PROVIDER REIMBURSEMENT REVIEW BOARD
HEARING DECISION

ON-THE-RECORD
98-D3

PROVIDER -Palo Verde Hospital
Tucson, Arizona

Provider No. 03-4001

vs.

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

DATE OF HEARING-
September 4, 1997

Cost Reporting Period Ended -
June 30, 1986 and June 30, 1987

CASE NO. 91-0133

INDEX

ISSUE:

Is the Provider entitled to an adjustment to its TEFRA limits for malpractice insurance costs for FYEs June 30, 1986 and June 30, 1987?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

Palo Verde Hospital ("Provider") is a non-profit psychiatric facility located in Tucson, Arizona.
On May 26, 1988, the Provider submitted to Blue Cross of Arizona ("Intermediary"), a request for an adjustment to its TEFRA target amount per discharge for FYE 6/30/86. The basis for this request included several areas including relocation expenses, increased malpractice insurance expenses, the addition of an adolescent/child care unit which altered the Provider's case mix and increased ancillary costs, the addition of a 12-bed ICU which created a substantial distortion between base year and FYE 6/30/86 costs, and increased costs due to the implementation of an approved medical education program. The Provider subsequently withdrew its request for an adjustment based on relocation costs.

On March 21, 1989, the Provider submitted to the Intermediary a request for an adjustment to its TEFRA target amount per discharge for FYE 6/30/87. The basis for the Provider's FYE 6/30/87 adjustment request included all of those items mentioned above in its request for FYE 6/30/86.

The Intermediary analyzed the FYE 6/30/86 and FYE 6/30/87 requests together. After reviewing the Provider's adjustment requests, the Intermediary forwarded its recommendation to the Health Care Financing Administration ("HCFA").[1] In that document, which was dated August 31, 1989, the Intermediary recommended approval of the Provider's request as it related to the increase in malpractice insurance costs, the addition of an ICU, and the establishment of an approved graduate medical education program.

On May 3, 1990, HCFA rendered a single decision on the Provider's TEFRA requests for FYE 6/30/86 and FYE 6/30/87.[2] HCFA agreed that higher malpractice costs could result in a distortion in the comparison of base year costs to present year costs. However, HCFA did not agree with the methodology used in determining the amount of the exception. In reviewing the Provider's 1986 cost report, HCFA found there were no malpractice insurance costs apportioned to Medicare Part A. Therefore, HCFA concluded no adjustment was warranted for fiscal year 1986.[3] Moreover, HCFA limited the amount of the exception for fiscal year

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1 See Intermediary Exhibit I-2 and Provider Exhibit P-1.

2 See Intermediary Exhibit I-1and Provider Exhibit P-2.

3 Id.

1987 to the difference between base period malpractice costs and the costs apportioned to Medicare Part A on the cost report.[4] Except for the above stated issue, all other issues previously appealed by the Provider have been withdrawn or failed to meet the jurisdictional requirements of the Provider Reimbursement Review Board ("Board").[5]

On October 1, 1990, the Provider appealed the adverse portions[6] of HCFA's determination to the Board pursuant to 42 C.F.R. §§ 405.1835-.1841, and has met the jurisdictional requirements of those regulations for the issue stated above. The Medicare reimbursement effect is approximately $17,000 and $24,500 for FYEs June 30, 1986 and June 30, 1987 respectively.[7] The Provider was represented by Anita D. Lee, Esquire of Weissburg and Aronson, Inc. The Intermediary was represented by Bonnie Irwin, Audit and Reimbursement Manager, Blue Cross and Blue Shield of Arizona.

Facts:

42 C.F.R. § 413.40, formerly 42 C.F.R. § 405.463, implements § 1886(B) of the Social Security Act establishing a ceiling on the rate of increase of operating costs per case for inpatient hospital services that will be recognized as reasonable for purposes of determining Medicare reimbursement. Procedures are outlined under this regulation for a provider of service to file for an exception to the rate that had been established in its base year.

PROVIDER'S CONTENTIONS:

The Provider maintains that since its base year, it has experienced an extraordinary increase in the cost of providing malpractice insurance for its facility which was beyond its ability to control. Accordingly, it requested an exception to its TEFRA limit under 42 C.F.R. § 413.40(g)(2), to account for the uncontrollable increases in malpractice insurance costs. The

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4 Id.

5 On December 28, 1992, the Provider requested that the Board add to its appeal a challenge to the 1979 and 1986 Malpractice Rules. The Board considered the positions of both parties and found the request to appeal the 1979 and 1986 Malpractice Rules was untimely filed, and therefore, the Board does not have jurisdiction over the issue. As a result, the appeal at issue here is limited to the Provider's original appeal of the adjustments to the TEFRA limits.

6 Provider's original appeal included three issues related to adjusting the TEFRA limits: high malpractice insurance costs, creation of an ICU, and a change in Medicare patient mix. The latter two issues were withdrawn by the Provider, leaving the high malpractice insurance costs as the sole issue in this appeal.

7 Intermediary Position Paper at 2.

Provider points out that an exception to the TEFRA limit is to be granted under § 413.40(g)(2) whenever the provider incurs "unusual costs (in either a cost reporting period subject to the ceiling or the hospital's base period) due to extraordinary circumstances beyond the hospital's control." Id.

The Provider contends that its malpractice insurance expenses are classic examples of costs for which an extraordinary circumstances exception should be granted. Its malpractice insurance costs skyrocketed during the mid-1980's from $11,284 during its base period, to $91,790 in FYE 6/30/86 and $95,244 in FYE 6/30/87.[8]

The Provider explains its higher insurance costs did not arise because it increased its coverage. The Provider maintained the same level of malpractice insurance coverage as it had during its base period.[9] The Provider points out it made concerted efforts to contain its insurance costs during the fiscal years at issue. Due to rate increases throughout the industry, the Provider's rates rose despite its efforts to control costs. One important factor in the insurance companies' rate setting decisions was the overall loss experience in the state of Arizona, which was much higher than the Provider's own loss experience.[10] Other factors, such as reductions in the insurance industry's revenue from outside investments and general uncertainty in the insurance industry over judgment amounts in lawsuits, also led to extraordinary rate increases. The Provider contends these factors were beyond its ability to control.

The Provider contends its unadjusted TEFRA limit does not properly reflect its higher insurance costs. The TEFRA limits for FYE 6/30/86 and FYE 6/30/87 were set by updating data from FYE 6/30/83 using a projection for annual inflation in the cost of providing hospital services known as the "market basket." The annual market basket increases used to compute the Provider's TEFRA limit were 5.95% for 1984, 6.25% for 1985, 6.8% for 1986 and 3.9% in 1987. In actuality, however, the Provider points out its malpractice insurance premiums for 1986 were approximately 7.7 times higher than the base period and malpractice insurance premiums for 1987 were approximately 8.0 times higher than the base period.[11] Accordingly, the market basket does not account for the unusually large increases in insurance premiums experienced here. Given the inordinate increase in its insurance costs since its base period, the Provider believes that an exception must therefore be granted.

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8 Provider Position Paper at 11.

9 See Provider Exhibit P-7.

10 Provider Exhibit P-8.

11 Provider Position Paper at 12.

The Intermediary has acknowledged that a steep increase in insurance expenses constitutes the basis for an exception. In its recommendations to HCFA regarding this aspect of the Provider's request, the Intermediary affirmed that the significant increase in the Provider's malpractice insurance expense was an extraordinary circumstance beyond its control.[12] Based on its initial review, the Intermediary recommended an adjustment of $60.20 per discharge for FYE 6/30/86 and $82.61 per discharge for FYE 6/30/87.[13]

In granting the Provider a limited exception for malpractice insurance costs for FYE 6/30/87, the Provider contends that HCFA too has expressly recognized that the increase in its malpractice insurance costs could constitute a valid basis for an exception to its TEFRA limit in accordance with 42 C.F.R. § 413.40(g)(2). However, in denying relief for FYE 6/30/86 and in reducing the recommended exception for FYE 6/30/87, HCFA did not agree with the methodology used by the Intermediary to calculate the adjustment.[14] More particularly, HCFA granted an exception only for the difference between those malpractice insurance costs which were actually reimbursed by Medicare in the base period and those which were actually reimbursed in the current periods. Because no malpractice insurance costs were reimbursed under Medicare Part A for the Provider's FYE 6/30/86 period, HCFA concluded that the Provider was not entitled to an exception for malpractice insurance for that year. Similarly, because only $6,238 in malpractice insurance expense was allowed under Medicare Part A for FYE 6/30/87, HCFA limited the exception granted to the Provider for FYE 6/30/87 to $4,382 (i.e. $6,238 minus $1,856 in costs already in the TEFRA limit).[15]

The Provider acknowledges that the exception for malpractice insurance costs should be based on the expenses which Medicare allows, however it initiated this appeal because it believes Medicare failed to recognize an appropriate share of its malpractice insurance costs.[16] The Provider believes that the exception for extraordinary malpractice insurance costs granted by HCFA is understated.[17] As discussed below, the Provider had more malpractice costs allowed during FYE 6/30/87 than HCFA recognized in calculating the exception. Therefore,

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12 Intermediary Exhibit I-2, Pg. 3.

13 Id., Pg. 6-7. The final overall recommendation by the Intermediary, however, reduced these amounts so that the Provider would not receive a "windfall" and would receive only the lower of actual Medicare costs (FY 1986) or the TEFRA target amount plus adjustments (FY 1987).

14 Intermediary Exhibit I-1 and Provider Exhibit P-2.

15 Provider Exhibit P-2 and Intermediary Exhibit I-1.

16 Provider Position Paper at 14.

17 Provider Position paper at 14-15.

it should recalculate the TEFRA exception using all of the malpractice insurance costs allowed during FYE 6/30/87.

The Provider explains that according to its FYE 6/30/87 audited cost report, the total risk component for malpractice insurance equaled $95,244 and its total administrative component for malpractice insurance equaled $8,096.[18] Costs in the administrative component were assigned to administrative and general cost center and then stepped down to the Provider's inpatient areas and apportioned to Medicare. However, when analyzing the Provider's exception request for FYE 6/30/87, the Provider contends that HCFA ignored amounts reimbursed under the administrative component and determined that total allowable malpractice costs for the period equaled the $6,238, reimbursed under the risk component.[19] The Provider asserts that allowable malpractice costs also include expenses from the administrative component. Therefore, the Provider believes that total allowable malpractice expenses for FYE 6/30/87 should also include the amount for the administrative component. Accordingly, the TEFRA exception for FYE 6/30/87 should be recalculated.

In summary, the Provider feels it is entitled to have its TEFRA limits for FYEs 6/30/86 and 6/30/87 increased, beyond HCFA's determination, to reflect significant increases in malpractice insurance costs.

INTERMEDIARY'S CONTENTIONS:

The Intermediary points out that HCFA did conditionally allow a TEFRA target rate exception for medical education costs for FYE 6/30/86.[20] The medical education exception increased the TEFRA ceiling amount to the Provider's overall Medicare costs.[21] Therefore, the Intermediary contends that the Provider is precluded from having its TEFRA target amount per discharge exceed its actual costs for FYE 6/30/86. The Intermediary maintains that the maximum adjustment possible for the Provider is the amount by which its overall Medicare costs exceed the TEFRA ceiling. The Intermediary points out that the HCFA

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18 According to the 1986 Malpractice Rule, a provider's malpractice expenses are divided into risk and administrative components. The administrative component, which constitutes 8.5% of the total premium is allocated to the A & G cost center and the remaining 91.5%, or risk component, is allocated to Medicare based on a scaling factor. 42 C.F.R. § 413.56 (b).

19 See Provider Exhibit P-2, pg. 1 and Intermediary Exhibit I-1.

20 See Intermediary Exhibit I-1, pg. 2, Provider Exhibit P-2. The medical education item was one of the several items, including malpractice insurance costs, that was in the Provider's original exception request to the Intermediary for FYE June 30, 1986.

21 See Intermediary Exhibit I-1, Exhibit 1 and Provider Exhibit P-2.

Administrator addressed this point in its findings in Redbud Community Hospital v. Blue Cross and Blue Shield Association/Blue Cross of California, PRRB Dec. No. 93-D22, February 24.1993,[22] Medicare & Medicaid Guide (CCH) ¶ 41,317, reversed in part HCFA Adm., April 26, 1993, Medicare & Medicaid Guide (CCH) ¶ 41,417 ("Redbud"). In Redbud, the HCFA Administrator stated, "[t]he Administrator agrees with both the Board majority and the dissenting Board member that a Provider, in requesting an exception, is limited to the overall Medicare costs that it has incurred." Accordingly, since the Provider has already received the maximum adjustment possible (up to its actual Medicare costs), it cannot receive any additional adjustments for increased malpractice insurance costs in FYE 6/30/86. As a result, the Intermediary believes the Board should only consider the Provider's exception request for FYE 6/30/87.

The Intermediary points out that it is the Provider's position that it is entitled to an exception to the TEFRA target rate for the increase in its malpractice costs under the provisions of 42 C.F.R. § 413.40(g)(2). The general rule for this section of the regulation at 42 C.F.R. § 413.40(g)(1) states:

> (1) General procedures. HCFA may adjust a hospital's operating costs (as described in paragraph (b)(1) of this section) upward or downward, as appropriate, under circumstances as specified in paragraph (g)(2) and (3) of this section. HCFA will make an adjustment only to the extent that the hospital's operating costs are reasonable, attributable to the circumstance specified, separately identified by the hospital and verified by the intermediary.

Id.

The Provider cites the following section as the basis for its exception request:

> (2) Extraordinary circumstances. The hospital can show that it incurred unusual costs (in either a cost reporting period subject to the ceiling or the hospital's base period) due to extraordinary circumstances beyond its control. These circumstances include, but are not limited to, strikes, fire, earthquakes, floods, or similar unusual occurrences with substantial cost effects.

42 C.F.R. § 413.40 (g)(2).

In its letter of May 3, 1990, HCFA allowed an additional $4,382 for the cost of malpractice insurance in FYE June 30, 1987.[23] As noted above, no exception was allowed by HCFA for FYE June 30, 1986. Although HCFA agreed that the higher malpractice costs could cause a

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[22] Intermediary Exhibit I-4.

[23] See Intermediary Exhibit I-1, Exhibit 2, and Provider Exhibit P-2.

distortion in the comparison of costs, it did not agree with the methodology used in determining the amount of the adjustment. On page 1 of its letter, HCFA states:

> For the cost reporting period ended June 30, 1987 the Medicare cost report shows $6,238 for malpractice costs apportioned to Medicare Part A. The target amount which is compared to such costs reflects $1,856 for malpractice costs (inflated Medicare's share of malpractice costs per discharge of $7.11 times 261 fiscal year 1987 Medicare discharges). Therefore, PVH warrants an adjustment in the amount of $4,382 for increased malpractice costs which represent the difference between Medicare's share of the actual malpractice costs and the amount reflected in the target amount.

Based on the above, the Intermediary contends the Provider is not entitled to further considerations of its exception request to the target amount per discharge under the provisions of 42 C.F.R. § 413.40.

CITATIONS OF LAWS, REGULATIONS AND PROGRAM INSTRUCTIONS:

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

§ 1395(v)(1)(A)	-	Reasonable Cost
§ 1886(b)	-	Rate of Increase in Target Amounts

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

§ 405.1835-.1841	-	Board Jurisdiction
§ 413.40	-	Ceiling on Rate of Hospital Rate Increases
§ 413.56	-	Malpractice Insurance Costs

3. Cases:

Redbud Community Hospital v. Blue Cross and Blue Shield Association/Blue Cross of California, PRRB Dec. No. 93-D22, February 24.1993, Medicare & Medicaid Guide (CCH) ¶ 41,317, reversed in part HCFA Adm., April 26, 1993, Medicare & Medicaid Guide (CCH) ¶ 41,417.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

The Board, after consideration of the controlling law, regulations, facts of the case, evidence presented, and the parties' contentions, finds and concludes that HCFA properly determined the the TEFRA target amount per discharge under 42 C.F.R. § 413.40, as it applies to the Provider's malpractice insurance costs for FYEs June 30, 1986 and June 30, 1987.

The Board notes that the 1979 Malpractice Rule was in effect during FY 1986, and accordingly, governs Medicare reimbursement. The 1979 Malpractice Rule allocates malpractice insurance premium costs to the Medicare cost report based on a ratio of Medicare losses to total losses. The Board finds nothing in evidence to indicate that the Provider had any malpractice insurance losses/claims for FYE June 30, 1986. The Board also notes there is nothing in evidence to suggest the Provider had any Medicare losses or any Medicare malpractice insurance costs apportioned to the Medicare cost report. Therefore, the Board finds no justification for granting the Provider an exception and agrees with HCFA's response to the Provider's exception request.[24] The Board notes, however, that the Provider was given an exception by HCFA for medical education costs, thereby increasing its TEFRA target rate and allowing the Provider to recover its full costs for FYE June 30, 1986.

For FYE June 30, 1987, the Board finds that the Provider's total malpractice insurance premium expenses were divided between a risk component and an Administrative & General component. The Board finds that $8,096 of the Provider's malpractice insurance expenses were assigned to the Administrative & General cost center on the Medicare cost report, stepped down and apportioned to Medicare.

The Board also finds that the risk component of the Provider's malpractice expenses appears to have been handled correctly using the scaling formula under the 1986 Malpractice Rule.

Based on the above, the Board finds the Provider's argument is without merit and concludes that HCFA's application of the 1986 Malpractice Rule, in effect during FYE June 30, 1987, was applied correctly in its review on the Provider's exception request.[25] The Board notes that the Provider was reimbursed for its Medicare malpractice expenses both through the risk component formula and the Administrative & General overhead step down process. In

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[24] It should be noted the Board denied jurisdiction on the Provider's challenge to the validity of the 1979 Malpractice Rule. The Provider's challenge was not filed timely and consequently, HCFA 89-1 could not be applied . Therefore, the Provider was bound by the 1979 Malpractice Rule for FYE June 30, 1986.

[25] It should be noted the Board denied jurisdiction on the Provider's challenge to the validity of the 1986 Malpractice Rule. The Provider's challenge was not filed timely and consequently, HCFA 91-1 could not be applied . Therefore, the Provider was bound by the 1986 Malpractice Rule for FYE June 30, 1987.

addition, the Provider received the balance of the Medicare malpractice insurance costs it was entitled to through the partial exception it received from HCFA on its TEFRA exception request.

DECISION AND ORDER:

HCFA's denial of the Provider's exception request, to increase its TEFRA target amount for high malpractice insurance costs incurred in FYE June 30, 1986, is affirmed. HCFA's partial denial of the Provider's exception request, to increase its TEFRA target amount for high malpractice insurance costs incurred in FYE June 30, 1987, is also affirmed. The Provider is not entitled to further adjustments to its TEFRA target rate.

Board Members Participating:

Irvin W. Kues
James G. Sleep
Teresa B. Devine
Henry C. Wessman, Esquire

FOR THE BOARD:

Irvin W. Kues
Chairman