PROVIDER REIMBURSEMENT REVIEW BOARD
HEARING DECISION

ON-THE-RECORD
2000-D15

PROVIDER -Medical Center of Orlando
Orlando, Florida

DATE OF HEARING-
October 10, 1999

Provider No. 10-0129

Cost Reporting Period Ended -
September 10, 1991

vs.

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

CASE NO. 94-1517

INDEX

ISSUE:

1. Does the recapture of depreciation due to the gain on the sale of depreciable assets have any effect on the Provider's equity capital for prior years?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

Medical Center of Orlando ("Provider") is a for profit, 1,163 bed, short-term acute care hospital located in Orlando, Florida. On September 10, 1991, the Provider was sold to an unrelated third party.[1] Because the sale resulted in a gain, Blue Cross and Blue Shield of Florida ("Intermediary"), in accordance with program rules, recaptured certain depreciation expenses previously allowed. The Intermediary, however, refused to apply the recaptured depreciation to the calculation of the Provider's return on equity capital ("ROE") for the same prior years.[2] On September 30, 1993, the Intermediary issued a Notice of Program Reimbursement for the subject cost reporting period, which did not reflect a recalculation of the Provider's ROE. On January 28, 1994, the Provider appealed the Intermediary's determination to the Provider Reimbursement Review Board ("Board") pursuant to 42 C.F.R. §§ 405.1835-.1841, and met the jurisdictional requirements of those regulations.[3] The amount of program funds in controversy is approximately $2,443,000.[4]

The Provider was represented by Patric Hooper, Esquire, of Hooper, Lundy and Bookman, Inc. The Intermediary was represented by Bernard M. Talbert, Esquire, of the Blue Cross and Blue Shield Association.

PROVIDER'S CONTENTIONS:

The Provider contends that the issue in this case is identical to the issue it brought before the Board in Parkway Regional Medical Center v. Blue Cross and Blue Shield Association/Blue Cross and Blue Shield of Florida, PRRB Dec. No. 98-D35, March 24, 1998, Medicare & Medicaid Guide (CCH) ¶ 46,173, decl'd rev. HCFA Administrator, May 20, 1998, aff'd. Parkway Regional Medical Center v. Shalala, No. 98-1100-Civ-Nesbitt (S.D. FL. 1999) ("Parkway"). Therefore, relying upon the arguments it brought in Parkway (Exhibit P-1), the Provider contends as follows:[5]

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[1] Provider's Position Paper at 2.

[2] Provider's Position Paper at 4. Intermediary's Position Paper at 6.

[3] Intermediary's Position Paper at 1.

[4] Provider's Amended Request for Board Hearing.

[5] Provider's Position Paper at 4.

The Provider contends that its equity capital should be adjusted for prior years for two reasons. First, the Provider argues that the Health Care Financing Administration ("HCFA") did not comply with the rule making requirements of the Administrative Procedure Act ("APA"), 5 U.S.C. § 553, in establishing the policy relied upon by the Intermediary until after the subject cost reporting period had ended. Therefore, the Provider maintains that the policy is not applicable to the transaction at issue in this case. Second, the Provider contends that there is a basis for the retroactive restatement of equity capital in the Medicare regulations and manual instructions, and notes previous Board decisions to that effect.

With respect to the rule making requirements of the APA, the Provider explains that the Intermediary's position is based upon Provider Reimbursement Manual, Part I ("HCFA Pub. 15-1") § 130, as amended in August 1984. This manual instruction prohibits an intermediary from making any adjustment to a provider's equity capital for prior years even though it has retroactively adjusted the provider's allowable depreciation expense as a result of a gain on sale.

The Provider points out, however, that the original version of HCFA Pub. 15-1 § 130, before its amendment in 1984, did not prohibit an adjustment to a provider's equity capital for prior years when a gain or loss on the disposal of depreciable assets occurred. Similarly, the governing regulation, 42 C.F.R. § 413.134(f)(1), did not prohibit an adjustment to a provider's equity capital in the event of a gain or loss on the disposition of depreciable assets. In 1992, HCFA amended the Medicare regulation at 42 C.F.R. § 413.134(f)(1), 57 Fed. Reg. 43906 (September 23, 1992), to provide that a gain or loss on disposition of depreciable assets has no retroactive effect on a proprietary provider's equity capital for years prior to the disposition. The Provider asserts that the Secretary of Health and Human Services ("Secretary") realized that the 1984 amendment to HCFA Pub. 15-1 § 130 constituted a substantive change in program policy, and it was this realization that prompted her to amend the governing regulation in 1992, i.e., to meet the requirements of the APA.

The Provider asserts that it is well established that the Secretary may not change or establish substantive Medicare reimbursement policy without complying with the rulemaking requirements of the APA. In Mt. Diablo Hospital Medical Center v. Bowen, 860 F.2d 951 (9th Cir. 1988), the court invalidated the application of Medicare policy issued by manual provision because the policy was not enacted in accordance with the rule-making requirements of the APA. Also, in Cedars-Sinai Medical Center v. Shalala, 939 F Supp. 1457 (C.D. Cal. 1996), aff'd in part, rev'd and remanded in part, 125 F.3d. 765 (9th Cir. 1997), the court found that Medicare manual instructions were invalid and void because they constituted a change in existing policy and had not been issued in accordance with the APA.

The Provider notes HCFA's position that the 1984 change to HCFA Pub. 15-1 § 130 was a clarification of existing policy as opposed to a change or establishment of new policy. The Provider disputes this claim by noting that the policy was not applied retroactively. In the HCFA Administrator's decision in Northgate General Hospital v. Ætna Life Insurance Company, PRRB Dec. No. 94-D16, March 30,1994, Medicare and Medicaid Guide (CCH) ¶ 42,215, aff'd. HCFA Administrator, June 3, 1994, Medicare and Medicaid Guide (CCH) ¶ 42,553 ("Northgate"), the retroactive recalculation of a

provider's ROE on a transaction prior to the 1984 amendment of HCFA Pub. 15-1 § 130 was permitted.

The Provider asserts that the Secretary may have remedied the procedural flaw with the 1992 regulation, but that the 1992 regulation may not be applied retroactively. The Provider cites Georgetown Hospital v. Sullivan, 488 U.S. 204 (1988), which holds that the Secretary does not have retroactive rule-making authority.

With respect to the Provider's second argument, the Provider notes that the Board has previously concluded that if depreciation of a provider's facility is recaptured there should be a corresponding recalculation of the provider's ROE. The Provider cites Deluxe Care Inn v. *Æ*tna Life Insurance Company, PRRB Dec. No. 94-D32, April 28, 1994, Medicare and Medicaid Guide (CCH) ¶ 42,409, rev'd. HCFA Administrator, June 24, 1994, Medicare and Medicaid Guide (CCH) ¶ 42,547 ("Deluxe Care"); Woodcliff Lake Manor Nursing Home, Inc. v. *Æ*tna Life Insurance Co., PRRB Dec. No. 91-D28, March 21, 1991, Medicare and Medicaid Guide (CCH) ¶ 35,151, mod'd. HCFA Administrator, May 17, 1991, Medicare and Medicaid Guide (CCH) ¶ 39,233 and Hassler Nursing Center v. *Æ*tna Life Insurance Co., PRRB Dec. No. 89-D44, June 13, 1989, Medicare and Medicaid Guide (CCH) ¶ 37,917 mod'd. HCFA Administrator, August 9, 1989, Medicare and Medicaid Guide (CCH) ¶ 37,990, aff'd. Hassler Nursing Center v. Sullivan, CV 89-2770 (JHG) (D.D.C. 1991), Medicare and Medicaid Guide (CCH) ¶ 39,631, where the Board expressly concluded that there is a basis for the retroactive restatement of equity capital in the Medicare regulations and manual instructions, which refers to the adjustment required when accelerated depreciation is converted to straight line depreciation.

The Provider acknowledges that the HCFA Administrator reversed each of the Board's determinations finding that a "windfall" occurs if the provider's equity capital is adjusted. The Board, however, found there was no windfall. See Deluxe Care, Medicare and Medicaid Guide (CCH) ¶ 42,409, at 40,310. According to the Board, depreciation is, in effect, the lost usefulness of the provider's original cost of its investment in plant, property and equipment related to patient care. Id. Reimbursement for depreciation expense is reimbursement for an allowable cost which represents the lost usefulness or wasting away of the provider's investment and is not comparable to the reasonable rate of return on equity which is capitalized, invested, and used in the provision of patient care. Id. According to 42 C.F.R. § 405.429 (redesignated § 413.157), ROE is paid in addition to the reasonable cost of covered services and thus, by recomputing the ROE, a provider is not receiving a windfall. Id.

In summary, the Provider contends that the 1984 policy prohibiting a recalculation of ROE was not a clarification of existing policy but a substantive change in policy which was not properly promulgated at the time of the transaction in the instant case. The Provider also contends that prior Board decisions allowing a recalculation of ROE were correct.

INTERMEDIARY'S CONTENTIONS:

The Intermediary contends that the issue in this case is identical to the issue brought before the Board in Parkway. Therefore, relying upon the arguments it brought in Parkway (Exhibit I-6), the Intermediary contends as follows:[6]

The Intermediary contends that it did not recalculate the Provider's ROE to reflect the gain on the sale of its depreciable assets because it is not permitted by program instructions at HCFA Pub. 15-1 § 130, which states:

> [d]epreciable assets may be disposed of through sale, scrapping, trade-in, donation, exchange, demolition, abandonment or involuntary conversion such as condemnation, fire, theft, or other casualty. If disposal of a depreciable asset results in a gain or loss, adjustment is necessary in the provider's allowable cost. The amount of gain included in the determination of allowable cost is limited to the amount of depreciation previously included in allowable costs. The amount of loss to be included is limited to the undepreciated basis of the asset permitted under the program. When an asset has been retired from active service but is being held for standby or emergency services, depreciation may continue to be taken on such assets. In no case, however, can gain or loss be computed on the retired asset until the asset is actually disposed of. A gain or loss on disposal of depreciable assets has no effect on a proprietary provider's equity capital for prior years.

HCFA Pub. 15-1 § 130 (emphasis added).

The Intermediary also contends that previous Board decisions addressing this matter, and relied upon by the Provider, have been overturned by the HCFA Administrator. In Deluxe Care, the HCFA Administrator stated:

> [t]he Board ruled that, if depreciation of the Provider's facility is recaptured, then there should be a corresponding recalculation of its return on equity capital for the cost years in which such return had been calculated on the basis of a depreciated value for the facility . . .
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> Medicare's return on equity capital does not reimburse a "cost" in an accounting sense, i.e., it is not reimbursement of "an expenditure or

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[6] Intermediary's Position Paper at 6.

> outlay of cash, other property, capital stock, or services . . . ." The return on equity capital is an allowance for profit. The return is a percentage of the value of the equity capital. It is paid to providers only if they are organized and operated with the expectation of making a profit.
>
> Moreover, retroactive recalculation of the return on equity capital would give the provider a windfall, i.e., a duplicate payment of profit. During the period between reimbursement and recapture, the Provider already had free use of the funds which Medicare paid to reimburse for depreciation expense. The Provider also had the opportunity to invest those funds and earn a profit. Retroactive recalculation of a return on equity capital would require Medicare to pay a second return on those funds which Medicare had already paid to the Provider. In recapturing the depreciation expense, the Medicare program does not seek to recapture any of the profits earned by the Provider on the use of these funds.

Deluxe Care, Medicare and Medicaid Guide (CCH) ¶ 42,547, at 41,193-4.

Accordingly, since the program's instruction precludes a recalculation of ROE, and previous Board decisions have been overruled, the Intermediary concludes that the Provider's request for a recalculation was properly denied.

CITATIONS OF LAWS, REGULATIONS AND PROGRAM INSTRUCTIONS:

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

42 U.S.C. § 1395x(v)(1)(A)	-	Reasonable Cost

2. Law - 5 U.S.C.:

§ 553	-	Administrative Procedure - Rule making

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

§ 405.429 (redesignated § 413.157)	-	Return on Equity Capital of Proprietary Providers
§§ 405.1835-.1841	-	Board Jurisdiction

§ 413.134 et seq. - Depreciation

4. Program Instructions - Provider Reimbursement Manual, Part I (HCFA Pub. 15-1):

§ 130 - Disposal of Assets
(Transmittal No. 313, August 1984)

5. Cases:

Parkway Regional Medical Center v. Blue Cross and Blue Shield Association/Blue Cross and Blue Shield of Florida, PRRB Dec. No. 98-D35, March 24, 1998, Medicare & Medicaid Guide (CCH) ¶ 46,173, decl'd rev. HCFA Administrator, May 20, 1998, aff'd. Parkway Regional Medical Center v. Shalala, No. 98-1100-Civ-Nesbitt (S.D. FL. 1999).

Cedar-Sinai Medical Center v. Shalala, 939 F. Supp. 1457 (C.D. Cal. 1996), aff'd. in part, rev'd. and remanded in part, 125 F.3d 765 (9th Cir. 1997).

Deluxe Care Inn v. Ætna Life Insurance Company, PRRB Dec. No. 94-D32, April 28, 1994, Medicare and Medicaid Guide (CCH) ¶ 42,409, rev'd. HCFA Administrator, June 24, 1994, Medicare and Medicaid Guide (CCH) ¶ 42,547.

Georgetown Hospital v. Sullivan, 488 U.S. 204 (1988).

Guernsey Memorial Hospital v. Shalala, 115 S.Ct. 1232 (1995).

Hassler Nursing Center v. Ætna Life Insurance Co., PRRB Dec. No. 89-D44, June 13, 1989, Medicare and Medicaid Guide (CCH) ¶ 37,917 mod'd. HCFA Administrator, August 9, 1989, Medicare and Medicaid Guide (CCH) ¶ 37,990, aff'd. Hassler Nursing Center v. Sullivan, CV 89-2770 (JHG) (D.D.C. 1991), Medicare and Medicaid Guide (CCH) ¶ 39,631.

Mt. Diablo Hospital District v. Bowen, 860 F.2d 951 (9th Cir. 1988).

Northgate General Hospital v. Ætna Life Insurance Company, PRRB Dec. No. 94-D16, March 30,1994, Medicare and Medicaid Guide (CCH) ¶ 42,215, aff'd. HCFA Administrator, June 3, 1994, Medicare and Medicaid Guide (CCH) ¶ 42,553.

Woodcliff Lake Manor Nursing Home, Inc. v. Ætna Life Insurance Co., PRRB Dec. No. 91-D28, March 21, 1991, Medicare and Medicaid Guide (CCH) ¶ 35,151, mod'd. HCFA Administrator, May 17, 1991, Medicare and Medicaid Guide (CCH) ¶ 39,233.

5. Other:

57 Fed. Reg. 43906 (September 23, 1992).

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 Intermediary properly refused to recalculate the Provider's prior years' ROE.

The Board finds that the Intermediary's decision not to recalculate the Provider's ROE was based upon a revision to HCFA Pub. 15-1 § 130, that was made in 1984. This revision specifically prohibits the revision of ROE to reflect the gain on the sale of a facility as in the instant case by stating: "[a] gain or loss on the disposal of depreciable assets has no effect on a proprietary provider's equity capital for prior years." Id. Moreover, the Board finds that HCFA considered the 1984 amendment to be a clarification of existing policy rather than a new rule by stating in Transmittal 313, the conveying document, the following:

> [t]his section has been clarified by adding a sentence at the end which indicates a gain or loss on the disposal of depreciable assets has no effect on a proprietary provider's equity for prior years. The basis for this clarification is that if the gain or loss did not exist in prior years, it could not represent a change in equity prior to the year of disposal. Any other interpretation is contrary to the regulations at 42 C.F.R. § 405.415(d)(3) which indicate the effect on equity capital in the respective year caused by recovery of accelerated depreciation should be recognized and 42 C.F.R. § 405.415(f) which does not recognize any prior year effect on equity with respect to gains and losses on disposal of assets.
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> NOTE: Because there has been misunderstanding with respect to this policy, intermediaries will take appropriate steps to assure proper implementation of this policy with respect to all assets and facilities disposed of after the month of this issuance. Intermediaries should not initiate action to reopen prior cost reporting periods. However, adjustments may be made based on specific provider requests for prior cost reports which may still be reopened under 42 C.F.R. § 405.1885.

Transmittal No. 313, August 1984.

The Board notes the Provider's argument that the 1984 amendment is invalid rendering the Intermediary's refusal improper. In particular, the Provider maintains that the amendment represents a

substantive change in program policy. Therefore, to be valid, the amendment would have had to been subject to a notice and comment period in accordance with the APA.

Contrary to the Provider's argument, the Board finds that HCFA's implementation of the 1984 amendment to HCFA Pub. 15-1 § 130 without the provision of a notice and comment period does not invalidate its application. The Board finds that the Secretary has already indicated by regulation that there should be recapture of depreciation and that only reasonable costs shall be reimbursed. The change to the manual instruction in Transmittal No. 313, which clarifies that there will be no retroactive adjustment to ROE, is consistent with these provisions. See Hassler Nursing Center v. Sullivan, supra. The courts have also ruled that HCFA may utilize its manual to establish consistent policies without violation of the APA. See Guernsey Memorial Hospital v. Shalala, 115 S.Ct. 1232 (1995). Although the manual does not have the effect of law as would a regulation, it is still available to enunciate interpretive rules that are not inconsistent with an existing regulation or statute.

The Board also notes that HCFA, in Transmittal No. 313, acknowledged that there was confusion prior to 1984 regarding its policy and that it would allow some providers to claim a retroactive ROE adjustment. See also Northgate, supra. The Board disagrees with the Provider's assertion that this is proof that the 1984 amendment was a change to existing policy or the establishment of a new substantive policy that had to be promulgated in accordance with the APA's notice and comment requirements.

In sum, the Board concludes that HCFA's 1984 amendment to HCFA Pub. 15-1 § 130 was a clarification of existing policy which did not violate the APA, and which is a reasonable interpretation of established statutes and regulations. Therefore, the Board finds that the 1984 amendment or clarification is applicable to the subject cost reporting period and is an appropriate basis for the Intermediary's decision not to restate the Provider's ROE.

The Board also notes the Provider's reliance on prior Boards' decisions regarding this matter and their favorable view towards the Provider's arguments. Respectively, the Board notes that its findings and conclusions in this case are consistent with the immediately preceding Board's decision in Parkview.

Finally, the Board finds there is no evidence in the record to indicate whether or not the Provider claimed reimbursement for the recalculation of its prior years' ROE in the subject cost report.

DECISION AND ORDER:

The Intermediary's refusal to recalculate the Provider's ROE was proper. The Intermediary's determination is affirmed.

Board Members Participating:

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

Date of Decision: February 7, 2000

FOR THE BOARD:

Irvin W. Kues
Chairman