

preamble language quoted above: "a program operated by an educational institution that is related to the provider through common ownership or control would not be considered to meet the criteria for provider operated" (66 FR 3363).

However, we understand that some hospitals, including this hospital, may have interpreted the preamble language that stated, "if the provider demonstrates that the educational institution it has established is wholly within the provider's control and ownership and that the provider continues to incur the costs of both the classroom and clinical training portions of the program, the costs would continue to be paid on a reasonable cost basis" (Ibid.), to mean that hospitals that establish wholly owned subsidiary colleges or educational institutions would continue to receive Medicare reasonable cost payment if the hospitals incur the costs of the classroom instruction and clinical training. We are proposing to clarify that transferring operation of previously provider-operated programs to educational institutions, even if the institutions are wholly owned by the hospital, does *not* necessarily mean that the programs continue to meet our provider-operated criteria under § 413.85(f). In order to remain provider operated, the hospital must have *direct control* of the program; the hospital itself must employ the teaching staff, have direct control of the program curriculum, and meet other requirements, as stated at § 413.85(f).

While we are proposing to clarify that merely operating programs through a wholly owned subsidiary college does not constitute direct operation of nursing or allied health education programs unless the hospital itself meets the requirements of the regulations at § 413.85(f), we believe it would be unfair to recoup Medicare payments that have already been made to hospitals that meet this very narrow fact pattern. Therefore, we are proposing that Medicare would not recoup reasonable cost payment from hospitals that have received pass-through payments for portions of cost reporting periods occurring on or before October 1, 2003 (the effective date of finalizing this proposed rule) for the nursing or allied health education program(s) where the program(s) had originally been operated by the hospital, and then operation of the program(s) had been transferred by the hospital to a wholly owned subsidiary educational institution in order to meet accreditation standards prior to October 1, 2003, and where the hospital had continuously incurred the costs of both

the classroom and clinical training portions of the programs at the educational institution.

In addition, we are proposing that, for portions of cost reporting periods occurring on or after October 1, 2003, such a hospital would continue to receive reasonable cost payments for the clinical training costs incurred by the hospital for the program(s) described above that were previously provider operated. However, we are further proposing that, with respect to classroom costs, only those classroom costs incurred by the hospital for the courses that were paid by Medicare on a reasonable cost basis and included in the hospital's provider-operated program(s) could continue to be reimbursed on a reasonable cost basis. That is, Medicare would pay on a reasonable cost basis for the classroom costs associated with the courses provided as part of the nursing and allied health education programs (for example, the courses relating to the theory and practice of the particular nursing and allied health discipline(s)) that were offered by the hospital when the hospital was the direct operator of the program(s).

We believe this proposed policy is appropriate since continued pass-through payment will allow these hospitals to maintain equal footing with other hospitals that receive pass-through payments and have maintained their provider-operated programs. In addition, it would not be equitable to discontinue longstanding Medicare pass-through payment to these hospitals (in fact, reasonable cost payment to at least one of these hospitals for nonprovider-operated programs preceded the publication of the January 12, 2001 final rule on nursing and allied health education payments by many years) that restructured operation of their nursing and allied health education program(s) as wholly owned subsidiaries in order to meet accreditation standards while relying on their understanding of CMS' prior expressions of provider-operated requirements and the recent preamble language. If these providers were now forced to restructure in order to meet the requirements of § 413.85(f), they would not be able to maintain their accreditation.

We note that Congress has specifically expressed its intent that providers that have restructured their programs to be operated by a wholly owned subsidiary educational institution in order to meet accreditation standards should continue to receive Medicare reasonable cost payment. In the conference report accompanying the Consolidated

Appropriations Resolution for FY 2003, Congress stated:

"The conferees are particularly concerned about nursing and allied health educational programs that cannot meet the regulations set forth at 42 CFR 413.85(f) solely as a result of regional educational accrediting criteria. Given the shortage of nursing and allied health professionals, the conferees support the payment of costs on a reasonable cost basis for a hospital that has historically been the operator of nursing and allied health education programs(s) that qualified for Medicare payments under 42 CFR 413.85, but, solely in order to meet educational standards, subsequently relinquishes some control over the program(s) to an educational institution, which meets regional accrediting standards; is wholly owned by the provider; and is supported by the hospital, that is, the hospital is incurring the costs of both the classroom and clinical training of the program." (H.R. Rep. No. 108–10, 108th Cong., 1st Sess., 1115 (2003).)

However, the proposed policy does not allow these hospitals to be paid for additional classroom costs for courses that were not paid on a reasonable cost basis to the hospitals in conjunction with their provider-operated programs (for example, additional classes needed to meet degree requirements). We believe that to allow pass-through payment for those additional costs would provide these hospitals with an unfair advantage over other hospitals with provider-operated programs.

We note that any hospital that chooses to restructure its programs to be operated by a wholly owned subsidiary educational institution on or after the effective date of this proposal when finalized (October 1, 2003) would not be eligible for pass-through payments under this proposed provision unless the hospital continues to meet the requirements of § 413.85(f). We believe it is appropriate to limit the proposed payments to hospitals that restructured before this proposed rule is made final because our policy with respect to programs by a wholly owned subsidiary of a hospital will have been clarified in that final rule.

We are proposing to revise § 413.85 by adding new paragraphs (d)(1)(iii) and (g)(3) to reflect this proposed payment policy.

F. Payment for Direct Costs of Graduate Medical Education (§ 413.86)

1. Background

Under section 1886(h) of the Act, Medicare pays hospitals for the direct costs of graduate medical education