PROVIDER REIMBURSEMENT REVIEW BOARD DECISION

2017-D31

PROVIDER –
Pocahontas Community Hospital

Provider No.: 16-1305

vs.

MEDICARE CONTRACTOR –
Wisconsin Physicians Service

DATE OF HEARING -
July 7, 2015

Cost Reporting Periods Ended -
June 30, 2011; June 30, 2012 and
June 30, 2010

CASE NOs.: 13-3331, 14-1269
and 14-3176

INDEX

ISSUE:

Whether the Wisconsin Physician Services ("Medicare Contractor")[1] improperly disallowed certain home office costs claimed by Pocahontas Community Hospital ("Pocahontas or Provider") on the grounds that it was not related to the entity that had furnished the services.[2]

DECISION:

After considering the Medicare law and regulations, the parties' contentions, and the evidence submitted, the Provider Reimbursement Review Board ("Board") finds that Pocahontas is related to Trinity Health Systems ("THS") within the meaning of Medicare "related organization" principles. Accordingly, the Board remands Pocahontas' cost reports for fiscal years ("FYs") 2010, 2011, and 2012 to the Medicare Contractor for audit, to determine if the costs incurred by THS and included by Pocahontas on these cost reports as home office costs, are reasonable and necessary.

INTRODUCTION:

Pocahontas is a 25-bed critical access hospital established by the City of Pocahontas, Iowa, under provisions of the Code of Iowa governing municipal hospitals.[3] During the relevant period, Pocahontas had a relationship with THS to assist Pocahontas in providing services to the community and reported the THS' costs as allowable home office costs on its as-filed cost reports for FYs 2010-2012.

On October 4, 2011, the Medicare Contractor issued a Notice of Program Reimbursement ("NPR") for FY 2010[4] which, consistent with previous years, included payment for the home office costs reported on the as-filed cost report. Months later, on July 3, 2012, the Medicare Contractor reopened the FY 2010 cost report and disallowed the home office costs on the basis that THS had no ownership of, or control over, Pocahontas and that Pocahontas and THS were not related entities. The Medicare Contractor removed the allocation of THS' home office from the cost report.[5] The Medicare Contractor made similar determinations for Pocahontas' cost reports for FYs 2011 and 2012.

Pocahontas timely appealed the Medicare Contractor's final determinations to the Board and met the jurisdictional requirements for a hearing. A live hearing was conducted on July 7, 2015. Robert E. Mazer, Esq. of the law firm, Ober, Kaler, Grimes & Shriver represented Pocahontas. David Sayers of the BlueCross BlueShield Association represented the Medicare Contractor.[6]

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[1] CMS' payment and audit functions under the Medicare program were historically contracted to organizations known as fiscal intermediaries ("FIs") and these functions are now contracted with organizations known as Medicare Administrative Contractors ("MACs"). The term "Medicare Contractor" refers to both FIs and MACs as relevant.

[2] Transcript ("Tr.") at 5-6.

[3] *See* Provider's Post Hearing Brief at 4.

[4] Provider Exhibit P-4.

[5] Medicare Contractor's Consolidated Final Position Paper at 7-9.

[6] The BlueCross BlueShield Association was subsequently replaced by Federal Specialized Services.

STATEMENT OF FACTS

During the cost years being appealed, THS was a controlled subsidiary or "senior affiliate" of Iowa Health System ("IHS"). IHS, as a regional health care system, delivered heath care throughout the State of Iowa. Through its senior affiliates, IHS assisted smaller community hospitals in rural areas to provide health care services and comply with Medicare requirements for critical access hospitals.[7]

Pocahontas is governed by a five member Board of Trustees ("Trustees") who are elected by the citizens of Pocahontas County.[8] Pocahontas serves approximately 9,000 people in Pocahontas County each year.[9] Pocahontas and THS entered into a Hospital Management Agreement in which THS would provide numerous management services including employing the Administrator/CEO of Pocahontas. This Agreement began in 1995 and was renegotiated in 2010.[10]

On January 1, 2008, Pocahontas, THS and Mr. James Roetman entered into an Employment Agreement where THS agreed to employ Mr. Roetman as Pocahontas' Administrator/CEO.[11] As the Administrator/CEO, Mr. Roetman was responsible for oversight of Pocahontas' personnel, budgets, and recommendations for the purchase of equipment, supplies and services, and oversaw Pocahontas' physical plant, buildings and grounds. He also supervised all business affairs for Pocahontas including financial transactions, collection of accounts, and insuring that all funds are collected and expended to the best possible advantage of Pocahontas.[12]

The second and more comprehensive Management Agreement between THS and Pocahontas became effective on July 1, 2010. This Agreement continued the relationship in which THS provided Pocahontas with a full time Administrator/CEO with the authority to "conduct, supervise and effectively manage the day-to-day operations of the Hospital". The management agreement also specified that THS would supply, subject to availability, assistance with special projects, temporary staff and education services for Pocahontas.[13]

In addition to the Management and Employment Agreements, Pocahontas and Trinity Regional Medical Center ("TRMC"), a subsidiary of THS, were parties to a Critical Access Hospital ("CAH") Network agreement which permitted Pocahontas to satisfy Medicare's requirements for critical access hospitals.[14] In particular, the CAH Network agreement allowed Pocahontas to transfer patients who were in need of a higher level of care to TRMC for treatment.[15] The CAH Network agreement also provides for TRMC participation in Pocahontas' quality assurance, peer review and credentialing programs.[16]

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[7] *See* Provider's Final Position Paper at 1.
[8] *See* Provider's Post Hearing Brief at 4.
[9] Tr. at 26.
[10] *See* Provider's Post Hearing Brief at 4-5; Provider Exhibit P-6 at 5-14; 51-55.
[11] Provider's Final Position Paper at 15-20.
[12] *See* Provider Exhibit P-6 at 15-21.
[13] *See id.* at 5-14.
[14] *See* Provider's Post Hearing Brief at 6. *See also* 42 C.F.R. §§ 485.616, 485.641(b)(4).
[15] Provider Exhibit P-6 at 62.
[16] *Id.* at 62-69.

Finally, TriMark Physicians group, also a subsidiary of THS, staffed the Hospital with two family practice physicians and two nurse practitioners. TriMark specialists came to Pocahontas on a regular basis to see patients in the outpatient clinics. The TriMark physicians met monthly with Pocahontas' staff to review and approve policy changes, credentialing and re-credentialing, and quality plans and indicators.[17]

Federal regulations at 42 C.F.R. § 413.17 (2008) direct how Medicare handles cost for "related organizations." Section (a) of this regulation states the principle of related organization costs as follows:

> (a) *Principle*. . . . [C]osts applicable to services, facilities, and supplies furnished to the provider by organizations related to the provider by common ownership or control are includable in the allowable cost of the provider at the cost to the related organization. However, such cost[s] must not exceed the price of comparable services, facilities, or supplies that could be purchased elsewhere.

Section (b) of this regulation defines related organizations as follows:

> (1) *Related to the provider.* Related to the provider means that the provider to a significant extent is associated or affiliated with or has control of or is controlled by the organization furnishing the services, facilities, or supplies.
>
> (2) *Common ownership*. Common ownership exists if an individual or individuals possess significant ownership or equity in the provider and the institution or organization serving the provider.
>
> (3) *Control*. Control exists if an individual or an organization has the power, directly or indirectly, significantly to influence or direct the actions or policies of an organization or institution.

CMS provides guidance on this regulation in the Provider Reimbursement Manual ("PRM") 15-1. Specifically, § 1000 reiterates the regulatory criteria of 42 C.F.R. § 413.17(a)—that the costs which related organizations furnish are includable in the provider's allowable costs and that these costs cannot exceed the price of comparable services that could be purchased elsewhere—and adds:

> The purpose of this principle is two-fold: (1) to avoid the payment of a profit factor to the provider through the related organization (whether related by common ownership or control), and (2) to avoid payment of artificially inflated costs which may be generated from less than arm's-length bargaining.

[17] Tr. 117, 137 - 139.

The manual further explains the situation where a contract creates the related organization relationship in § 1011.1 which states:

> If a provider and a supplying organization are not related before the execution of a contract, but common ownership **or control** is created at the time of execution by any means, the supply contract will be treated as having been made between related organizations (emphasis added).

Finally, § 1004.3 defines the term "control" as follows:

> The term "control" includes any kind of control, whether or not it is legally enforceable and however it is exercisable or exercised. It is the reality of the control which is decisive, not its form or the mode of its exercise.

The parties dispute whether the above regulatory and manual guidance on related organizations supports the Medicare Contractor's adjustments to remove the amounts claimed by Pocahontas as related organization/home office costs from THC.

DISCUSSION, FINDINGS OF FACT, AND CONCLUSIONS OF LAW

A. DISCUSSION RELATED TO RELATED PARTY STATUS

The Medicare Contractor contends that the management agreement between Pocahontas and THS did not allow the Pocahontas to claim THS' home office costs as a related organization. The Medicare Contractor asserts that Pocahontas' Board of Trustees is the governing body responsible for the management, control, policy making, operations and direction of Pocahontas.[18] The Medicare Contractor points out that the 1995 management agreement states that "it is further understood and agreed that Pocahontas Board of Trustees shall be responsible for the control, policy making, operations, and directions of Pocahontas…"[19] Further the Medicare Contractor points out the 2010 agreement similarly specifies that "[t]he Hospital Board shall retain all authority over the hospital granted to it under Iowa law and its Bylaws…"[20] The Medicare Contractor maintains that, while the Administrator/CEO of Pocahontas may have some influence over Pocahontas, the Administrator's influence is primarily related to his job responsibilities. The Medicare Contractor concludes that the Trustees control Pocahontas and, as a result, THS is not a related organization.[21] As THS provides services to the Pocahontas through a management agreement, the Medicare Contractor limited the management costs to the actual amounts that the Pocahontas incurred.[22]

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[18] Medicare Contractor's Final Position Paper at 8.
[19] Medicare Contractor's Post Hearing Brief at 2; Provider Exhibit P-6 at 55.
[20] Medicare Contractor's Post Hearing Brief at 2; Provider Exhibit P-6 at 10.
[21] Medicare Contractor's Consolidated Final Position Paper at 9-12.
[22] Tr. at 239; Provider Exhibit 49 at 5.

The Medicare Contractor relies primarily on PRM 15-1 § 2135 which provides detailed guidance related to purchased management and administrative support services.[23] The Medicare Contractor asserts that Pocahontas failed to document the costs and services associated with its contracts. The Medicare Contractor submitted a Request for Production of Documents and Interrogatories to obtain documentation to show what services were rendered, as well as invoices and payment records. However, Pocahontas failed to respond.[24] Specifically, the Medicare Contractor explains that Pocahontas has not submitted the documentation as specified at § 2135.5 "a" through "f" and that, if the Board finds that THS and Pocahontas are related organizations, the cases must be remanded back to the Medicare Contractor for review to determine the extent to which the claimed home office costs are allowable.[25]

Pocahontas argues that THS qualifies as a related party under Medicare rules governing related party determinations because THS significantly influences Pocahontas' actions and policies.[26] In support of its position, Pocahontas points to CMS' related organization regulations which define the term "control" to mean "the power to directly or indirectly *significantly* to influence or direct the actions or policies of an organization."[27] Pocahontas further notes that the PRM 15-1 definition for "control" makes clear that "any kind of control" suffices "whether or not it is legally enforceable and however it is exercisable or exercised."[28] Based on these definitions, Pocahontas asserts the Medicare Contractor is simply wrong in its new interpretation of the related organization rules.[29]

Finally, Pocahontas points out that the Medicare Contractor accepted THS' home office cost statement reflecting both the home office costs incurred by THS and the allocation of such costs to Pocahontas and asserts that it cannot now reverse these determinations through the settlement process of the provider's cost report.[30] Pocahontas also argues that, if the Board finds the these organizations are related parties, 42 C.F.R. § 405.1871(b)(5) does not provide for a remand to the Medicare Contractor to make a second, and different, determination on the claimed home office costs.[31]

The Board finds that the Medicare regulation, specifically 42 C.F.R. § 413.17(b)(3), broadly defines the term "control" as "the power, directly or indirectly, significantly to influence or direct the actions or policies of an organization or institution." Similarly, program guidance at PRM 15-1 § 1004.3 defines "control" to include "any kind of control, whether or not it is legally enforceable and however it is exercisable or exercised." Based on these definitions, it is clear that THS controlled Pocahontas because the evidence in these cases demonstrates that THS had significant influence over the management staff, policies and day-to-day operations of

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[23] Medicare Contractor's Final Position Paper at 6-7.
[24] *Id.* at 14; Medicare Contractor Exhibit I-5. The Provider responded to the Medicare Contractor's Requests on April 22, 2015. *See* Provider's Rebuttal to Medicare Contractor's Final Position Paper at 11n.7; Provider Exhibit P-48.
[25] Medicare Contractor's Final Position Paper at 7.
[26] Provider's Post Hearing Brief at 8.
[27] *Id.* (quoting 42 C.F.R. § 413.17(b)(3)) (emphasis added).
[28] Provider's Post Hearing Brief at 23 (quoting PRM 15-1 § 1004.3).
[29] Provider's Post Hearing Brief at 8.
[30] Provider's Post Hearing Brief at 29-30.
[31] Provider's Post Hearing Brief at 30-33.

Pocahontas and that this control was beyond that of a typical management contract. Thus, the Board finds that the Pocahontas is related to THS within the meaning of Medicare "related organization" principles.

THS employs the Administrator/CEO for Pocahontas.[32] This individual is on THS' payroll and runs the day-to-day operations of Pocahontas and is answerable to THS.[33] The Administrator/CEO of Pocahontas testified that THS acts as an ongoing resource for professional, legal, financial, and regulatory services. The Administrator/CEO stated that TriMark Physicians Group, a subsidiary of THS, provided two family practice doctors and two nurse practitioners that comprised the Pocahontas' Medical Staff Committee and was responsible for credentialing, compliance and quality.[34]

The record demonstrates that THS provided operational policies and procedures that Pocahontas adopted. Pocahontas' witnesses testified that, when Pocahontas reviewed a new policy, it would "usually get a policy that was already in place or a recommendation from the system related to that policy and then we change it or tweak it to meet the needs of our facility."[35] The witness noted that this strategy ensured that "we were giving the same quality of care and following the same rules and regulations throughout the entire system…"[36]

Finally the record shows that Pocahontas is a small CAH and that the Pocahontas' Trustees were elected community leaders who had no background or experience in healthcare.[37] In providing direction to the Trustees, THS supplied the experience and expertise required to manage a healthcare entity that neither Pocahontas nor the local community had. The Administrator/CEO testified that he could not remember a time when his recommendation to the Trustees was not approved.[38]

In evaluating this evidence, the Board concludes that THS has the power, directly or indirectly, to significantly influence or direct the actions or policies of Pocahontas. As such, under Medicare rules, Pocahontas and THS can be considered related parties under Medicare rules governing related party determinations.

B. DISCUSSION RELATING TO REASONABLE AND NECESSARY COSTS

While the Board agrees and has determined that Pocahontas is a related party of THS under Medicare's rules, the Board does not agree that the Medicare Contractor, by simply accepting THS' home office cost statement, also accepted the reasonableness of the home office costs. The Board agrees with the Medicare Contractor that Medicare's reasonable cost principles apply to home office costs and concludes that a remand is necessary to determine the propriety of these costs.

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[32] Provider Exhibit P-6 at 5, 15, 52-53.
[33] *Id.* at 6, 16.
[34] Tr. at 136-139.
[35] Tr. at 134-135.
[36] Tr. at 135-136.
[37] Tr. at 141.
[38] Tr. at 148.

The Board reviewed the Medicare Contractor's home office adjustments for the fiscal years at issue and noted that these adjustments removed THS' related organization home office costs *in toto* from Pocahontas' cost reports.[39] The Medicare Contractor stated that these amounts had not been reviewed as THS and Pocahontas were determined not to be related.[40] The Board finds that the Medicare Contractor's determinations did not accept the home office costs at issue but rather stated that amounts had not been reviewed.

The Board also finds that reasonable cost principles do apply to costs from home offices.[41] Specifically, Medicare regulations at 42 C.F.R. § 413.17(a) allow a provider to claim the cost of services provided by organizations related to the provider by common ownership or control, as long as these costs do not exceed the price of comparable services. The intent of this provision is to ensure that Medicare does not pay artificially inflated costs which may be generated from less than arm's length bargaining. Additionally, PRM 15-1, § 1005 specifies that the "principles of reimbursement of provider costs described elsewhere in this manual will generally be followed in determining the reasonableness and allowability of the related organization's costs."

The Board further concludes that it does have the authority to remand Pocahontas' Medicare cost reports for the fiscal years at issue to the Medicare Contractor for a review of the home office costs. In 2008, CMS amended federal regulations governing Medicare reimbursement determinations and appeals to add 42 C.F.R. § 405.1871(b)(5).[42] As a procedural matter, the regulation instructs:

> When the intermediary's denial of the relief that the provider seeks before the Board is based on procedural grounds…or is based on an alleged failure to supply adequate documentation to support the provider's claim and the Board rules that the basis of the intermediary's denial is invalid, the Board remands to the intermediary for the intermediary to make a determination on the merits of the provider's claim.

Pocahontas asserts that the application of this regulation is limited to situations where the Medicare contractor's adjustments were based on procedural grounds or lack of documentation and that the Medicare Contractor's denial does not fall within either situation.[43] The Board disagrees because the Medicare Contractor's denial was "based on . . . a lack of documentation" to support the condition precedent to auditing home office costs (*i.e.*, based on a finding of insufficient documentation to support a related party determination).[44]

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[39] *See* Provider Exhibits P-11 at 3, P-14 at 3, P-17.
[40] *See* Medicare Contractor's Consolidated Final Position Paper at 9, 11. *See also* Tr. at 273-275.
[41] As stated in PRM 15-1 § 2150, the Medicare program does not recognize home offices as Medicare providers and, as a result, does not directly reimburse home offices for their costs related to patient care. Rather, to the extent the home office furnishes services related to patient care to a provider, the reasonable costs of such services are includable in the provider's cost report and are reimbursable as part of the provider's costs.
[42] 73 FR 30190, 30261 (May 23, 2008).
[43] *See* Provider's Post Hearing Brief at 31-33.
[44] Moreover, the Board notes that 42 C.F.R. § 405.1871(b)(5) does not prevent the Board from exercising its discretion to issue a remand.

In the cases at hand, the Medicare Contractor never reached a determination regarding the amount or validity of the home office costs because it made a determination that Pocahontas and THS were *not* related parties and allowed only THS' fees. Accordingly, the Medicare Contractor did not audit the home office costs and never reached the merits of Pocahontas' claim. The Board finds that Pocahontas and THS are, in fact, related organizations, thus removing the restriction on payment arising from the Medicare Contractor's finding that the parties were not related. However, since the home office costs themselves have never been audited or otherwise validated by the Contractor, the Board remands these cases back to the Medicare Contractor for audit and verification per applicable Medicare cost reimbursement rules and principles.

DECISION AND ORDER

After considering the Medicare law and regulations, the parties' contentions, and the evidence submitted, the Board finds that Pocahontas is an organization related to THS within the meaning of Medicare "related organization" principles.

Accordingly, the Board remands Pocahontas' cost reports for FYs 2010, 2011, and 2012 to the Medicare Contractor for audit to determine if the costs, incurred by THS and included by Pocahontas on these cost reports, are reasonable and necessary.

BOARD MEMBERS PARTICIPATING

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FOR THE BOARD:

/s/
L. Sue Andersen, Esq.
Chairperson

DATE: September 29, 2017