

criteria under § 413.85(f).” Rather, the commenter believed that programs that are wholly owned or wholly controlled by a hospital are provider-operated programs. The commenter asserted that CMS’ distinction between provider-operated programs and wholly owned programs conflicts with CMS’ regulations at § 413.17(c)(2) which state that “If the provider obtains items of services, facilities, or supplies from an organization, even though it is a separate legal entity, and the organization is owned or controlled by the owner(s) of the provider, in effect the items are obtained from itself.” The commenter also referenced § 412.2(c)(5)(i) concerning the DRG 3-day payment window that applies to services provided by a hospital or by an entity wholly owned or operated by the hospital, and asserted that there is “no rational basis” for treating wholly owned or wholly controlled affiliates differently for purposes of pass-through payment.

*Response:* The commenter is incorrect in stating that, in the proposed rule, we indicated that wholly owned (or wholly controlled) programs by definition cannot meet the provider-operated criteria and, therefore, would not qualify for reasonable cost pass-through payments. In fact, as we have stated in the January 12, 2001 final rule (66 FR 3363), and reiterated in the preamble to the proposed rule, if the hospital that wholly owns the educational institution meets the provider-operated criteria, the hospital would qualify to receive reasonable cost pass-through payment. Specifically, we stated in the proposed rule (68 FR 27210) that “Concerning those hospitals that have established their own educational institution to meet accrediting standards, we believe that, in some cases, these providers can be eligible to receive payment for the classroom and clinical training of students in approved programs. \* \* \* An example of a program that *could be considered provider-operated* would be one in which the hospital is the sole corporate member of the college, elects the board of trustees, has board members in common, employs the faculty and pays the salaries, controls the administration of the program and the curriculum, and provides the site for the premises of the hospital (emphasis added). Thus, while we still believe 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) (68 FR 27211), we reiterate that only in instances where the hospital continues to meet the provider-operated criteria under § 413.85(f) would the hospital continue to qualify for reasonable cost pass-through payments, as it did prior to transferring operation of a provider-operated program(s) to a wholly owned educational institution.

The commenter also mentioned the generally applicable “related-entity” rules, and suggested that a wholly owned school would be a related entity that should be treated as if it is the provider. Thus, a wholly owned educational institution would remain provider-operated. However, we note that, for purposes of nursing or allied health education payment under § 413.85, it is not sufficient for a program to be operated by a related entity. Rather, the “related entity” principles do not apply under the agency’s nursing and allied health education payment policy because, as indicated in previous rulemakings, that policy requires that a program be directly operated by the provider itself. Requiring direct operation of a program by the provider ensures that, under § 413.85(c), costs borne by related organizations (that is, the community) are not redistributed to the hospital and claimed as a pass-through under the Medicare program.

*Comment:* Commenters requested clarification on whether the proposed change regarding providers that created wholly owned subsidiary educational institutions to meet accreditation requirements would have any effect on provider-operated nursing or allied health programs that have entered into written contracts with colleges or universities to award their degrees.

*Response:* As we have explained in response to a previous comment, the proposed change was extremely limited in scope and only relates to hospitals with a unique set of circumstances surrounding operation of their programs by a wholly owned subsidiary educational institution. Therefore, the proposed changes do not have any impact on existing policy related to hospitals that enter into contracts with academic institutions to award their degrees. However, we stress that, in the instance where an academic institution other than the hospital grants the final certificate or degree upon completion of the program, the burden of proof is on the hospital to demonstrate that it, in fact, meets the “provider-operated” criteria under § 413.85(f) before reasonable cost payment may be made to that hospital.

*Comment:* One commenter believed that it is inappropriate to use the term “wholly owned” in reference to entities that, in many cases, are nonprofit institutions because, technically, nonprofit organizations are public trusts. The commenter suggested that it would be more accurate to refer to “wholly owned” or “wholly controlled” educational institutions.

*Response:* We believe that, for purposes of payment under § 413.85, it is appropriate to use the term “wholly owned.” Although we recognize that nonprofit entities would not technically be “wholly owned” since they do not issue stock, we do not agree with the commenter that “wholly controlled” is an appropriate alternative because of the potential for confusion over issues relating to “control” and “provider operation.” Further, we believe that the term “wholly owned” is commonly used in the context of nonprofit entities, and implies the kind of relationship we intend—where there is a single founder or member. Therefore, we will continue to use the term “wholly owned subsidiary” in the context of payment under § 413.85.

We are finalizing the two proposals associated with programs operated by wholly owned subsidiary educational institutions of hospitals. Specifically, we are finalizing the proposal under new § 413.85(g)(3) that, effective for portions of cost reporting periods occurring on or after October 1, 2003, a provider that incurs costs for a nursing or allied health education program(s) where those program(s) had originally been provider-operated, and then operation of the program(s) was transferred to a wholly owned subsidiary educational institution in order to meet accreditation standards prior to October 1, 2003, and where the provider has continuously incurred the costs of both the classroom and clinical training portions of the program(s) at the educational institution, may receive reasonable cost payment for such a program(s). Further, reasonable cost payment will be made if a provider received reasonable cost payment for those nursing and allied health education program(s) both prior and subsequent to the date the provider transferred operation of the program(s) to this wholly owned subsidiary educational institution (and ceased to be provider-operated program(s)). Such a provider would receive reasonable cost payments for: (a) The clinical training costs incurred for the program(s), and (b) classroom costs, but only those classroom costs incurred by the provider for the courses that were included in the programs that were