view that the Provider failed to enter into a binding agreement to acquire these assets prior to December 31, 1990. The Provider asserts that in the Intermediary's view, purchase orders do not constitute binding contractual

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6 Provider Exhibit P-4.

7 Intermediary Position Paper at 6.

agreements.

Pursuant to HCFA Pub. 15-1 ' 2807.3C(4) (Provider Exhibit P-3):

> A purchase order executed by a hospital for equipment acquisitions does not, by itself, necessarily constitute a contract binding on both parties. Most States have adopted the Uniform Commercial Code with little or no change. The code provides that an order may represent an invitation to contract for goods and is not an absolute obligation to perform on the parties involved. If the supplier of goods or services does demonstrate acceptance of the offer by December 31, 1990, (e.g., by delivery of order, return invoice or acceptance of a down-payment by the deadline) or is required to perform by the deadline, under State law even in the absence of such evidence of acceptance, the requirements for the existence of a binding contract may be met.

Id.

The Provider asserts that West Virginia adopted the Uniform Commercial Code (UCC) with little or no change. The Provider points out that the UCC does not, however, specifically refer to purchase orders and does not prescribe their legal effect. However, the UCC does emphasize that in analyzing any transaction's legal effect, the substance of the contract, not its particular form, will dictate its legal effect. Thus, the Provider contends that where there is a legally sufficient offer followed by an acceptance of that offer, a binding legal agreement will be concluded regardless of its particular form. W. Va. Code ' 46-2-206 (1997) (Provider Exhibit P-6). Consequently, the Provider argues that the mere fact that a document is entitled "Purchase Order" does not automatically mean that it does not constitute a legally binding agreement. See United States of America for the Use of Westinghouse Electric Corporation v. Marietta Manufacturing Co , 339 F. Supp 18, 23-24 (S.D. W.Va. 1972) (Provider Exhibit P-5) (court concluded that Marietta confirmed its agreement to purchase certain equipment by issuing a document entitled APurchase Order@ and that this APurchase Order@ constituted a binding legal agreement).

The Provider contends that the decision of the District Court for the Southern District of West Virginia noted above is consistent with the decision of the District Court for the District of Columbia in Sentara Hampton General Hospital v. Sullivan, 799 F. Supp. 128 (D.D.C. 1991), aff d, 980 F.2d 749 (D.C. Cir. 1992). (Provider Exhibit P-7). In Sentara Hampton, the court, in dealing with the issue of whether a hospital's funded depreciation account was contractually committed, held that purchase orders are binding contractual obligations.

The Provider contends that pursuant to the UCC as adopted by West Virginia, a vendor's price quotation constitutes an offer, and when this offer is accepted by the purchaser, a binding contract is

created. See W. Va. Code ' 46-2-206 (1997). It is the Provider=s position that by applying this provision of the UCC to the transactions at issue, and looking at the substance of these transactions rather than their particular form (ie., purchase orders), it is readily apparent that the purchase orders issued by the Provider are documents that merely reflect the mutually agreed terms of a concluded sales agreement. The Provider believes that its position is evident from both the Provider=s own policies (Provider Exhibit P-8) and from the consistently-followed procedures followed by the personnel in its Purchasing Department during the cost year at issue. (Provider Exhibit P-9).

The Provider contends that it's own Purchasing Policy expressly states that "[a] purchase order is considered a valid contract." (See Provider Exhibit P-8). This Policy implicitly states that a purchase order constitutes acceptance of the vendor's offer. This is implied from the fact that "[p]urchasing has the sole responsibility for obtaining price quotations from vendors." Id. The Provider points out that these quotations are submitted to the Department Heads for approval prior to their acceptance by the Provider.

As an example of how capital equipment is procured using the above policies, the Provider offers the following summary of the steps necessary to purchase capital equipment during the FY at issue: The Department Heads drew up a list of all the items of capital equipment that they wanted to purchase during FY 1992 and submitted their lists to the Capital Budget Committee. The Capital Budget Committee met in the Fall preceding FY 1992 to establish the capital budget for FY 1992. No item of capital equipment could be purchased unless it was approved by the Capital Budget Committee. In preparing their lists for submission to the Capital Budget Committee, it was not unusual for the Department Heads and/or Purchasing Agents to contact the vendors to inquire about the availability, price, payment terms, warranties, delivery and other relevant information that might assist the Capital Budget Committee in making a decision to approve the particular request. It was also not unusual for the vendor to ship a particular item to the Department Head for a trial period or to otherwise make a particular piece of equipment available for inspection.

After approval of the capital budget, the actual process of purchasing an item of equipment commences with either the Department Head or one of the Purchasing Agents contacting the vendor to elicit information, either in writing or orally, about the item that is the subject of the proposed sale, including its specifications, purchase price, payment terms, warranties, delivery and other relevant information. This process terminates with the Department Head and the Purchasing Agent agreeing to the terms negotiated with the vendor, and the issuance of a purchase order by the Purchasing Department. The Provider argues that clearly, the purchase order is a document that merely reflects the mutually agreed terms of the sale agreement and also explains the provision in the Provider's Policy specifying that "[a] purchase order is considered a valid contract." (See Provider Exhibit P-8). See also Affidavit of Steven F. Bowman (Provider Exhibit P-9).

When the purchase order is sent or faxed to the vendor, the Provider contends that it is contractually

committed to purchase the vendor's goods at the agreed price and terms, and the vendor is contractually committed to delivering the goods at the agreed price and terms. The Provider further contends that clearly, if, after the issuance of a purchase order, either party breached the agreement, the non-breaching party could seek to either specifically enforce the agreement or seek damages for breach of contract in the West Virginia courts. Consequently, the mere fact that the agreement to buy and sell the capital items at issue are reflected in documents labeled "purchase orders" does not thereby change the legal effect of these agreements. Therefore, because the purchase orders constitute proof that binding contractual commitments were entered into by the Provider to purchase the items of equipment at issue, and because they were issued to the vendors prior to December 31, 1990, the subject matter of these sales agreements qualifies as obligated capital and should be treated as "old" capital pursuant to 42 C.F.R. ' 412.302(c) and HCFA Pub. 15-1 ' 2807.3C.

INTERMEDIARY'S CONTENTIONS:

The Intermediary acknowledges the Provider=s argument that the assets in dispute should qualify as obligated capital because it had executed purchase orders to acquire the assets before December 31, 1990. However, the Intermediary refers to HCFA Pub. 15-1, ' 2807.3 which states that a purchase order by itself does not necessarily constitute a binding contract for both the purchaser and the seller. The Intermediary contends that a purchase order is considered an invitation to contract for goods and is not an absolute obligation. If the seller demonstrates acceptance of the offer by the deadline, the requirements for a binding contract may exist. The Intermediary further contends that acceptance of the offer may be made by the delivery of the order, return invoice, or acceptance of a down payment.

The Intermediary points out that when the original listing of potential obligated capital as submitted by the Provider was reviewed, it determined that assets for which a purchase order had been executed and for which the asset had either been shipped or invoiced, did qualify as obligated capital. However, the Intermediary asserts that assets which did not fall into this category were determined not to be obligated capital. Therefore, the related depreciation expense was reclassified from Aold@ capital to Anew@ capital.

The Intermediary asserts that the Provider does not appear to disagree with this position as it has stated in its position paper that it believes there is a binding enforceable agreement if there is an offer and an acceptance. The Intermediary contends that in the absence of documentation to support the Provider=s assertion that there were binding enforceable agreements, its adjustment is proper and requests that the Board uphold its adjustment.

CITATIONS OF LAW, REGULATIONS AND PROGRAM INSTRUCTIONS:

1. Regulations-42 C.F.R:

'' 405.1835-.1841 - Board Jurisdiction

' 412.302(c) - Introduction to Capital Costs-Obligated Capital Costs

2. Program Instructions-Provider Reimbursement Manual-Part 1 (HCFA Pub.15-1):

' 2807.3C et seq - Obligated Capital Costs

3. West Virginia Code Annotated, Chapter 46, Uniform Commercial Code:

' 46-2-206 (1997) - Offer and Acceptance in Formation of Contract

4. Cases:

Sentara Hampton General Hospital v. Sullivan, 799 F. Supp. 128 (D.D.C. 1991), aff d, 980 F.2d 749 (D.C. Cir. 1992).

United States of America for the Use of Westinghouse Electric Corporation v. Marietta Manufacturing Co , 339 F. Supp 18, (S.D. W.Va. 1972).

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

The Board, after consideration of the facts, parties' contentions, and evidence presented in the record, finds and concludes that the purchase orders in question in this particular case were binding legal agreements that obligated the Provider to purchase certain equipment and also obligated the vendor to deliver certain equipment at an agreed upon price.

The Board finds that the issue in this case is primarily a legal issue as to whether a purchase order is a valid obligating document and whether the purchase order can be used as a consumation of a contract. In making its decision in this case, the Board would have preferred to have seen the actual purchase orders in question, or even a sample of the Provider=s purchase order, however, the record was void of any of these documents. The Board notes however, that the Intermediary did not challenge this documentation as evidenced by the inclusion of a list of the purchase orders in question at Intermediary Exhibit I-10. Additionally, the Board finds that the dates of these purchase orders were all before December 31, 1990.

In making its decision, the Board reviewed the Uniform Commercial Code [W. Va. Code ' 46-2-206 (1997), (Provider Exhibit P-6)] and found that the Code does not exclude the use of a purchase order as an acceptance device. The Board also discussed the Intermediary=s primary argument that HCFA

Pub. 15-1 ' 2807.3C(4) expressly prohibits the use of a purchase order as a binding contract. Pursuant to HCFA Pub. 15-1 ' 2807.3C(4) (Provider Exhibit P-3):

> A purchase order executed by a hospital for equipment acquisitions does not, by itself, necessarily constitute a contract binding on both parties. Most States have adopted the Uniform Commercial Code with little or no change. The code provides that an order may represent an invitation to contract for goods and is not an absolute obligation to perform on the parties involved. If the supplier of goods or services does demonstrate acceptance of the offer by December 31, 1990, (e.g., by delivery of order, return invoice or acceptance of a down-payment by the deadline) or is required to perform by the deadline, under State law even in the absence of such evidence of acceptance, the requirements for the existence of a binding contract may be met.

Id.

The Board opines that the above program instruction does not expressly preclude the use of a purchase order as a contract binding on both parties, especially when there are other documents, policies, and procedures to evidence that a valid obligation has taken place. The Board notes that the Provider=s affidavit at Provider Exhibit P-9 appears to support its policy and argument that purchase orders are used as valid obligating documents, however, the affidavit does not support the period in question.

Based on its analysis of the record, the Board concludes that the purchase orders in question in this particular case, were binding enforceable agreements entered into before December 31, 1990, requiring the Provider to acquire the assets.

DECISION AND ORDER:

The Provider appropriately claimed the cost of depreciation for the assets in question as Aold capital.@ The Intermediary=s adjustment is reversed.

Board Members Participating:

Irvin W. Kues
Henry C. Wessman, Esquire
Martin W. Hoover, Jr. , Esquire
Charles R. Barker
Stanley J. Sokolove

FOR THE RECORD

Irvin W. Kues
Chairman