PROVIDER REIMBURSEMENT REVIEW BOARD
HEARING DECISION

2000-D67

PROVIDER -
The Methodist Hospital
Houston, Texas

Provider No. 45-0358

vs.

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

DATE OF HEARING-
June 13, 2000

Cost Reporting Period Ended -
December 31, 1989

CASE NO. 94-0654

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ISSUE:[1]

Was the Intermediary=s adjustment reclassifying costs related to equipment which was part of a supply purchase agreement proper?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

The Methodist Hospital (AProvider/Methodist@) is a nonproprietary, general, short-term hospital located in Houston, Texas. The Provider entered into several supply contracts with vendors which allowed it the use of supplier owned equipment under the condition that the Provider purchase a minimum amount of supplies. Based on data furnished by the Provider for the fiscal year ended December 31, 1989, Blue Cross and Blue Shield of Texas (AIntermediary@) permitted a portion of the amounts paid on certain supply contracts to be classified as capital-related costs as part of the reopening of the Provider=s cost report and issuance of a Notice of Program Reimbursement dated July 23, 1993.[2] With respect to a supply contract entered into with Kardiothor on October 20, 1987,[3] the Provider obtained the use of eight (8) Baylor Rapid Auto Transfusion Systems (ABRATS@). The Purchase Agreement with Kardiothor included the following terms and conditions:

> Section A - Kardiothor agrees to provide eight (8) BRAT systems to Methodist as herein specified in exchange for the purchase by Methodist of BRAT disposables as described in paragraph B below.
>
> Section B - As consideration for the above, Methodist agrees to purchase a minimum of six thousand (6,000) disposable sets from Kardiothor, at a minimum rate of one hundred sets (twenty cases) per month.
>
> Section C - It is agreed between the parties that Kardiothor will retain title to the above eight BRAT systems until it has received payment in full as specified from Methodist for six thousand disposable sets, at which time Kardiothor will deliver title to Methodist.

The disposable sets were priced at $137 per set for a total minimum requirement under the supply

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[1] Except for the issue stated, all other issues previously appealed by the Provider have been administratively resolved or withdrawn from this case.

[2] See Provider Exhibit P-2.

[3] See Provider Exhibit P-3/Intermediary Exhibit I-3.

contract of $822,000. At the rate of 100 sets per month, title to the equipment would not be delivered to the Provider for five years. Based on the terms of the Purchase Agreement and a subsequent letter from COBE Laboratories, Inc., dated December 11, 1990,[4] the Provider proposed to capitalize the BRATS at a cost of $34,500 per unit (Total Value - $276,000), with the cost to be amortized over a five year term (1987-1991).

The Provider did not claim any of the costs for the AKardiothor@ contract on its initial cost report. However, in its request for reopening, the Provider did request that a portion of this contract be treated as capital-related costs. Upon review of the supply contract with Kardiothor, the Intermediary determined that the contract did not meet the requirements of the Medicare program for recognition as capital-related costs.[5] Accordingly, no adjustment was proposed by the Intermediary to classify any costs related to the eight BRATS as capital-related costs. The Provider appealed the Intermediary=s determination to the Provider Reimbursement Review Board pursuant to 42 C.F.R. '' 405.1835-.1841. The reimbursement effect estimated by the Intermediary is $16,600.

PROVIDER=S CONTENTIONS:

The Provider contends that the cost of the eight BRATS should be capitalized and depreciated over a five-year period. Although the original Purchase Agreement did not separately specify the capital-related portion of the charge, the terms clearly delineated that the Provider was acquiring capital equipment in conjunction with its purchase of disposable sets. Further, it was clear that the disposable sets did not have any independent value apart from the BRATS. Accordingly, the Provider believes that the documentation letter it received from COBE Laboratories, Inc., dated December 11, 1990, properly accounts for the capital and operating cost components that were implicit in the Purchase Agreement. This document advises that pricing for the eight BRATS was $34,500 each at the time the Provider entered into the Purchase Agreement.[6]

The Provider believes that its diligence in ensuring that the capital and operating cost components of its bundled pricing arrangement were properly considered is also consistent with the stated policy of the Health Care Financing Administration (AHCFA@). In support of this argument, the Provider cites the example included in the July 29, 1991 issue of the Federal Register, Volume 56, No. 145, which states the following regarding the necessity of accurate pricing:

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[4] See Provider Exhibit P-4/Intermediary Exhibit I-4. Note: Kardiothor was purchased by COBE Laboratories, Inc. on September 1, 1988 and assumed all outstanding agreements.

[5] See Intermediary Exhibit I-2.

[6] See Provider Exhibit P-4/Intermediary Exhibit I-4.

> The necessity of reporting the true acquisition costs of intraocular lenses (IOLs) undistorted by bundling arrangements is underscored by HCFA=s stated policy in its final rule promulgating a $200 add-on rate: Ato continue to collect data on IOL acquisition costs and purchasing arrangements to ensure that the IOL rate appropriately reflects lens acquisition costs.@

56 Fed. Reg. 35978 (Jul. 29, 1991).

The Provider concludes that it has presented clear and convincing evidence that the disposable set costs should be properly allocated between the capital and operating cost components implicit in the Purchase Agreement. This allocation would be properly effected by reducing supply costs by an amount equal to annual depreciation cost on the BRATS using a five year useful life. The Provider believes any other accounting would improperly shift costs on its Medicare cost report, thereby distorting its true cost participation in the Medicare program.

INTERMEDIARY=S CONTENTIONS:

The Intermediary contends that the supply contract between the Provider and Kardiothor does not meet the requirements of 42 C.F.R. '413.130 which set forth the Medicare program=s policy for treating costs from a supplying organization as capital-related cost. The Intermediary cites the provisions of 42 C.F.R '413.130(h)(2) which states the following:

> (2) Supplying organizations not related to the provider. If the supplying organization is not related to the provider within the meaning of '413.17, no part of the charge to the provider may be considered a capital-related cost (unless the services, facilities, or supplies are capital-related in nature) unless-
>
> > (i) The capital-related equipment is leased or rented (as described in paragraph (b) of this section) by the provider;
> >
> > (ii) The capital-related equipment is located on the provider=s premises, or is located offsite and is on real estate owned, leased or rented by the provider; and
> >
> > (iii) The capital-related portion of the charge is separately specified in the charge to the provider.

42 C.F.R. '413.130(h)(2).

The Intermediary argues that the supply contract does not meet the requirement of subparagraph (iii) because no separate charge was specified for the use of the equipment. Although the contract contains a clause allowing the title of the equipment to be delivered to the Provider, no specified amount is identified in the contract which could be considered rental expense for the equipment during the five year period. Further, the contract does not address what the Provider would be required to pay as rental of the equipment should the Provider fail to meet the minimum purchase of 6,000 disposable sets.

The Intermediary further contends that the letter submitted by the supplying organization in 1990, for the purpose of establishing a price for the BRATS, does not meet the requirements of 42 C.F.R. '413.130(h)(2) because the letter is not part of the contract nor an amendment to the contract. Moreover, the 1990 letter is subsequent to the effective date of the supply contract (October 20, 1987) and the 1989 fiscal year at issue. In addition, there is no documentation supporting the pricing amount for each BRAT system, and no acknowledgement signature by the Provider indicating agreement with the pricing of the equipment. The Intermediary concludes that its treatment of the total expense was in compliance with the regulation at 42 C.F.R. '413.130(h)(2), and the Board should affirm its determination.

CITATION OF LAW, REGULATIONS AND PROGRAM INSTRUCTIONS:

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

'' 405.1835 -.1841	-	Board Jurisdiction
' 413.130 et seq.	-	Introduction to Capital-Related Costs
' 413.130(h)(2) [Previously '413.130(g)(2)]	-	Costs of Supplying Organizations - Supplying Organizations Not Related to the Provider

2. Other:

56 Fed. Reg. 35978 (Jul. 29, 1991)

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

The Board, after consideration of the facts, parties contentions, and evidence in the record, finds and concludes that none of the payments made by the Provider pursuant to the Purchase Agreement with Kardiothor qualify as capital-related costs under the governing regulatory provisions of 42 C.F.R. ' 413.130(h)(2).

The regulation at 42 C.F.R. ' 413.130(h)(2) sets forth the following specific requirements which must be met by a supplying organization not related to the provider in order for charges to be treated as capital-related costs:

> (i) The capital-related equipment is leased or rented (as described in paragraph(b) of this section) by the provider;
>
> (ii) The capital-related equipment is located on the provider=s premises, or is located offsite and is on real estate owned, leased or rented by the provider; and
>
> (iii) The capital-related portion of the charge is separately specified in the charge to the provider.

42 C.F.R. ' 413.130(h)(2).

The Board finds that the Provider did not meet the requirement of subparagraph (iii) of the regulation which requires the capital-related portion of the charge to be separately specified in the charge to the provider. The record shows that the Provider entered into a Purchase Agreement with Kardiothor, dated October 20, 1987, which sets forth the terms and conditions for the sale of eight BRATS and the purchase of disposable sets to be used with the BRATS. The Provider and Kardiothor respectively signed the Purchase Agreement on January 28th and February 5th of 1988, and agreed that the Purchase Agreement was a binding contract constituting the complete agreement.[7] While the Purchase Agreement established a specific charge of $137 for the disposable sets to be used with the BRATS, the Purchase Agreement is void of any provision which could be utilized to establish a separate specific charge for the capital-related portion relating to the purchase of the BRATS. In addition to the absence of an identifiable capital-related amount at the time the Purchase Agreement was formalized, the Board observes that no contemporaneous billings from the Kardiothor have been included in the record which would provide supportive documentation of the capital-related portion of the charge incurred by the Provider.

With respect to the letter submitted by COBE Laboratories, Inc. dated December 11, 1990,[8], the Board finds this belated attempt to comply with the separate charge requirement of the regulation to be inadequate and without legal standing. This letter is not an amendment to the Purchase Agreement, and cannot be subsequently integrated into a contractual agreement that was consummated three years

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[7] See Provider Exhibit P-3/Intermediary Exhibit I-3.

[8] See Provider Exhibit P-4/Intermediary Exhibit I-4.

earlier. Even if the letter could be construed to be a part of the original agreement, it would have no application for the 1989 fiscal year in contention. In the absence of any evidence which would establish the Provider=s compliance with the provisions of 42 C.F.R. ' 413.130(h)(2), the Board concludes that the Purchase Agreement was for the acquisition of supplies which were not capital-related in nature.

DECISION AND ORDER:

The Intermediary properly classified costs related to equipment which was part of a supply purchase agreement. The Intermediary=s determination is affirmed.

Board Members Participating:

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

FOR THE BOARD

Irvin W. Kues
Chairman