PROVIDER REIMBURSEMENT REVIEW BOARD
HEARING DECISION

ON-THE-RECORD
98-D78

PROVIDER -Olive View Medical Center
Sylmar, CA

Provider No. 05-0040

vs.

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

DATE OF HEARING-
July 8, 1998

Cost Reporting Period Ended -
June 30, 1988

CASE NO. 91-1509

INDEX

ISSUE:

Was the Health Care Financing Administration's ("HCFA") denial of portions of the Provider's request for exceptions and adjustments to the rate of increase ceiling ("TEFRA Limit") for the exempt psychiatric unit proper?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

Olive View Medical Center ("Provider") is a general acute care hospital, owned and operated by the County of Los Angeles, and located in Sylmar, California. During FYE 6/30/88, approximately 42 percent of Olive View's patients were Medi-Cal beneficiaries, and approximately 5 percent were Medicare patients. Based on its indigent care, Olive View is considered a disproportionate share provider by Medicare and Medi-Cal. By letter to Blue Cross of California ("Intermediary") dated December 28, 1992, HCFA denied, in part, the Provider's TEFRA exception request[1] for the exempt psychiatric unit. The Provider had requested adjustments to its TEFRA target limit under 42 C.F.R. § 413.40(g) based on extraordinary circumstances due to an earthquake in 1971 and a nurses' strike in 1988. HCFA granted a partial adjustment due to increased start-up costs for the new facility that replaced the one destroyed in the earthquake but denied an adjustment related to the nurses strike. The Provider had also requested adjustments to its TEFRA rate under 42 C.F.R § 413.40(h) based on a significant distortion in its operating costs between the current year and its base year, June 30, 1985. The Intermediary denied adjustments in these areas which included increased indirect medical education (IME) costs and increased dietary costs. On March 2, 1991, the Provider appealed the TEFRA issue and four other issues to the Provider Reimbursement Review Board ("Board") and has met the jurisdictional requirements of the regulations in 42 C.F.R. § 405.1835-.1841. With the exception of the TEFRA issue, all other items in the appeal have been administratively resolved or withdrawn. The Medicare reimbursement effect of HCFA's denial of the TEFRA items is $158,141.[2] The Provider is represented by Jon Neustadter of Hooper, Lundy & Bookman. The Intermediary is represented by Bernard Talbert of the Blue Cross and Blue Shield Association.

BACKGROUND:

The Provider was originally opened as a tuberculosis hospital and was subsequently licensed as a general acute care hospital in 1959. Recognizing that the need for acute care beds would continue to increase, the Provider began in 1965 to construct a new facility designed especially for the peculiar requirements of a public hospital in Sylmar, California. The first patient was admitted to this faculty in October of 1970.

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1 See Provider Exhibit P-8.

2 Provider Position Paper at 3.

On February 9, 1971, an earthquake with a magnitude of 6.5 on the Richter Scale struck Los Angeles County and the Provider was severely damaged. The entire facility had to be abandoned and demolished. Immediately after the earthquake, the Provider's patients were transferred to LAC/USC Medical Center and San Fernando Community Hospital. In order to provide services while the Sylmar facility was being replaced, the Provider took up temporary residence in a facility in Van Nuys, California. Known as Mid-Valley, this building was the Provider's primary campus during FYE 6/30/85, its base period. Mid-Valley was licensed for 123 beds, of which 36 were specifically licensed for psychiatric services. Because this psychiatric unit was not large enough to fulfill the demand for inpatient psychiatric services, the Provider also leased 22 psychiatric beds at either San Fernando Community Hospital or at LAC/USC Medical Center.[3] Those beds were operated by Provider personnel and the patients in them were treated as Provider patients. The leased beds were included in the exemption from PPS granted by HCFA in 1985.

While treating patients at Mid-Valley, the Provider was also working on restoring its permanent facility in Sylmar. A lengthy process of demolition and planning ensued, and reconstruction was time consuming and expensive. On May 9, 1987, most of the acute services, including psychiatry, were transferred to the Sylmar facility.

PROVIDER'S CONTENTIONS:

The Provider contends it is entitled to an exception under the rate of increase ceiling ("TEFRA Limit") 42 C.F.R. § 413.40(g)(2) due to extraordinary circumstances beyond its control. The Provider contends its costs increased at a faster rate than was provided for in the TEFRA limits due to a nurses' strike during January 1988. The Provider maintains that the strike-generated expenses, which included increased nursing salary costs under the terms of the strike settlement, were a circumstance beyond its control and therefore serve as a basis for an exception to the TEFRA limits.

In addition to higher costs incurred as a result of extraordinary circumstances (i.e. nurses' strike), the Provider contends there were distortions between its base year costs, FYE 6/30/85, and the present year, FYE 6/30/88. The Provider asserts this distortion warrants an adjustment to the TEFRA limit pursuant to 42 C.F.R. § 413.40(h). These distortions occurred in the areas of IME costs and dietary costs.

The Provider contends it experienced an increase in the size of its approved psychiatric interns and residents program. Accordingly, the indirect costs of this graduate medical education program were greater during FYE 6/30/88 than they were during the base period, FYE 6/30/85.
In addition, the Provider also experienced a sharp increase in dietary expenses which was the

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[3] Provider Position Paper at 20-21.

indirect product of its move to Sylmar. The Provider contends this also distorted costs and provides the basis for an adjustment.

Following is a more detailed explanation of the Provider's arguments in each of the three areas in which it maintains that it is entitled to a TEFRA exception or adjustment.

1. Increased nursing salaries due to a strike.

The Provider notes that the regulation at 42 C.F.R. § 413.40(g)(2) provides for an exception to the TEFRA limit where:

> [T]he hospital can show that it incurred unusual costs . . . due to extraordinary circumstances beyond its control. These circumstances include, but are not limited to, strikes, fire, earthquakes, floods or substantial unusual occurrences with cost effects.

42 C.F.R. § 413.40(g) (2)

The Provider maintains that an extraordinary circumstance must be out of a provider's control; however, HCFA has recognized that an exception may be appropriate where a management decision influenced the outcome or occurrence of the extraordinary event. The Provider points to the HCFA Deputy Administrator's decision in Boone County Community Hospital v. Blue Cross, PRRB Decision No. 87-D56, aff'd HCFA Adm., May 1, 1987, Medicare & Medicare Guide (CCH) ¶ 36,350, ("Boone"). In Boone, the HCFA Deputy Administrator found that an extraordinary circumstance existed where four of five doctors on the hospital's medical staff resigned as a result of a dispute over certain disciplinary actions taken by the hospital. Although a management decision was involved in creating the extraordinary circumstance, the Deputy Administrator found that the hospital's response was reasonable and prudent. The Provider also contends that providers may receive an extraordinary circumstance exception where they are doing new construction or remodeling to retain licensure or accreditation even though such actions are within management's control. See Clinton Regional Hospital v. Mutual of Omaha, PRRB Dec. No. 80-D89. October 17, 1980, Medicare & Medicare Guide (CCH) ¶ 30,751.

The Provider asserts that the costs in its psychiatric unit during FYE 6/30/88 were influenced by two extraordinary circumstances: an earthquake and a strike. HCFA has already granted the Provider's request for an adjustment for the move as a result of the earthquake. See Provider Exhibit P-8. The Provider points out that in addition to an earthquake, a strike is also listed in the regulation as an extraordinary circumstance. See 42 C.F.R. § 413.40(g)(2) For three days, from January 26, 1988 through January 28, 1988, the nurses at the Provider, along with nurses throughout the County health system, were on strike. At issue were wages,

security and staffing.[4] The strike was strongly supported at Olive View. According to statistics published in the Los Angeles Times, over 80 per cent of its nurses did not report to work.[5] Due to its brevity, the immediate financial effects of the strike were minimal. The lasting financial effects of the strike were, however, much more serious.

The Provider points out that the County nurses struck, in part, because they felt they were substantially underpaid when compared to other community nurses. Eventually, the nurses settled for an approximate 7 percent increase effective March 1, for the remainder of the 1988 fiscal year. The Provider explains that this 7 percent increase was substantially more than the 1.15 percent increase allowed by the TEFRA limit.[6] Therefore, because the County could not have avoided this cost increase in light of the strike, and because the increase was reasonable under the circumstances, the Provider contends it is entitled to an extraordinary circumstance exception of $46.47 per discharge for additional nursing costs.[7]

2. Adjustments for Indirect medical education and dietary expenses

In addition to exceptions, the Provider points out that HCFA has a duty to grant adjustments to the TEFRA limits "[t]o take into account factors that could result in a significant distortion in the operating costs of inpatient hospital services." 42 C.F.R. § 413.40(h). In this case, the Provider contends that a number of factors significantly distorted its operating costs in the psychiatric unit when compared with the base period. First, the interns and residents program was larger during FYE 6/30/88 than it had been during the base period. The Provider contends this would have led to higher IME costs. Second, the Provider contends it incurred additional dietary expenses, in part due to its move, which distorted the cost comparison between years.

Adjustment for indirect medical education expenses

The Provider points out that it is affiliated with the UCLA School of Medicine and provides clinical experience to interns and residents in a variety of medical specialties. Among the approved training programs at the Provider during FYE 6/30/88 was one in psychiatry. The Provider notes that according to an intermediary adjustment, it had thirteen (13) FTE interns and
residents during FYE 6/30/88. However, the Provider maintains it only had four (4) FTE

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4 See Provider Exhibit P-10.

5 See Provider Exhibit P-11.

6 Provider Position Paper at 24.

7 See Provider Exhibit P-12 for the calculation.

interns and residents during FYE 6/30/85, its base period, also according to the audited cost report. The Provider contends this difference leads to a distortion in costs.

Since 1980, HCFA has recognized that hospitals which provide approved graduate medical education incur two kinds of costs not incurred by non-teaching hospitals.[8] First, the hospitals

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[8] See 45 Fed. Reg. 21584 (April 1, 1980).

have direct costs such as salaries paid to interns and residents, stipends paid to physicians for teaching and supervision, and program administrative expenses.[9] See 42 C.F.R. § 413.86(g).

The Provider points out that the second kind of costs are known as IME expenses. The Provider contends IME costs are those higher expenses incurred by hospital departments such as medical records and laboratory due to the way interns and residents practice medicine. The Provider contends that interns and residents treat patients differently than community physicians by ordering more ancillary tests, performing more procedures, and seeking more consultations both from other physicians and from allied health professionals. According to the Provider, this extra activity generates additional costs.

The Provider asserts that HCFA has also recognized that it is exceptionally difficult to draw a direct causal relationship between the existence of interns and residents in a hospital and particular cost items. The Provider contends that HCFA's own studies have shown there is a consistent linear relationship between higher total costs and the size of the interns and residents program.
". . . [t]here is a high degree of correlation between a hospital's level of general inpatient routine operating costs and the extent of its teaching activities." See 42 Fed. Reg. 21584 (April 1, 1980). According to HCFA, the additional costs per discharge are generally equal to 6.06% of total costs for each .1 increase above zero in the hospital's ratio of interns and residents to beds. See 47 Fed. Reg. 43302 (September 30, 1982).

The Provider notes that in most hospitals the provision of graduate medical education does not affect the TEFRA limits because IME expenses are part of the base year costs. However, where there is an increase in the size of the graduate medical education program since the base year, substantially more IME costs will be incurred than the TEFRA limit presently accounts for, and a distortion will occur. Under such circumstances, the Provider contends an exception is warranted.

The Provider explains that the ratio of interns and residents to beds during the base period was .083 (i.e., 4 divided by 48). In this case, the ratio of interns and residents to beds, based on the audited figures for FYE 6/30/88, was .186 (i.e., 13 divided by 70), which is more than twice that of the base period. As a result, the Provider contends that it incurred substantially more IME expenses during FYE 6/30/88.

Because graduate medical education has been recognized as an appropriate hospital function and because increases in the size of the graduate medical education program at the Provider have

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[9] Because these direct medical education costs are excluded from the TEFRA limit calculation, the Provider is not seeking an adjustment for such amounts. See Provider Position Paper at 26.

created a distortion in costs between the base period and FYE 6/30/88, the Provider contends it is entitled to an adjustment to its TEFRA rate of $292.18 per discharge.[10]

Adjustment for dietary expenses

The Provider also believes that it is entitled to an adjustment for unusual dietary expenses. The Provider explains that when it moved to the Sylmar campus in 1987, it had to terminate a very favorable agreement with the outside contractor which operated its dietary department. This agreement, which had been negotiated several years previously and existed during FYE 6/30/85, based payment for dietary services on a predetermined amount for a specified number of meals. Despite its best efforts, the County was unable to obtain an equally favorable agreement from a contractor willing to handle the larger Sylmar campus. Instead, the Provider explains it had to agree to a contract which based payment on the contractor's actual costs of providing the meals. Because dietary costs had risen significantly since it entered into the original contract, the dietary costs rose steeply once the new contract was implemented. The Provider points out that because the dietary costs of patients treated in the leased beds were directly assigned to the psychiatric unit and were not stepped down from the dietary cost center, a comparison between the FYE 6/30/88 dietary allocation to the psychiatric unit and the allocations made in previous years is not instructive.

The Provider believes that the change in the dietary contract, which was precipitated by the move to Sylmar, created a substantial distortion between the base period and current period costs in the psychiatric unit. Therefore, the Provider contends it is entitled to have its TEFRA limits adjusted by $49.03 per discharge.[11]

The Provider also notes that, although HCFA granted it an adjustment for start-up costs related to the move after the Sylmar earthquake, the Intermediary has not implemented the adjustment. Thus, the Provider requests an order from the Board directing the Intermediary to implement the HCFA-approved TEFRA start-up costs adjustment.

In summary, the Provider believes that it is entitled to adjustments and exceptions to its TEFRA limit for FYE 6/30/88 in the amount of $387.68 (plus the $92.99 for start-up costs the Provider maintains it was previously granted by HCFA).

INTERMEDIARY'S CONTENTIONS:

The Intermediary points out that the Provider is contesting a HCFA decision rendered on December 28, 1992 concerning the Provider's request for an adjustment to its TEFRA target

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[10] See Provider Exhibit P-13 for calculation.

[11] See Provider Exhibit P-14 for calculation

limit under 42 C.F.R. § 413.40(g). See Provider Exhibit P-8. The Intermediary received HCFA's determination regarding the adjustment request on January 4, 1993 and forwarded it to the Provider on January 19, 1993. HCFA denied the requested adjustments in all areas except start-up costs.

In response to the Intermediary's recommendation, HCFA approved an adjustment to the Provider's TEFRA limit to consider increased start-up costs. HCFA, however, did not specify the amount of the adjustment granted for start-up costs. HCFA directed the Intermediary to reprocess the effected cost reports to exclude the start-up costs in order to determine the adjustment amount. The Intermediary explains that the difference between the inpatient operating costs of the exempt unit, including and excluding the start-up costs, would be the amount of the recognized adjustment. The Intermediary points out that HCFA denied the Provider's request for an adjustment to the TEFRA limit for all other areas. Following is HCFA's reasoning, as indicated in its letter to the Intermediary,[12] for denying the Provider's request for exceptions and adjustments to the TEFRA limits.

1. Increased nursing salaries due to a strike

HCFA stated that it did not agree with the Provider's request for an adjustment based on an increase in nursing wages regardless of the 3 day strike in 1988. HCFA referred to an Exhibit 1 in its letter which indicated that increases in routine costs were not significant enough to warrant an adjustment. HCFA maintains that the Provider did not meet the criteria for a separate wage increase under 42 C.F.R. § 413.40(g). HCFA asserts that the Provider,

> "[d]id not experience a significant wage increase in excess of the national average hourly wage accounted for in the update factor between its base year and the appeal year (see Federal Register, Vol. 56, No. 169, August 30, 1991, Pg. 43345, Table 9). Furthermore, the adjustment for increased wages is not effective for cost reporting periods beginning before April 1, 1990."

Provider Exhibit P-8, Pg. 3.

2. Adjustment for indirect medical education expenses

In its denial letter, HCFA noted that,

> "[A]cute care hospitals may receive an indirect medical education adjustment to augment their standard rate under the prospective payment system. However, OVMC-PU is not subject to the standard rate methodology of the prospective payment system. For a TEFRA unit, we may administer an

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[12] Provider Exhibit P-8.

adjustment for increased routine service intensity which would also encompass cost increases due

> to the practice patterns of interns and residents. However, an adjustment is not warranted for increased service intensity as demonstrated on Exhibit 1."

Provider Exhibit P-8, Pg. 2

3. Adjustment for dietary expenses

In its denial letter, HCFA noted that,

> "[Y]our analysis regarding increased dietary costs is appropriate. As you stated in you letter dated September 10, 1992, "renegotiation of contract is a normal business task, and prudent management recognizes the necessity of offsetting rising costs in some areas with cost containment efforts in other areas." Thus, we are denying an adjustment for increased dietary costs. We noted that Medicare inpatient days decreased from 2,911 in the base year to 2,039 in FY 1987 and 1414 in FY 1988. Overall, the total occupancy decreased from 97.48 percent in the base year to 94.63 percent in FY 1987 and 77.66 percent in FY 1988. A decline in utilization causing increases in direct costs does not warrant adjustments under section 413.40 of the Medicare regulations."

Provider Exhibit P-8, Pg. 2

Based on the HCFA denial letter, the Intermediary requests the Board affirm its position.

CITATIONS OF LAW, REGULATIONS AND PROGRAM INSTRUCTIONS:

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

§ 405.1835-.1841	-	Board Jurisdiction
§ 413.40 et seq.	-	Ceiling on Rate of Hospital Cost Increases
§ 413.86(g)	-	Determining the Weighted Number of FTE Residents

2. Cases:

Boone County Community Hospital v. Blue Cross, PRRB Decision No. 87D-56, aff'm HCFA Adm., May 1, 1987, Medicare & Medicare Guide (CCH) ¶ 36,350.

Clinton Regional Hospital v. Mutual of Omaha, PRRB Dec. No. 80-D89, October 17,

1980, Medicare & Medicare Guide (CCH) ¶ 30,751.

3. Other Sources:

45 Fed. Reg. 21584 (April 1, 1980).

47 Fed. Reg. 43302 (September 30, 1982).

56 Fed. Reg. 43345 (August 30, 1991).

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

The Board, after consideration of the facts, parties' contentions, and evidence presented finds and concludes that the Provider has not demonstrated that it is entitled to additional relief from its TEFRA target amount beyond the adjustment granted by HCFA for the amortization of start-up costs due to the 1971 earthquake. The Board further concludes that the methodology employed by HCFA in analyzing the Provider's request was reasonable.

The Board notes that the Provider's request for relief to the Intermediary, from its TEFRA target amount, was not in evidence.

The Board finds that the governing regulatory provisions of 42 C.F.R. §§ 413.40(g) and (h) apply in this case. Under these regulations, HCFA may grant relief from the TEFRA ceiling where events beyond the provider's control or extraordinary circumstances create a distortion in the costs in the base period. Such an adjustment may be granted only to the extent that the hospital's operating costs are reasonable, attributable to the circumstances specified, separately identified by the hospital, and verified by the intermediary. An adjustment to the operating cost per case for one or more cost reporting periods subject to the TEFRA ceiling may also be made by HCFA to take into account factors that could result in a significant distortion in the operating costs of inpatient hospital services. Accordingly, the Board considered both of these subsections in determining whether the Provider satisfied the respective requirements.

The Board notes that HCFA's letter, Provider Exhibit P-8, denying the Provider's request, was a key piece of evidence in this case. In reviewing the record, the Board notes that the Provider did not challenge HCFA's Exhibit 1 calculations included in Provider Exhibit P-8.

The Provider argued that an adjustment was warranted for unusual dietary expenses because a change in the dietary contract created a substantial distortion between the base period and current period costs. The Board agrees with the Intermediary that a renegotiation of a contract is a normal business task and finds the HCFA methodology analyzing this expense was reasonable.

The Provider maintained that it had experienced an increase in its residents and intern program between the base year and current year. Accordingly, the Provider argued that it was entitled to an adjustment because the IME expenses had increased significantly. The Board notes that since the distinct psychiatric unit of the Provider was not a part of the Prospective Payment System, there is no separate IME adjustment. An adjustment for such expenses would be covered under changes in service intensity. Since the Provider supplied no evidence regarding service intensity, the Board finds that HCFA's analysis of this item was reasonable.

The Provider maintained that strike-generated expenses, due to a three day nurses strike during January 1988, increased nursing salary costs under the terms of the strike settlement. The Provider argued that this event was a circumstance beyond its control and therefore served as a basis for an exception to the TEFRA limits. The Board finds no Provider analysis of the financial effects of the strike in evidence. Therefore, the Board agrees with the HCFA analysis as shown in Exhibit 1 of Provider Exhibit P-8. The Board notes, however, that it did not find HCFA's argument regarding the Provider not experiencing a significant wage increase in excess of the national average hourly wage convincing.

The Board notes that the Provider requested it to direct the Intermediary to implement the adjustment HCFA granted for start-up costs related to the move after the earthquake. The Board notes that this was provided for in HCFA's analysis in Provider Exhibit P-8.

DECISION AND ORDER:

The Health Care Financing Administration properly denied portions of the Provider's request for exceptions and adjustments to the rate of increase ceiling ("TEFRA") for the exempt psychiatric unit. The Board affirms HCFA's determination.

Board Members Participating:

Irvin W. Kues
James G. Sleep
Henry C. Wessman, Esquire
Martin W. Hoover, Jr.

Date of Decision: July 30, 1998

FOR THE BOARD:

Irvin W. Kues
Chairman