

**PROVIDER REIMBURSEMENT REVIEW BOARD
DECISION
On the Record**

2022-D32

PROVIDER-

Galesburg Cottage Hospital

PROVIDER NO.: 14-0040

vs.

MEDICARE CONTRACTOR –

Wisconsin Physicians Service

RECORD HEARING DATE –

February 3, 2022

COST REPORTING PERIOD ENDED –

04/30/2009

CASE NO. 14-1466

CONTENTS

ISSUE STATEMENT.....	2
DECISION.....	2
INTRODUCTION.....	2
STATEMENT OF FACTS AND RELEVANT LAW.....	2
DISCUSSION, FINDINGS OF FACT, AND CONCLUSIONS OF LAW.....	5
DECISION.....	15

ISSUE STATEMENT

Whether the Medicare Contractor properly calculated the volume decrease adjustment (“VDA”) owed to Galesburg Cottage Hospital (“Galesburg” or the “Provider”) for the greater than five percent decrease in inpatient discharges that occurred in its cost reporting period ending April 30, 2009 (“FY 2009”).¹

DECISION

After considering Medicare law and regulations, arguments presented, and the evidence admitted, the Provider Reimbursement Review Board (“Board”) finds that the Medicare Contractor improperly calculated Galesburg’s VDA payment for FY 2009, and that Galesburg should receive a VDA payment in the amount of \$243,426 for FY 2009.

INTRODUCTION

Galesburg is a Medicare Dependent Hospital (“MDH”) located in Galesburg, Illinois.² The Medicare contractor³ assigned to Galesburg for this appeal is Wisconsin Physicians Service Government Health Administrators. (“Medicare Contractor”). Galesburg requested a VDA⁴ and the Medicare Contractor denied Galesburg’s request via letter dated June 20, 2013, finding that the request package failed to substantiate Galesburg’s claims related to the loss in volume.⁵ A request for reconsideration by Galesburg also resulted in a denial from the Medicare Contractor, dated September 20, 2013, which stated “[t]he hospital did not meet the criteria to qualify for a potential volume decrease adjustment, as detailed above. Had the hospital met the criteria, the potential payment would have been zero as we noted in our denial dated June 20, 2013, and readdressed above.”⁶ Galesburg timely appealed the Medicare Contractor’s final decision and met all jurisdictional requirements for a hearing before the Board.

The Board approved a record hearing on February 3, 2022. Galesburg was represented by Ronald Rybar of The Rybar Group, Inc. The Medicare Contractor was represented by Scott Berends, Esq. of Federal Specialized Services.

STATEMENT OF FACTS AND RELEVANT LAW

Medicare pays certain hospitals a predetermined, standardized amount per discharge under the inpatient prospective payment system (“IPPS”) based on the diagnosis-related group (“DRG”) assigned to the patient. These DRG payments are also subject to certain payment adjustments.

¹ Provider’s Consolidated Final Position Paper (hereinafter “Provider’s FPP”) at 2 (Nov. 4, 2021); Medicare Contractor’s Consolidated Final Position Paper (hereinafter “Medicare Contractor’s FPP”) at 4 (Dec. 2, 2021).

² Stipulations at ¶ 1.

³ 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 appropriate and relevant.

⁴ Stipulations at ¶ 5.

⁵ Medicare Contractor’s FPP Exhibit C-1 at 2-4.

⁶ *Id.* at 5-8.

One of these payment adjustments is referred to as a VDA payment and it is available to MDHs if, due to circumstances beyond their control, they incur a decrease in their total number of inpatient cases of more than 5 percent from one cost reporting year to the next.⁷ VDA payments are designed “to fully compensate the hospital for the fixed costs it incurs in the period providing inpatient hospital services, including the reasonable cost of maintaining necessary core staff and services.”⁸ The implementing regulations, located at 42 C.F.R. § 412.108(d), reflect these statutory standards. When promulgating § 412.108(d), CMS made it clear that the VDA rules for MDHs were identical to those already in effect for sole community hospitals (“SCHs”).⁹

It is undisputed that Galesburg experienced a decrease in discharges greater than 5 percent from FY 2008 to FY 2009 due to circumstances beyond its control, and that, as a result, Galesburg was eligible to have a VDA calculation performed for FY 2009.¹⁰ However, when the Medicare Contractor made the FY 2009 VDA calculation, it determined that Galesburg’s IPSP payments exceeded its allowable inpatient fixed and semi-fixed program operating costs by \$1,832,640,¹¹ concluding that the Provider did not qualify for a VDA payment.¹²

The regulation at 42 C.F.R. § 412.108(d) directs how the Medicare Contractor must determine the VDA once an MDH demonstrates that it experienced a qualifying decrease in total inpatient discharges. Specifically, § 412.108(d)(3) (2009) states, in pertinent part:

(3) The intermediary determines a lump sum adjustment amount *not to exceed* the difference between the hospital's Medicare inpatient operating costs and the hospital's total DRG revenue for inpatient operating costs based on DRG-adjusted prospective payment rates for inpatient operating costs (including outlier payments for inpatient operating costs determined under subpart F of this part and additional payments made for inpatient operating costs hospitals that serve a disproportionate share of low-income patients as determined under § 412.106 and for indirect medical education costs as determined under § 412.105).

(i) In determining the adjustment amount, the intermediary *considers* –

(A) The individual hospital’s needs and circumstances, including the reasonable cost of maintaining necessary core staff and services in view of minimum staffing requirements imposed by State agencies;

(B) The hospital's fixed (and semi-fixed) costs, other than those costs paid on a reasonable cost basis under part 413 of this chapter. . . .¹³

⁷ 42 U.S.C. § 1395ww(d)(5)(G)(iii).

⁸ *Id.*

⁹ 55 Fed. Reg. 15150, 15155 (Apr. 20, 1990). *See also* 71 Fed. Reg. 47870, 48056 (Aug. 18, 2006).

¹⁰ Stipulations at ¶ 3.

¹¹ *Id.* at ¶¶ 6, 12.

¹² *Id.* at ¶ 6.

¹³ (Emphasis added.)

As CMS noted in the preamble to the final rule published on August 18, 2006,¹⁴ the Provider Reimbursement Manual, CMS Pub. 15-1 (“PRM 15-1”), § 2810.1 (Rev. 371) provides further guidance related to VDAs. In particular, PRM 15-1 § 2810.1(B) states, in pertinent part:

Additional payment is made to an eligible [MDH] for the fixed costs it incurs in the period in providing inpatient hospital services including the reasonable cost of maintaining necessary core staff and services, not to exceed the difference between the hospital’s Medicare inpatient operating cost and the hospital’s total DRG revenue.

Fixed costs are those costs over which management has no control. Most truly fixed costs, such as rent, interest, and depreciation, are capital-related costs and are paid on a reasonable cost basis, regardless of volume. Variable costs, on the other hand, are those costs for items and services that vary *directly* with utilization such as food and laundry costs.¹⁵

The chart below depicts how the Medicare Contractor and Galesburg each calculated the VDA payment.

	Medicare Contractor calculation using fixed costs ¹⁶	Provider/PRM calculation using total costs ¹⁷
a) Prior Year Medicare Inpatient Operating Costs		\$13,538,823
b) IPSS update factor		1.036
c) Prior year Updated Operating Costs (a x b)		\$14,026,221
d) FY 2009/Current Year Operating Costs		\$13,977,887
e) Lower of c or d		\$13,977,887
f) DRG/MDH payment		\$13,258,537
g) Cap (e-f)		\$ 719,350
h) FY 2009 Inpatient Operating Costs	\$13,977,887	\$13,977,887
i) Fixed Cost percent	.8484 ¹⁸	1.000 ¹⁹
j) FY 2008 Fixed Costs (h x i)	\$11,858,310 ²⁰	\$13,977,887
k) Total DRG/MDH Payments ²¹	\$13,690,950 ²²	\$13,258,537 ²³
l) VDA Payment Amount (The Medicare Contractor’s VDA is based on the amount by which line j exceeds line k)	(\$1,832,640)	

¹⁴ 71 Fed. Reg. at 48056.

¹⁵ (Emphasis added.)

¹⁶ Stipulations at ¶ 12.

¹⁷ *Id.* at ¶ 9.

¹⁸ Calculation = \$11,858,310 / \$13,977,887 = 0.84836213, rounded to 0.8484.

¹⁹ Galesburg does not remove variable costs from the VDA calculation. Galesburg states that variable costs are not removed in any of the examples in PRM 2810.1 nor in the Federal Register published in 2008. Provider’s FPP at 6.

²⁰ Stipulations at ¶ 12. *See also* Exhibit C-1 at 22.

²¹ The parties dispute the proper payment calculation. Galesburg uses Worksheet E, Part A, Line 647 while the Medicare Contractor uses Worksheet E, Part A, Line 8 (which includes the hospital specific portion of the payment paid to MDHs).

²² Stipulations at ¶ 12. *See also* Exhibit C-1 at 23.

²³ *Id.* at ¶ 9. *See also* Exhibit C-1 at 23.

m) VDA Payment Amount (The Provider's VDA is based on the amount by which line j exceeds line k.)		\$ 719,350
--	--	------------

The parties to this appeal dispute the application of the statute and regulations used to calculate the VDA payment.²⁴

DISCUSSION, FINDINGS OF FACT, AND CONCLUSIONS OF LAW

The Medicare Contractor argues that “the additional [VDA] payment is to compensate for fixed and semi-fixed costs only, not variable costs.”²⁵ The Medicare Contractor also asserts that the Provider “believes any potential volume decrease adjustment should ensure [the provider] is fully reimbursed for all costs, including variable costs.”²⁶

The Medicare Contractor removed variable costs through Worksheet A-8 adjustments on Galesburg’s cost report. As specific instructions to determine the fixed/semi-fixed costs are not included in the statute, regulations, or the PRM, the Medicare Contractor used the cost report as a method of calculating fixed/semi-fixed costs, and argues that this “provides the most accurate determination of Medicare inpatient fixed and semi-fixed costs.”²⁷ The Medicare Contractor notes that “CMS has long considered a provider’s Medicare cost report the most accurate and efficient way of reporting, calculating, and determining Medicare costs. . . .”²⁸ The Medicare Contractor also asserts that this calculation “was the methodology utilized in the *Greenwood*, *Unity*, and *Lakes* cases. . . . [and] if CMS disagreed with the MAC’s methodology, the Administrator would have reversed the Board’s determination in the *Greenwood* case and would not have affirmed the *Unity* and *Lakes* calculations.”²⁹

Galesburg argues that the Medicare Contractor’s calculation of the VDA was incorrect because the Medicare Contractor “departed from CMS’s Manual instructions and step-by-step guide and added an unauthorized and monumental extra step. . . .”³⁰ According to Galesburg, “[n]owhere in the Federal Register does it say to subtract variable costs from the Provider’s costs.”³¹ The Board notes that the Final Rule published on September 1, 1983 (“FFY 1984 IPPS Final Rule”) states that “[t]he statute requires that the [VDA] payment adjustment be made to compensate the hospital for the *fixed* costs it incurs in the period. . . . An adjustment will *not* be made for truly variable costs, such as food and laundry services.”³²

Galesburg contends that the Medicare Contractor’s approach “does not fully compensate the Provider for its fixed costs.”³³ Galesburg also maintains that its current VDA calculation is in

²⁴ *Id.* at ¶ 14.

²⁵ Medicare Contractor’s FPP at 8.

²⁶ *Id.*

²⁷ *Id.* at 12.

²⁸ *Id.*

²⁹ *Id.* at 15 (referencing *Unity Healthcare v. Blue Cross Blue Shield Ass’n*, Adm’r Dec. 2014-D15 (Sept. 4, 2014) and *Lakes Reg’l Healthcare v. Blue Cross Blue Shield Ass’n*, Adm’r Dec. 2014-D16 (Sept. 4, 2014)).

³⁰ Provider’s FPP at 7.

³¹ *Id.* at 6.

³² 48 Fed. Reg. 39752, 39781-39782 (Sept. 1, 1983) (emphasis added).

³³ Provider’s FPP at 11.

accordance with PRM 15-1 § 2810.1,³⁴ and this methodology was in effect during the cost reporting periods under appeal. Galesburg argues that “the methodology employed by the MAC is inherently flawed. This methodology guarantees that a Medicare Dependent Hospital will never receive the full compensation mandated by Congress because its fixed costs will always be reduced by reimbursement attributable to both fixed and variable costs.”³⁵ Further, Galesburg argues that, if variable costs are to be excluded from inpatient operating costs when calculating the VDA, then there should also be a corresponding decrease to the DRG payment for variable costs. Galesburg concludes that, “[t]he MAC’s methodology, therefore, reducing a hospital’s total fixed costs by DRG revenue attributable to both fixed and variable costs render[s] an understated VDA.”³⁶ Galesburg maintains the DRG payment is intended to cover both fixed *and* variable costs.

Galesburg also references the fact that CMS essentially adopted a methodology which compares fixed inpatient costs to fixed MS-DRG revenue, and clarified these calculations to reflect that the same ratio is used for costs and payments when it prospectively changed the final rule for calculating VDA payments, starting in FFY 2018.³⁷ Moreover, Galesburg maintains that this method would assure an accurate matching of revenue with expenses “because the DRG payment revenue is intended to cover compensates a hospital for all its expenses in treating inpatients - both fixed *and* variable costs.”³⁸

Galesburg also references the fact that CMS essentially adopted a methodology which compares fixed inpatient costs to fixed MS-DRG revenue, and clarified these calculations to reflect that the same ratio is used for costs and payments when it prospectively changed the final rule for calculating VDA payments, starting in FFY 2018.³⁹

The Board identified two basic differences between the Medicare Contractor’s and Galesburg’s calculations of the VDA payment. The first dispute is that Galesburg included the DRG payments on Worksheet E, Part A, Line 6 as the DRG revenue and the Medicare Contractor included Worksheet E, Part A, Line 8, which includes line 6 plus a percentage of the Hospital Specific Rate (“HSR”) payment (on line 7), as the DRG revenue.

The Board reviewed the VDA regulations at 42 C.F.R. § 412.108(d) and finds that these regulations require the VDA to be calculated using “the hospital’s *total DRG revenue for inpatient operating costs* based on DRG-adjusted prospective payment rates for inpatient operating costs (including outlier payments for inpatient operating costs determined under subpart F of this part and additional payments made for inpatient operating costs for hospitals that serve a disproportionate share of low-income patients as determined under § 412.106. . . .)”⁴⁰ The Board also reviewed the MDH payment methodology at 42 C.F.R. § 412.108(c) in order to determine what payments should be included in the hospital’s “total DRG revenue for inpatient operating costs.” 42 C.F.R. § 412.108(c) provides that MDHs are paid for inpatient operating costs based on the sum of the “Federal payment rate applicable to the hospital” and “75 percent of the amount that

³⁴ *Id.* at 3.

³⁵ *Id.* at 8.

³⁶ *Id.* at 9.

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ (Emphasis added.)

the Federal rate . . . is exceeded by the . . . hospital-specific rate.”⁴¹ Based on these regulations, the Board finds that an MDH’s total DRG revenue for inpatient operating costs includes both the amount paid based on the federal rate and the amount paid based on the hospital-specific rate.

The second disagreement centers on whether variable costs are to be removed from the VDA calculation. The Medicare Contractor removed variable costs from the Medicare inpatient operating costs when calculating Galesburg’s VDA payment. However, Galesburg argues that its VDA must be calculated in accordance with the statute, regulations, and PRM instructions, none of which remove variable costs from Medicare inpatient operating costs when calculating VDA payments.⁴²

In recent Board decisions addressing VDA payments,⁴³ the Board has disagreed with the methodology used by various Medicare contractors (including the one involved in this appeal) to calculate VDA payments because the methodology used compares fixed costs to total DRG payments and only results in a VDA payment if the fixed costs exceed the total DRG payment amount. In these cases, the Board has recalculated the hospitals’ VDA payments by estimating the fixed portion of the hospital’s DRG payments (based on the hospital’s fixed cost percentage as determined by the Medicare contractor), and comparing this fixed portion of the DRG payment to the hospital’s fixed operating costs, so there is an apples-to-apples comparison. The Board notes that Galesburg disagrees with the Medicare Contractor’s methodology of computing the variable cost and that the parties have provided an alternative VDA calculation using their interpretation of the Board’s methodology.⁴⁴

Referring to the methodology adopted by the Board in previous decisions, Galesburg implies that, if variable costs are to be excluded from inpatient operating costs when calculating the VDA, there should also be a corresponding decrease to the DRG payment for variable costs.⁴⁵ Galesburg states its “DRG payments would have been multiplied by the percentage of fixed program costs to all program costs (84.37%) to calculate the DRG payments attributable to fixed costs.”⁴⁶ Galesburg also references the fact that CMS essentially adopted this approach when it prospectively changed the final rule for calculating VDA payments, starting in FFY 2018.⁴⁷

The Administrator has overturned these Board decisions, stating:

[T]he Board attempted to remove the portion of DRG payments the Board attributed to variable costs from the IPPS/DRG revenue.

⁴¹ 42 C.F.R. § 412.108(c) references various sections including § 412.79, the section that the Medicare Contractor used to calculate Galesburg’s hospital specific rate payment. 42 C.F.R. § 412.79 provides for the determination of the hospital specific rate, stating in subsection (e): “[t]he applicable hospital-specific cost per discharge is multiplied by the appropriate DRG weighting factor to determine the hospital-specific base payment amount (target amount) for a particular covered discharge.”

⁴² Provider’s FPP at 6.

⁴³ *St. Anthony Reg’l Hosp. v. Wisconsin Physicians Servs.*, PRRB Dec. No. 2016-D16 (Aug. 29, 2016), *modified by*, Adm’r Dec. (Oct. 3, 2016); *Trinity Reg’l Med. Ctr. v. Wisconsin Physicians Servs.*, PRRB Dec. No. 2017-D1 (Dec. 15, 2016), *modified by*, Adm’r Dec. (Feb. 9, 2017); *Fairbanks Mem’l Hosp. v. Wisconsin Physicians Servs.*, PRRB Dec. No. 2015-D11 (June 9, 2015), *modified by*, Adm’r Dec. (Aug. 5, 2015).

⁴⁴ Stipulations at ¶ 13.

⁴⁵ Provider’s FPP at 9.

⁴⁶ *Id.*

⁴⁷ *Id.*

. . . In doing so the Board created a “fixed cost percentage” which does not have any source of authority pursuant to CMS guidance, regulations or underlying purpose of the VDA amount. . . . The VDA is not intended to be used as a payment or compensation mechanisms that allow providers to be made whole from variable costs, i.e., costs over which providers do have control and are relative to utilization. The means to determine if the provider has been fully compensated for fixed costs is to compare fixed costs to the total compensation made to the provider. . . .⁴⁸

Recently, the Eighth Circuit upheld the Administrator’s methodology in the *Unity* case, stating the “Secretary’s interpretation was not arbitrary or capricious and was consistent with the regulation.”⁴⁹

At the outset, the Board notes that Galesburg is not located in the Eighth Circuit, and that Administrator decisions are not binding precedent, as explained by PRM 15-1 § 2927(C)(6)(e):

e. Nonprecedential Nature of the Administrator’s Review Decision.—Decisions by the Administrator ***are not precedents*** for application to other cases. A decision by the Administrator may, however, be examined and an administrative judgment made as to whether it should be given application beyond the individual case in which it was rendered. If it has application beyond the particular provider, the substance of the decision will, as appropriate, be published as a regulation, HCFA Ruling, manual instruction, or any combination thereof so that the policy (or clarification of policy [*sic*] having a basis in law and regulations may be generally known and applied by providers, intermediaries, and other interested parties.⁵⁰

While the statutes and regulations regarding VDAs for SCHs and MDHs are identical, the Board finds that the applicable statutes and regulations only provide a framework by which to calculate a VDA payment.⁵¹ As a result, the Board is not bound to apply the *specific* VDA calculation methodology that the Administrator applied (and the Eighth Circuit upheld) in *Unity*.⁵² In this

⁴⁸ *Fairbanks Mem’l Hosp. v. Wisconsin Physicians Serv.*, Adm’r Dec. at 8 (Aug. 5, 2015), *modifying*, PRRB Dec. No. 2015-D11 (June 9, 2015).

⁴⁹ *Unity Healthcare v. Azar*, 918 F.3d 571, 579 (8th Cir. 2019), *cert. denied*, 140 S. Ct. 523 (2019).

⁵⁰ (Bold and italics emphasis added).

⁵¹ With regard to SCHs, 42 U.S.C. § 1395ww(d)(5)(D)(ii), *see, e.g., St. Anthony Reg’l Hosp. v. Azar*, 294 F. Sup. 3d 768, 779 (N.D. Iowa 2018) (stating that § 1395ww(d)(5)(D)(ii) contains a gap as it directs that “the Secretary shall provide for such . . . payment . . . as may be necessary” and that “[t]he Secretary has filled that gap in a manner that I find to be reasonable in light of the statutory framework and purpose.”), *aff.d, Unity HealthCare v. Azar*, 918 F.3d 571 (8th Cir. 2019). With regard to SCHs, 42 C.F.R. § 412.92(e)(3), *see, e.g., id.* at 772, 781 (adopting the Magistrate’s report which found that “[t]he regulations promulgated by the Secretary in effect during the relevant time period did not provide a specific formula for calculating the VDA payment[.]” and “[i]nstead, the regulation directed that the following factors be considered in determining the VDA payment amount..”). The Board’s plain reading of the regulation is confirmed by the Agency’s discussion of this regulation in the preamble to rulemakings. *See, for SCHs, e.g., 52 Fed. Reg. 33034, 33049* (Sept. 1, 1987) (stating that “[w]e determine *on a case-by-case basis* whether an adjustment will be granted and the amount of that adjustment.” (emphasis added)); 48 Fed. Reg. 39752, 39781-82 (Sept. 1, 1983).

⁵² *See, e.g., Allina Health Servs. v. Sebelius*, 746 F.3d 1102, 1107-08 (D.C. Cir. 2014) (discussing regulatory

regard, the Board further notes that §§ 412.92(e)(3) and 412.108(d)(3) make clear that the VDA payment determination is subject to review through the Board's appeal process.⁵³ Thus, the Board finds that the Eighth Circuit's *Unity* decision was simply adjudicating a dispute regarding the reasonableness of the Administrator's interpretation of the statute and regulations governing VDAs that the Administrator applied in rendering her decision in *Unity*. As such, the Eighth Circuit's decision in *Unity* did not create a binding precedent as to the specific VDA calculation methodology that the Board is obligated to follow.

Significantly, *subsequent to the time period at issue in this appeal*, CMS essentially adopted the Board's methodology for calculating VDA payments. In the preamble to FFY 2018 IPPS Final Rule,⁵⁴ CMS prospectively changed the methodology for calculating the VDA to one that is very similar to the methodology used by the Board. Under this new methodology, CMS requires Medicare contractors to compare the estimated portion of the DRG payment that is related to fixed costs to the hospital's fixed costs, when determining the amount of the VDA payment.⁵⁵ The preamble to the FFY 2018 IPPS Final Rule makes this change effective for cost reporting periods beginning on or after October 1, 2017, explaining that it will "remove any conceivable possibility that a hospital that qualifies for the volume decrease adjustment could ever be less than fully compensated for fixed costs as a result of the application of the adjustment."⁵⁶

Pursuant to 42 C.F.R. § 405.1867, the Board must give great weight to interpretive rules and general statements of policy. As set forth below, the Board finds that the Medicare Contractor's calculation of Galesburg's VDA methodology for FY 2009 was incorrect because it was *not* based on CMS' stated policy as delineated in PRM 15-1 § 2810.1 and the Secretary's endorsement of this policy in the preambles to the relevant Final Rules.

The Medicare Contractor determined Galesburg's VDA payment by comparing its FY 2009 fixed costs to its total FY 2009 DRG payments. However, neither the language nor the examples⁵⁷ in PRM 15-1 § 2810.1 compare only the hospital's fixed costs to its total DRG payments when calculating a hospital's VDA payment. Similar to the instructions in PRM 15-1, the preambles to both the FFY 2007 IPPS Final Rule⁵⁸ and the FFY 2009 IPPS Final Rule⁵⁹ reduce the hospital's cost *only* by excess staffing (not variable costs) when computing the VDA. Specifically, both preambles state:

interpretations adopted through adjudication versus through rulemaking).

⁵³ Moreover, the Board notes that, subsequent to the Eighth Circuit's decision in *Unity*, the U.S. Supreme Court issued its decision in *Azar v. Allina Health Servs.*, 139 S. Ct. 1804, 1810, 1817 (2019) ("*Allina IP*") where the Supreme Court ruled on the scope of Medicare policy issuances that are subject to the notice and comment requirements under 42 U.S.C. § 1395hh(a)(2) by making clear that "the government's 2014 announcement of the 2012 Medicare fractions [to be used in DSH calculations for FY 2012 where the Agency] 'le[t] the public know [the agency's] current adjudicatory approach' to a critical question involved in calculating payments for thousands of hospitals nationwide" was a "statement of policy that establishes or changes a substantive legal standard" as that phrase is used in 42 U.S.C. § 1395hh(a)(2) and, thus, was subject to the notice and comment requirements under 42 U.S.C. § 1395hh(a)(2). (Citations omitted.)

⁵⁴ 82 Fed. Reg. 37990, 38179-38183 (Aug. 14, 2017).

⁵⁵ This amount continues to be subject to the cap specified in 42 C.F.R. § 412.108(d)(3).

⁵⁶ 82 Fed. Reg. at 38180

⁵⁷ PRM 15-1 § 2810.1(C)-(D).

⁵⁸ 71 Fed. Reg. 47870, 48056 (Aug. 18, 2006).

⁵⁹ 73 Fed. Reg. 48434, 48631 (Aug. 19, 2008).

[T]he adjustment amount is determined by subtracting the second year's MS-DRG payment from the lesser of: (a) The second year's cost minus any adjustment for excess staff; or (b) the previous year's costs multiplied by the appropriate IPPS update factor minus any adjustment for excess staff. The SCH or MDH receives the difference in a lump-sum payment.

It is clear from the preambles to these Final Rules that the only permissible adjustment to the hospital's cost for calculating the VDA is for excess staffing. Therefore, the Board finds that the Medicare Contractor did not calculate Galesburg's VDA using the methodology laid out by CMS in PRM 15-1 or by the Secretary in the preambles to the FFY 2007 and 2009 IPPS Final Rules.

Rather, the Board finds the Medicare Contractor calculated Galesburg's FY 2009 VDA based on an otherwise *new* methodology that the Administrator adopted through adjudication in her decisions described as follows: the hospital's "VDA [payment] is equal to the difference between its fixed and semi- fixed costs and its DRG payment . . . subject to the ceiling[.]"⁶⁰ The Board suspects that the Administrator developed this new methodology using fixed costs because of a seeming conflict between the methodology explained in the FFY 2007 and 2009 IPPS Final Rules/PRM and the statute. Notably, in applying this new methodology through adjudication, CMS did not otherwise alter its written policy statements in either the PRM or Federal Register until it issued the FFY 2018 IPPS Final Rule.⁶¹

The statute at 42 U.S.C. § 1395ww(d)(5)(G)(iii) is clear that the VDA payment is intended to fully compensate the hospital for its fixed costs:

In the case of a medicare dependent, small rural hospital that experiences, in a cost reporting period compared to the previous cost reporting period, a decrease of more than 5 percent in its total number of inpatient cases due to circumstances beyond its control, the Secretary shall provide for such adjustment to the payment amounts under this subsection (other than under paragraph (9)) as may be necessary to *fully compensate the hospital for the fixed costs it incurs* in the period in providing inpatient hospital services, including the reasonable cost of maintaining necessary core staff and services.⁶²

In the FFY 1984 IPPS Final Rule, the Secretary further explained the purpose of the VDA payment: "[t]he statute requires that the [VDA] payment adjustment be made to compensate the hospital for the fixed costs it incurs in the period. . . . An adjustment will *not* be made for truly variable costs, such as food and laundry services."⁶³ However, the VDA payment methodology as explained in the

⁶⁰ *Lakes Reg'l Healthcare v. BlueCross BlueShield Ass'n*, Adm'r Dec. 2014-D16 at 8 (Sept. 4, 2014).; *Unity Healthcare v. BlueCross BlueShield Ass'n*, Adm'r Dec. 2014-D15 at 8 (Sept. 4, 2014); *Trinity Reg'l. Med. Ctr. v. Wisconsin Physician Servs.*, Adm'r Dec. 2017-D1 at 12 (Feb. 9, 2017).

⁶¹ 82 Fed. Reg. at 38179-38183.

⁶² (Emphasis added.)

⁶³ 48 Fed. Reg. 39752, 39781-39782 (Sept. 1, 1983) (emphasis added).

FFY 2007 and 2009 IPPS Final Rules and PRM 15-1 § 2810.1 compares a hospital's total cost (reduced for excess staffing) to the hospital's *total* DRG payments and states in pertinent part:

C. Requesting Additional Payments.— . . .

4. Cost Data.—The hospital's request must include cost reports for the cost reporting period in question and the immediately preceding period. The submittal must demonstrate that the Total Program Inpatient Operating Cost, excluding *pass-through costs*, exceeds DRG payments, including outlier payments. *No adjustment is allowed if DRG payments exceeded program inpatient operating cost.* . . .

D. Determination on Requests.— . . . The payment adjustment is calculated under the same assumption used to evaluate core staff, i.e. *the hospital is assumed to have budgeted based on prior year utilization and to have had insufficient time in the year in which the volume decrease occurred to make significant reductions in cost.* Therefore, the adjustment allows an increase in cost up to the prior year's total Program Inpatient Operating Cost (excluding pass-through costs), increased by the PPS update factor.

EXAMPLE A: Hospital C has justified an adjustment to its DRG payment for its FYE September 30, 1987. . . . Since Hospital C's FY 1987 Program Inpatient Operating Cost was less than that of FY 1986 increased by the PPS update factor, *its adjustment is the entire difference between FY 1987 Program Inpatient Operating Cost and FY 1987 DRG payments.*

EXAMPLE B: Hospital D has justified an adjustment to its DRG payment for its FYE December 31, 1988. . . . Hospital D's FY 1988 Program Inpatient Operating Cost exceeded that of FY 1987 increased by the PPS update factor, so *the adjustment is the difference between FY 1987 cost adjusted by the update factor and FY 1988 DRG payments.*⁶⁴

At first blush, this would appear to conflict with the statute and the FFY 1984 IPPS Final Rule, both of which limit the VDA to fixed costs. The Board believes that the Administrator tried to resolve this seeming conflict by establishing a new methodology through adjudication in the Administrator decisions stating that the "VDA is equal to the difference between its *fixed and semi-fixed costs* and its DRG payment . . . subject to the ceiling."⁶⁵

⁶⁴ (Emphasis added.)

⁶⁵ *St. Anthony Reg'l Hosp.*, Adm'r Dec. at 13; *Trinity Reg'l Med. Ctr.*, Adm'r Dec. at 12.

Based on its review of the statute, regulations, PRM 15-1 and the Eighth Circuit's decision, the Board respectfully disagrees that the Administrator's methodology complies with the statutory mandate to "fully compensate the hospital for the fixed costs it incurs."⁶⁶ Using the Administrator's rationale, a hospital is fully compensated for its fixed costs when the total DRG payments issued to that hospital are equal to or greater than its fixed costs. This assumes that the entire DRG payment is payment *only for the fixed costs* of the services actually furnished to Medicare patients. However, the statute at 42 U.S.C. § 1395ww(a)(4) makes it clear that a DRG payment includes payment for both fixed *and* variable costs of the services rendered because it defines operating costs of inpatient services as "**all** routine operating costs . . . and includes the *costs of all services* for which payment may be made[.]" The Administrator cannot simply ignore 42 U.S.C. § 1395ww(a)(4) and deem all of a hospital's DRG payments as payments solely for the fixed cost of the Medicare services actually rendered when the hospital, in fact, incurred both fixed and variable costs for those services.

Indeed, the Board must conclude that the purpose of the VDA payment is to compensate an MDH for all the fixed costs associated with the qualifying volume decrease (which must be 5 percent or more). This is in keeping with the assumption stated in PRM 15-1 § 2810.1.D that "the hospital is assumed to have budgeted based on prior year utilization and to have had insufficient time in the year in which the volume decrease occurred to make significant reductions in cost." This approach is also consistent with the directive in 42 C.F.R. § 412.108(d)(3)(i)(A) that the Medicare contractor "considers . . . [t]he individual hospital's needs and circumstances" when determining the payment amount.⁶⁷ Clearly, when a hospital experiences a decrease in volume, the hospital should reduce its variable costs associated with the volume loss, but the hospital will always have some variable costs related to furnishing Medicare services to its *actual* patient load.

Critical to the proper application of the statute, regulation and PRM provisions related to the VDA, are the unequivocal facts that: (1) the Medicare patients to which a provider furnished *actual* services in the current year are not part of the volume decrease, and (2) the DRG payments made to the hospital for services furnished to Medicare patients in the current year are for *both* the fixed and variable costs of the *actual* services furnished to those patients. Therefore, in order to fully compensate a hospital for its fixed costs in the year of a qualifying decrease, the hospital must receive payment for the variable costs related to its *actual* Medicare patient load for that year, *as well as* its full fixed costs for that year.

The Administrator's methodology clearly does not do this, as it takes the portion of the DRG payment intended for variable costs incurred in the current year and impermissibly characterizes it as payment for the hospital's fixed costs. The Board can find no basis in 42 U.S.C. § 1395ww(d)(5)(G)(iii) allowing the Secretary to ignore 42 U.S.C. § 1395ww(a)(4) – which makes clear that the DRG payment is payment for *both* fixed and variable costs – and deem the entire DRG payment as payment solely for fixed costs. Thus, the Board concludes that the Administrator's methodology does not ensure that a hospital, eligible for a VDA adjustment, has been fully compensated for its fixed costs and, therefore, is not a reasonable interpretation of the statute.

⁶⁶ 42 U.S.C. § 1395ww(d)(5)(G)(iii).

⁶⁷ The Board recognizes that 42 C.F.R. § 412.108(d)(3)(i)(B) instructs the Medicare contractor to "consider[]" fixed and semifixed costs for determining the VDA payment amount but this instruction does not prevent payment through the DRG of the variable costs for those services *actually* rendered.

Galesburg further argues that “[w]hen the [Medicare Contractor] changed the VDA calculation without following the legal notice and comment period, they unlawfully changed regulations.”⁶⁸ Galesburg also argues that “[t]he VDA calculation was not lawfully altered until the August 17, 2017, Federal Register was issued.”⁶⁹ Galesburg contends that “[t]he methodology in effect during the four years under appeal was the one described in section 2810.1 of the PRM, as formally adopted and modified in the IPPS rulemakings for FYs 2007 and 2009”⁷⁰ and also contends that CMS and/or the Medicare Contractor improperly departed from this methodology. However, the Board notes that the examples in PRM 15-1 § 2810.1 relate to the cap and not the actual VDA calculation, as the Eighth Circuit recently confirmed in *Unity HealthCare v. Azar*:

The hospitals' main argument to the contrary relies on the premise that the Manual's sample calculations unambiguously conflict with the Secretary's interpretation and that the Secretary is bound by the Manual as incorporated via later regulations. The hospitals point out that the Secretary has previously stated that § 2810.1(B) of the Manual, where the examples are located, contains “the process for determining the amount of the volume decrease adjustment.” See 71 Fed. Reg. 47,870, 48,056 (Aug. 19, 2006). However, the examples are not presented in isolation. The same section of the Manual reiterates that the volume-decrease adjustment is “not to exceed the difference between the hospital's Medicare inpatient operating cost and the hospital's total DRG revenue.” In a decision interpreting § 2810.1(B) immediately following the Secretary's guidance, the Board found “that the examples are intended to demonstrate how to calculate the adjustment limit as opposed to determining which costs should be included in the adjustment.” See Greenwood Cty. Hosp. v. BlueCross BlueShield Ass'n, No. 2006-D43, 2006 WL 3050893, at *9 n.19 (P.R.R.B. Aug. 29, 2006). That decision was not reviewed by the Secretary and therefore became a final agency action. The agency's conclusion that the examples are meant to display the ceiling for a VDA, rather than its total amount, is a reasonable interpretation of the regulation's use of “not to exceed,” rather than “equal to,” when describing the formula. *We conclude that the Secretary's interpretation was not arbitrary or capricious and was consistent with the regulation.*⁷¹

Accordingly, what Galesburg points to as written or published CMS “policy” on how to calculate the VDA payment was not, in fact, such a policy.

⁶⁸ Provider's FPP at 11-12.

⁶⁹ *Id.* at 12.

⁷⁰ *Id.*

⁷¹ 918 F.3d 571, 578-79 (8th Cir. 2019) (footnotes omitted; bold and italics emphasis added).

Moreover, the fact that the Medicare Contractor may have previously calculated VDAs differently does not automatically mean there is a departure from a Medicare program “policy.”⁷² The Board notes that the D.C. Circuit has confirmed that substantive Medicare reimbursement policy can be adopted through case-by-case adjudication.⁷³ This is different than the situation discussed by the Supreme Court in *Allina*, where a new substantive reimbursement policy was announced on the CMS website and was applied nationwide to all hospitals at one time.⁷⁴ Indeed, the Board notes that VDA calculations, by their very nature, are provider specific and subject to appeal, as explained in 42 C.F.R. § 412.108(d)(3).⁷⁵ Moreover, the Board has had long standing disagreements with Medicare contractors and the Administrator on their different interpretations and application of the relevant statutes, regulations and PRM guidance regarding the calculation of VDAs.⁷⁶ Accordingly, the Board rejects Galesburg’s argument regarding lack of notice or comment opportunity.

Finally, the Board recognizes that, while PRM 15-1 § 2810.1 and 42 U.S.C. § 1395ww(d)(5)(G)(iii) do not fully explain how to remove variable costs when calculating a VDA adjustment, the VDA payment is **clearly not intended** to fully compensate the hospital for its variable costs.⁷⁷ Additionally, based on 42 U.S.C. § 1395ww(a)(4), the Board finds that DRG payments are intended to pay for both variable and fixed costs for the Medicare services *actually* furnished. The Board concludes that, in order both to ensure the hospital is fully compensated for its fixed costs and to be consistent with the PRM 15-1 § 2810.1 assumption that “the hospital is assumed to have budgeted based on the prior year utilization,” the VDA calculation must compare the hospital’s fixed costs to that portion of the hospital’s DRG payments attributable to fixed costs.

As the Board does not have the IPPS actuarial data to determine the split between fixed and variable costs related to a DRG payment, the Board opts to use the Medicare Contractor’s fixed/variable cost percentages as a proxy. In this case, the Medicare Contractor determined that Galesburg’s fixed costs (which includes semi-fixed costs) were 84.84 percent⁷⁸ of Galesburg’s Medicare costs for FY 2009. Applying the rationale described above, the Board finds the VDA in this case should be calculated as follows:

Step 1: Calculation of the Cap

2008 Medicare Inpatient Operating Costs ⁷⁹	\$13,538,823
Multiplied by the 2008 IPPS update factor ⁸⁰	<u>1.036</u>

⁷² Moreover, the fact that any particular Medicare contractor historically calculated VDAs in a particular manner does not make that CMS policy.

⁷³ See, e.g., *Catholic Health Initiatives Iowa Corp. v. Sebelius*, 718 F.3d 914 (D.C. Cir. 2013).

⁷⁴ 139 S. Ct. at 1808, 1810.

⁷⁵ This regulation specifies that the Medicare contractor “considers” three hospital specific factors “[i]n determining the [volume decrease] adjustment amount” and that this “determination is subject to review under subpart R of part 405 of this chapter.”

⁷⁶ See, e.g., *Unity Healthcare v. Blue Cross Blue Shield Ass’n*, PRRB Dec. No. 2014-D15 (July 10, 2014); *Halifax Reg’ Med. Ctr. v. Palmetto GBA*, PRRB Dec. No. 2020-D1 (Jan. 31, 2020). Further, the application of the PRM definitions of the terms “variable” and “semi-fixed” costs to a particular provider’s VDA request seems to be the very nature of adjudicatory fact-finding and why providers may appeal Medicare contractor VDA determinations to the Board.

⁷⁷ 48 Fed. Reg. 39752, 39782 (Sept. 1, 1983).

⁷⁸ Stipulations at ¶ 13.

⁷⁹ *Id.*

⁸⁰ *Id.* (The Board further notes that this stipulated amount is the IPPS Update factor for the Federal fiscal year

2008 Updated Costs (max allowed)	\$14,026,221
2009 Medicare Inpatient Operating Costs ⁸¹	\$13,977,887
Lower of 2008 Updated Costs or 2009 Costs	\$13,977,887
Less 2009 IPPS payment ⁸²	\$13,690,950
2009 Payment Cap	\$ 286,937

Step 2: Calculation of the VDA

2009 Medicare Inpatient Fixed Operating Costs ⁸³	\$11,858,310
Less Excess Staffing	\$ 0
2009 Medicare Inpatient Fixed Costs less Excess Staff	\$11,858,310
Less 2009 IPPS payment – fixed portion (84.84%) ⁸⁴	\$11,614,884
Payment adjustment amount (subject to cap)	\$ 243,426

Since the payment adjustment amount of \$243,426 is less than the cap of \$286,937, the Board concludes that Galesburg's VDA payment for FY 2009 should be \$243,426.

DECISION

After considering Medicare law and regulations, arguments presented, and the evidence admitted, the Board finds that the Medicare Contractor improperly calculated Galesburg's VDA payment for FY 2009, and that Galesburg should receive a VDA payment in the amount of \$243,426 for FY 2009.

Board Members Participating:

Clayton J. Nix, Esq.
 Gregory H. Ziegler, CPA
 Robert A. Evarts, Esq.
 Kevin D. Smith, CPA
 Ratina Kelly, CPA

For the Board:

9/23/2022

X Clayton J. Nix

Clayton J. Nix, Esq.
 Chair
 Signed by: PIV

ending September 30, 2009, and thus, Galesburg, with a fiscal year end of April 30, 2009, requires a blended rate reflecting portions of the Federal fiscal years 2008 and 2009. This is calculated based on the number of days in each fiscal year. (2008 = 153 days x 1.033) + (2009 = 212 days x 1.036) / 365 days total = 1.0347. This results in an updated 2008 inpatient operating cost figure of \$14,008,620 (\$13,538,823 x 1.0347). The 2009 inpatient operating costs are still the lesser figure, so the above calculation is acceptable.)

⁸¹ *Id.*

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *Id.* (13,690,950 * 0.8484 = 11,615,402) the difference is due to rounding the fixed cost percentage.