OAH 8-1800-30119

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS

FOR THE DEPARTMENT OF HUMAN SERVICES

In the Matter of the Consolidated Hospital Surcharge Appeals of Gillette Children's Speciality Healthcare, *et al.*	**RECOMMENDATION ON CROSS-MOTIONS FOR SUMMARY DISPOSITION**

This matter came before Administrative Law Judge Eric L. Lipman on December 16, 2013 for oral arguments on cross-motions for summary disposition.

Barry R. Greller, Assistant Attorney General, appeared on behalf of the Minnesota Department of Human Services (Department or DHS).

Salvatore G. Rotella, Jr., Frank J. Gallo and Murray Klein, Reed Smith LLP, and Thomas R. Muck and Samuel D. Orbovich, Fredrikson & Byron, P.A., appeared on behalf of Respondents Gillette Children's Specialty Healthcare, St. Luke's Hospital, North Memorial Health Care, HealthEast Care System, Park Nicollet Health Services, Fairview Health Services, and Children's Hospital and Clinics of Minnesota (Hospitals).

Based upon the submissions of the parties and the contents of the hearing record,

STATEMENT OF THE ISSUES

1. Is Minnesota's surcharge on net patient revenues a "tax, fee, or other monetary payment" that is imposed "indirectly" on carriers operating under the Federal Employee Health Benefits Act (FEHBA)?

2. If so, are these surcharges preempted by federal law and the Supremacy Clause of the U.S. Constitution?

SUMMARY OF CONCLUSIONS

The Administrative Law Judge concludes that Minnesota's surcharge on net patient revenues is not a "tax, fee, or other monetary payment" that is imposed indirectly on insurance carriers operating under the FEHBA. For that reason, federal law does not preempt the imposition of surcharges on the net patient revenues of Minnesota hospitals.

Based upon the hearing record and for the reasons set forth in the accompanying Memorandum, the Administrative Law Judge respectfully makes the following:

RECOMMENDATION

IT IS HEREBY RECOMMENDED THAT:

1. The Department's Motion for Summary Disposition should be **GRANTED**.

2. The Hospitals' Motion for Partial Summary Disposition should be **DENIED**.

3. The Hospitals' Appeal should be **DISMISSED**.

Dated: January 15, 2014

__s/Eric L. Lipman_____
ERIC L. LIPMAN
Administrative Law Judge

MEMORANDUM

Factual Background

I. FEHBA

Federal employees and their families are eligible for health benefits through the FEHBA program. The program is administered by the Office of Personnel Management (OPM). OPM contracts with health insurance carriers to develop plans that will deliver health care services to covered employees and their families.[1]

Each FEHBA insurance carrier, in turn, contracts with local health care providers to build a "network" from which the FEHBA plan enrollees will receive most of their care. These network contracts include agreed-upon rates for the services. These rates typically reflect a discount from the provider's ordinary, full-billed charges.[2] Local health care providers are willing to negotiate discounts from their regular rates in exchange for the opportunity to treat a larger number of FEHBA plan members than would otherwise present themselves for care.[3] Being part of a FEHBA provider network is a valuable designation for the health care providers that enter into these arrangements.

Because each of the providers in this appeal was part of an "experience-rated" plan, they all received payments for their services in the same way: The FEHBA insurance carrier paid local providers for the health care services – including hospital

[1] *See, United States v. West Virginia,* 339 F.3d 212, 213 (4th Cir. 2003).

[2] *See,* Exhibit G attachments 1 and 2 to the Hospitals' Motion for Summary Disposition.

[3] *See e.g.,* Declaration of Mike Busch at ¶ 27.

services – which the providers rendered to FEHBA enrollees. These sums are initially furnished by the insurance carrier itself, but the carrier later receives reimbursements for these payments from a FEHBA account in the U.S Treasury.[4]

The statute that authorizes the FEHBA program includes a provision preempting certain contrary state laws. The provision states:

> (1) **No tax, fee, or other monetary payment may be imposed, directly or indirectly, on a carrier** or an underwriting or plan administration subcontractor of an approved health benefits plan **by any State** … **with respect to any payment made from the Fund**.
>
> (2) Paragraph (1) shall not be construed to exempt any carrier or underwriting or plan administration subcontractor of an approved health benefits plan from the imposition, payment, or collection of a tax, fee, or other monetary payment on the net income or profit accruing to or realized by such carrier or underwriting or plan administration subcontractor from business conducted under this chapter, if that tax, fee, or payment is applicable to a broad range of business activity.[5]

II. TRICARE

TRICARE is the federal health care program for active U.S. military personnel and their dependents, National Guard and Reserve members and their families, military retirees, and certain other eligible beneficiaries. Under the program, the Department of Defense contracts with regional managed care contractors to develop and oversee networks of health care providers.[6]

Health care providers that provide services to TRICARE beneficiaries typically submit claims to the appropriate regional contractor for payment by, or on behalf of, TRICARE.[7]

The rate at which a hospital is paid for covered health care services to a TRICARE beneficiary depends upon whether the hospital is within the regional contractor's network of providers. If the hospital is not within the provider network, the hospital is paid the TRICARE allowable amount, including copayments, coinsurance, and deductible amounts paid by the beneficiary. If the hospital is a member of the

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[4] *United States v. West Virginia,* 339 F.3d at 213; Declaration of Mike Busch at ¶ 28.

[5] 5 U.S.C. § 8909(f)(1) and (2) (emphasis added); *see also,* U.S. Const. Art. VI, § 1, Cl. 2 ("the laws of the United States … shall be the supreme law of the land … anything in the Constitution or laws of any State to the contrary notwithstanding") (the Supremacy Clause).

[6] *See generally,* 32 C.F.R. § 199.17; *Baptist Physician Hosp. Org., Inc. v. Humana Military Healthcare Servs., Inc.*, 481 F.3d 337, 340 (6th Cir. 2007).

[7] *See,* Declaration of Catherine Lenagh at ¶¶ 27 - 29.

provider network, the hospital will receive the rates it earlier-negotiated with the regional contractor up to the "TRICARE allowable amount."[8]

For the time periods at issue in this case, the managed care support contractor for the West Region, which includes Minnesota, was Tri West Healthcare.[9]

Like the FEHBA, the statute authorizing TRICARE includes a preemption provision. 10 U.S.C. § 1103 (a) states:

> A law or regulation of a State or local government relating to health insurance, prepaid health plans, or other health care delivery or financing methods shall not apply to any contract entered into pursuant to this chapter by the Secretary of Defense or the administering Secretaries to the extent that the Secretary of Defense or the administering Secretaries determine that—
>
> (1) the State or local law or regulation is inconsistent with a specific provision of the contract or a regulation promulgated by the Secretary of Defense or the administering Secretaries pursuant to this chapter; or
>
> (2) the preemption of the State or local law or regulation is necessary to implement or administer the provisions of the contract or to achieve any other important Federal interest.[10]

While the hearing record in this case does not include a determination from Defense Department officials that Minnesota's surcharge is "inconsistent with a specific provision of the contract or a regulation promulgated by the Secretary" or "any other important Federal interest," there are regulations interpreting this statute. 32 C.F.R. § 199.17 (a)(7)(iii) states:

> **The preemption of State and local laws** set forth in paragraph (a)(7)(ii) of this section **includes State and local laws imposing premium taxes on health or dental insurance carriers or underwriters or other plan managers**, or similar taxes on such entities. Such laws are laws relating to health insurance, prepaid health plans, or other health care delivery or financing methods, within the meaning of the statutes identified in paragraph (a)(7)(i) of this section. **Preemption, however, does not apply to taxes, fees, or other payments on net income or profit realized by such entities in the conduct of business relating to DoD health services contracts, if those taxes, fees or other payments are applicable to a broad range of business activity**. For purposes of assessing the effect of Federal preemption of State and local taxes and

[8] *See,* Declaration of Catherine Lenagh at ¶ 29.

[9] *See, id.* at ¶ 27.

[10] 10 U.S.C. § 1103(a).

> fees in connection with DoD health and dental services contracts, interpretations shall be consistent with those applicable to the Federal Employees Health Benefits Program under 5 U.S.C. 8909(f).[11]

III. The Hospital Surcharge

Minnesota imposes a surcharge on the net patient revenues of health care providers. Minn. Stat. § 256.9657, subd. 2(a) and (b) read:

> (a) Effective October 1, 1992, each Minnesota hospital except facilities of the federal Indian Health Service and regional treatment centers shall pay to the medical assistance account a surcharge equal to 1.4 percent of net patient revenues excluding net Medicare revenues reported by that provider to the health care cost information system according to the schedule in subdivision 4.
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> (b) Effective July 1, 1994, the surcharge under paragraph (a) is increased to 1.56 percent.

The surcharge amounts were assessed and remitted on a monthly basis to fund Minnesota's Medical Assistance program.[12]

The Department applied the surcharge against 1.56 percent of net patient revenues, excluding Medicare revenues, for each Hospital.[13]

IV. The Appeals in this Matter

Minn. Stat. § 256.9657, subd. 6, provides that upon receipt of a notice from the Commissioner of Human Services as to the surcharge amounts that are due, a provider may request a contested case hearing under Chapter 14 to contest the payment obligation.

The Hospitals initiated timely appeals of their respective assessments. By a letter order of September 21, 2012, DHS denied the appeals of these hospitals.[14]

Pursuant to a request by these Hospitals, DHS thereafter initiated a consolidated contested case before the Office of Administrative Hearings (OAH). The Department issued a Notice of and Order for Prehearing Conference on November 15, 2012. The appeals of the following assessments were consolidated into this matter:

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[11] 32 C.F.R. § 199.17 (a)(7)(iii) (emphasis added).

[12] Minn. Stat. § 256.9657, subd. 4; Declaration of Mike Busch at ¶¶ 8 and 11; Declaration of Catherine Lenagh at ¶¶ 8 and 11.

[13] Joint Stipulation of the Parties at ¶¶ 3 and 5 (Joint Stipulation).

[14] Joint Stipulation at ¶ 8; Tolling Agreement of the Parties at 2 (Tolling Agreement).

- Gillette Children's Specialty Care, January 2011 – February 2013;
- North Memorial Healthcare, January 2011 – February 2013;
- HealthEast Care System, September 2011 – February 2013;
- Park Nicollet Health Services, August 2010 – February 2013;
- Fairview Health Services, January 2011 – February 2013;
- St. Luke's Hospital, December 2010 – February 2013; and,
- Children's Hospitals of Minnesota, September 2012 – September 2013.[15]

By way of a letter order dated July 15, 2013, DHS similarly denied the surcharge appeal of Respondent Children's Hospitals and Clinics of Minnesota. Pursuant to a joint request by the Hospitals and DHS, OAH added the denial of the appeal of Children's Hospitals and Clinics of Minnesota to the consolidated cases.[16]

To simplify the discovery and presentation of relevant financial information, the parties agreed that North Memorial Healthcare (North Memorial) and Park Nicollet Health Services (Park Nicollet) would serve as "Representative Hospitals" for the larger group. The parties agreed that whatever legal conclusion is made as to the propriety of surcharging the Representative Hospitals will apply with equal force to all of the Respondent Hospitals.[17]

During the relevant time periods, North Memorial and Park Nicollet contracted with FEHBA insurance carriers BlueCross BlueShield of Minnesota and HealthPartners (FEHBA insurance carriers).[18]

Additionally, Park Nicollet contracted with TriWest, the managed care support contractor in the region, and Government Employees Hospital Association, another FEHBA insurance carrier.[19]

During their respective annual budgeting processes, the Representative Hospitals identified expected expenses.[20] These expenses included: personnel costs, purchased services, supplies, drugs, depreciation, interest, the MinnesotaCare tax, and the hospital surcharge.[21] The Hospitals factored this list of expenses into its pricing decisions for various services.[22]

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[15] Joint Stipulation at ¶ 8; First and Second Amendments to the Joint Stipulation.

[16] *See,* Second Amendment to the Joint Stipulation; SIXTH PREHEARING ORDER, OAH 8-1800-30119 (September 16, 2013).

[17] Tolling Agreement at ¶ 5.

[18] Declaration of Mike Busch at ¶ 28; Declaration of Catherine Lenagh at ¶ 26.

[19] Declaration of Catherine Lenagh at ¶¶ 26 - 27.

[20] *See e.g.,* Declaration of Mike Busch at ¶¶ 18 - 21.

[21] Declaration of Mike Busch at ¶ 20; Declaration of Catherine Lenagh at ¶ 20.

[22] Declaration of Mike Busch at ¶¶ 21 – 27; Declaration of Catherine Lenagh at ¶¶ 18 – 25.

Later, the Hospitals negotiated payment rates with the FEHBA insurance carriers and TriWest based upon the amount that each needed to charge for services.[23] The Representative Hospitals had a "positive margin" when providing services for FEHBA beneficiaries – meaning that the payments received from the FEBHA insurance carriers were higher than the Representative Hospitals' expenses, including the surcharge.[24]

North Memorial did not contract with Tri West Healthcare, but was a certified, participating, out-of-network provider in the TRICARE program. Accordingly, TRICARE typically reimbursed North Memorial at the pre-set, TRICARE maximum allowable amount for services rendered to TRICARE members.[25]

V. Legal Standard

Summary disposition is the administrative law equivalent of summary judgment. Summary disposition is appropriate where there is no genuine issue as to any material fact and one party is entitled to judgment as a matter of law.[26]

The Office of Administrative Hearings has generally followed the summary judgment standards developed by the state courts when addressing motions for summary disposition of contested cases.[27]

The moving party has the initial burden of showing the absence of a genuine issue concerning any material fact.[28]

To successfully resist a motion for summary judgment, the nonmoving party must show that there are specific facts in dispute that have a bearing on the outcome of the case. If reasonable minds could differ as to the import of the evidence, disposition as a matter of law should not be granted.[29]

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[23] Declaration of Mike Busch at ¶ 27; Declaration of Catherine Lenagh at ¶ 25.

[24] Declaration of Mike Busch at ¶ 27; Declaration of Catherine Lenagh at ¶ 28.

[25] Declaration of Mike Busch at ¶¶ 29 and 31.

[26] *See, Sauter v. Sauter*, 70 N.W.2d 351, 353 (Minn. 1955); *Louwgie v. Witco Chemical Corp*., 378 N.W.2d 63, 66 (Minn. App. 1985); Minn. R. 1400.5500(K).

[27] *See,* Minn. R. 1400.6600.

[28] *See, Thiele v. Stich*, 425 N.W.2d 580, 583 (Minn. 1988); *Hunt v. IBM Mid-America Employees Federal*, 384 N.W.2d 853, 855 (Minn. 1986).

[29] *See, Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 250-251 (1986).

VI. Analysis

While the underlying factual record of this case is complex, the legal question is fairly straightforward: Because appropriations from the federal government were ultimately used to pay for portions of Minnesota's surcharge on the Hospitals, is the surcharge an "indirect monetary payment" prohibited by 5 U.S.C. § 8909(f)(1), 10 U.S.C. § 1103(a) and the Supremacy Clause?

The Hospitals argue that because the costs of the surcharge are passed-through to the federal government, they qualify as "indirect" impositions on the U.S. Treasury. The Department responds that no court has ever accepted this economic pass-through theory and shielded lower-tier vendors of FEHBA plans from paying taxes.

In the view of the Administrative Law Judge, Minnesota's surcharge upon net patient revenues is not a prohibited tax upon the federal government because it does not qualify as an indirect assessment upon either FEHBA or TRICARE carriers.

The decision of the U.S. Court of Appeals for the Fourth Circuit in *United States v. West Virginia*[30] is instructive. West Virginia, like Minnesota, imposes a tax on the receipts that hospitals receive for the services that they provide. Although the local hospitals alone were liable for the payment of this tax, West Virginia conceded that part of the economic burden of the tax was passed on by the hospitals to the FEHBA insurance carriers that served federal employees in that state. The question for the appellate panel, thus, was whether passing along a portion of the economic impact of a tax, through prices, was a prohibited "indirect tax" upon the federal government.

The appellate panel concluded that a receipt tax upon local hospitals was not a prohibited imposition on the federal government because it did not meet the definition of an "indirect tax." As Judge J. Michael Luttig explained for the panel majority:

> For over two hundred years, a single, consistent usage of the term "indirect tax" has been employed in reference to the relationship between a tax and its payer. That usage establishes that an indirect tax is one imposed on goods….
>
> And, up to the present time, the Supreme Court has consistently employed this same usage, saying, for example, that "an indirect tax [is] a tax levied on the goods themselves, and computed as a percentage of the manufacturer's sales price rather than the income or wealth of the purchaser or seller." As a consequence of this consistent usage, Congress' reference in section 8909(f) to a tax being imposed indirectly, without further legislative or agency definition, is best understood to refer to a tax, and the legal incidents thereof, being levied on goods in which taxpayers transact.[31]

[30] *United States v. West Virginia,* 339 F.3d 212 (4th Cir. 2003).

[31] *United States v. West Virginia,* 339 F.3d at 215 (citations omitted).

Because the West Virginia tax was not applied upon the federal insurance carriers, or their goods, it was not prohibited by federal law.[32]

Importantly, and apart from the conclusion in *United States v. West Virginia,* the hearing record does not establish that the surcharge was enacted by the Minnesota Legislature, or applied by the Department, with the purpose of extracting revenue from the U.S. Treasury. In this way, the surcharge is not "indirect" in the sense that we ordinarily use this word: to signify a roundabout way of achieving a particular object; or methods that involve deception or a subterfuge.[33]

This case is thus different from the early, landmark case of *McCulloch v. Maryland*.[34] In that case, the U.S. Supreme Court expressed concern that Maryland's tax assessments upon the Bank of the United States would result in the destruction of the Bank itself.[35] Here, the federal entity is not legally responsible for payment of the surcharge or its intended source of revenue.[36]

Further, the structure of both the FEHBA and TRICARE statutes are at odds with the economic pass-through claims made by the Hospitals today. Both 5 U.S.C. § 8909 (f) and 10 U.S.C. § 1103 (a) limit their reach to insurance carriers, underwriters or plan managers. Lower-tier contractors – such as hospitals, clinics, local physicians and medical supply companies – all may receive money that was earlier drawn from the FEHBA account, but only after it has been disbursed by the carriers or plan managers. The preemption provisions do not reach these lower-tier contractors or shield them from state surcharges.

More telling still, the insurance carriers themselves cannot claim relief from some state assessments under 5 U.S.C. § 8909 (f) and 10 U.S.C. § 1103 (a). Each of these statutes allows taxes directly upon the federal carriers if the "tax, fee, or payment is applicable to a broad range of business activity."[37] To accept the argument of the

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[32] *Id*. at 218-19.

[33] *See,* Merriam-Webster Online Dictionary (http://www.merriam-webster.com/dictionary/indirect) ("Indirect").

[34] *McCulloch v. Maryland*, 17 U.S. 316 (1819).

[35] *See, McCulloch v. Maryland*, 17 U.S. at 427-32 ("That the power of taxing it by the States may be exercised so as to destroy it is too obvious to be denied…. If the States may tax one instrument, employed by the Government in the execution of its powers, they may tax any and every other instrument. They may tax the mail; they may tax the mint; they may tax patent rights; they may tax the papers of the custom house; they may tax judicial process; they may tax all the means employed by the Government to an excess which would defeat all the ends of Government. This was not intended by the American people. They did not design to make their Government dependent on the States.").

[36] *See, U.S. v. West Virginia*, 339 F.3d at 219 ("The mere fact that a provider may opt to pass through the cost it bears to carriers, does not, in my judgment, transform the West Virginia provider tax into an illicit indirect imposition of a state tax upon the FEHBP fund") (Traxler, J., concurring).

[37] *See,* 5 U.S.C. § 8909 (f)(2) and 32 C.F.R. § 199.17 (a)(7)(iii); *see also, United States v. Fresno,* 429 U.S. 452, 459-60 (1977) ("the economic burden on a federal function of a state tax imposed on those who

Hospitals, therefore, one must conclude that Congress sought to prohibit federal health care plans from paying any portion of state taxes that are applied to lower-tier vendors, but is content to pay state taxes directly applied to the federal carriers so long as they are "broadly applicable." This is not a sensible reading of Congressional purposes or the statutes themselves.

For all of these reasons, the Administrative Law Judge recommends that the Commissioner conclude that Minnesota's surcharge is not preempted by federal law, grant summary disposition to the Department and affirm her earlier denial of the Hospitals' appeals.

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deal with the Federal Government does not render the tax unconstitutional so long as the tax is imposed equally on the other similarly situated constituents of the State").