IN THE SUPREME COURT OF MISSISSIPPI

HTC HEALTHCARE II, INC. — **APPELLANT**

V. — **NO. 2007-SA-01086**

MISSISSIPPI STATE DEPARTMENT OF HEALTH & GEORGE COUNTY HOSPITAL — **APPELLEES**

APPEAL FROM THE DECISION OF THE HINDS CHANCERY COURT, FIRST JUDICIAL DIVISION

REPLY BRIEF FOR APPELLANT

ORAL ARGUMENT NOT REQUESTED

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REBUTTAL ARGUMENT

I. It Was Arbitrary and Capricious for the Department to Ignore the Surrounding Facts Concerning the True Medicaid Per Diem Rate.

The single most dispositive issue in this case, requiring reversal, is the issue of the Medicaid per diem rate, addressed at issue I of HTC's first brief. The Mississippi State Department of Health ("the Department") and George County Hospital ("GCH") bury their attempted response to this issue in part C of their brief's Argument section. GCH Brief at 21-23. However, this response dodges the issue and fails on the merits, proving that reversal of the CON grant is proper.

As this Court will recall from HTC's first brief, the per diem issue arises because the Certificate of Need ("CON") application for GCH relied upon a Medicaid per diem rate that everyone knew would not be the rate actually in effect for GCH when it began operations. Everyone knew this because the regulations implementing the change in upper payment limits (UPLs) already had been published. Rather than receiving $69.50 per patient per day from Medicaid, GCH would actually receive about $250.00 *more* per patient per day, because as a state-owned facility, it would qualify to be reimbursed by the state Medicaid program at the higher Medicare rate (the "upper payment limit").

HTC showed in its initial brief that GCH's administrator, Paul Gardner, admitted the following under cross-examination:

- that GCH would qualify for the UPL (T.151);
- that the UPL was "not extended to privately-owned nursing homes" such as his competing applicants (T.151);

- that GCH would thus be reimbursed at the higher Medicare rate for its Medicaid nursing-home residents (T.152);
- that GCH would "get paid $250.00 more for [each] Medicaid patient than [HTC] would get paid because [GCH is] a County hospital" (T.153).

In short, there was no question of fact before the Department on this issue, and there is none before this Court: the CON application did not accurately state the reimbursement rate for GCH.

Faced with the devastating admissions of Mr. Gardner, GCH and the Department have taken refuge in three defenses: (1) the UPL change wasn't effective yet on June 3, 2002, when the CON application was filed; (2) the federal regulation in question allowed Medicaid to postpone implementing the UPL rates until 2008; and (3) Medicaid's own per diem estimates found GCH's per diem to be a couple of dollars lower than HTC's. None of these defenses has any merit.

A. The Department Should Have Looked to the Real Rates.

First, we're told, the UPL changes were not already in effect on the date that the CON application was filed, and therefore, the CON application should have been judged by the existing rates, rather than by the rates that everyone knew would actually be applied. GCH Brief at 21. We completely agree with Appellees that the Department should disregard *unforeseeable* changes that occur after the filing of the application.

But such unforeseeable changes, or even probable-but-uncertain changes like the rise in construction costs mentioned by Appellees (at 22), are not what's at issue in the present

case. *Here*, we are talking about *known changes in regulations that were already published.*[1] There was nothing unforeseen about the UPLs and about GCH's entitlement to greater reimbursement, and therefore, the Department should have taken into account the known facts surrounding the GCH per diem rate — particularly after Mr. Gardner's admissions went on the record at the hearing during the course of review.

To ignore the CON applicant's own admission under oath that his per diem reimbursement would be $250.00 more than $69.50, merely because GCH got its application filed shortly before that rate went into effect, is quintessentially an arbitrary and capricious act: done with "disregard for the surrounding facts." *Miss. State Dep't of Health v. Natchez Cmty. Hosp.*, 743 So. 2d 973, 977 (Miss. 1999).

We draw this Court's attention to the fact that this "surrounding facts" language was drawn by this Court ultimately from a decision of the North Carolina Supreme Court. *See Miss. State Dep't of Health v. S.W. Miss. Reg'l Med. Ctr.*, 580 So. 2d 1238, 1240 (Miss. 1991) (quoting *In re Hous. Auth. of City of Salisbury, N.C.*, 70 S.E.2d 500, 503 (N.C. 1952)). In that North Carolina case, the court held that it was arbitrary and capricious for the agency in question to ignore effects "likely to come" in the future. *In re Hous. Auth.*, 70 S.E.2d at 504. Similarly, it was arbitrary and capricious for the Department in this case simply to

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[1]As an aside, the fact of prior publication is what distinguishes the present case from *Greenwood-Leflore Hospital v. Mississippi State Dep't of Health*, No. 2007-SA-00877 (Apr. 17, 2008), *mandate iss'd*, May 1, 2008. In that case, new federal regulations were published in the *Federal Register* in between the chancery court's affirmance of the CON grant and the appeal of that decision to this Court. *Id.* at ¶ 15 n.7. This Court properly held that it would not consider matters outside the record and happening after the appeal had been filed. *Id.* at ¶ 16. By contrast, the present case involves regulations that were published before the CON application was even filed.

disregard the facts of the UPL rate that was not merely "likely," but a known *fact* controlling the greater reimbursement which GCH, and GCH alone, would receive.

Where, as in the particular, limited instance present here, the "surrounding facts" include the knowledge of the agency or department that the state of affairs at the time of the application, does not in fact agree with the state of affairs at the time of the facility's actual operation, we submit that it is arbitrary and capricious to base an administrative decision on the unrealistic, existing state of affairs at the time of the application. This narrow holding agrees with the rationale set forth in *Natchez Community Hospital*, which itself merely recounts black-letter law regarding the "arbitrary and capricious" standard of review.

We believe that this Court should look to such precedents as that of the South Dakota high court, which held that it was arbitrary and capricious for a municipality to base utility rates on a particular "test year" when the municipality's own witness admitted that "those low costs would not be experienced again within the foreseeable future." *N.W. Pub. Serv. Co. v. City of Chamberlain*, 265 N.W. 867, 879 (S.D. 1978). Given the city's own knowledge that higher rates would prevail in the future, it was arbitrary and capricious of the city to legislate on the basis of those lower rates. *Id.*

B. The UPL Rates Were in Effect Before the CON Was Granted.

The Department and GCH try to distract this Court by implying that the UPL might not have been actually in effect until as late as 2008, in which case the Department might have had a more reasonable basis for not taking them into account. GCH Brief at 21-22. It's true that the federal regulation, 42 C.F.R. § 447.272(d)(1), provides states with the option for such a late implementation. But that argument will not work, because of yet another admission by Mr. Gardner at the hearing on October 18, 2004:

A. . . . so I can't speak to what UPL would have done when the application would have been filed, but, yes, sir, by **today**, if we get it, **we will be entitled to that money**, but that's a Federal program and was not a factor when that application was originally filed.

Q. But the answer to my question, though, is — is that you're going — if we just go get them built, start building **today** and get them built, you're going to get **paid $250.00 more** for that Medicaid patient than my client would get paid because you're a County hospital, correct?

A. **Yes, sir, that's correct.**

T.152 (emphasis added). HTC respectfully submits that Appellees are estopped from pretending that the UPL rates "might" have been in effect as late as 2008, when by Mr. Gardner's own testimony, the rates were already in effect no later than October 18, 2004.

C. The Alleged Medicaid Calculations Are Not Supported by the Record and Are Not Substantial Evidence.

The final recourse of GCH and the Department, in justifying the Department's error, is to appeal to the finding of another state agency, the Division of Medicaid. In boldfaced sentences at three different points in their brief, Appellees breathlessly notify this Court that Medicaid "itself projected the Medicaid per diem for each of the three applicants," and that GCH's was supposedly lowest. GCH Brief at 22; *see also* GCH Brief at 7, 13 (same).

We do not find in the record, and Appellees certainly do not cite, any letter from Medicaid setting forth its estimate of the per diem costs. Appellees themselves cite only to the Department's own staff analyses, which claim that Medicaid arrived at certain figures. GCH Brief at 7, 13, 22. We have no indication that Medicaid took UPL rates for GCH into account, or on what basis it supposedly made these calculations. All we have is, frankly, hearsay — a Department document alleging that Medicaid found thus-and-such.

As this Court can see from the comparative analysis that's attached at the end of each of Appellees' record excerpts, the Department in fact relied on the per diem rates calculated by the applicants themselves, not on any rate allegedly calculated by Medicaid. Therefore, the Department cannot now profess to rely upon the alleged Medicaid calculations.

The Medicaid numbers were $109.55 per diem for GCH and $110.62 for HTC, but the Department relied on the per diem figures calculated by the applicants and stated in their CON applications. This provides a valuable insight into the CON application process, since this Court can see that the $69.50 figure claimed by GCH is in its June 28, 2002 *supplement* to its CON application. (The supplement is in the Department record as Exhibit 1, and the substituted page is page 37; we attach that page as exhibit A to this brief.) Previously, in its application filed June 3, 2002 (ex. 2 in the Department record), GCH at page 37 (exhibit B to this brief) had projected a per diem of $73.52.

The basis for the correction, one just might possibly infer, is that HTC had projected *its* own per diem to be $73.20, which would have been the lowest per diem of the three applicants. *See* Appellees' R.E. 1 at 11. However, once GCH had "supplemented" its application, it was GCH that had the lowest per diem. This resembles a game of "rock, paper, scissors," in which, when you see your opponent's "rock" versus your "scissors," you "supplement" your move by playing "paper" instead. Kindergartners would have the good sense to rebel at such a "supplementation" rule, but it raises no eyebrows at the Mississippi State Department of Health.

Regardless, the problem with the alleged Medicaid rates goes beyond the fact that the Department didn't use them. The closeness of the estimates for GCH and HTC — they are $1.07 apart — provides unmistakable proof that the UPL was not taken into account in

figuring those estimates. The Department had before it the testimony of GCH's own administrator that the real rate of reimbursement would be about $250.00 *more* per diem than HTC could receive as a non-public entity. Whether the estimated per diems without the UPL should have been about $70.00 (as in the applications) or closer to $110.00 (as in the alleged Medicaid estimates), a UPL bonus to GCH of $250.00 *more*, which its administrator admitted to at the hearing, would inescapably make HTC's reimbursement lower than GCH's. In failing to take this "surrounding fact" into account, the Department acted arbitrarily, capriciously, and without substantial evidence.

This is not a case where the Department had substantial evidence of two different possibilities — either GCH's per diem rate would be about the same as HTC's, or else it would not — and must be deferred to in its choice of which evidence to believe. (*Any* deference to the hearing officer's borrowed "opinion" is of course suspect, as set forth at Issue III below.) Substantial evidence can only be such as reasonable people would find adequate to base their conclusion upon. *Pub. Employees' Ret. Sys. v. Marquez,* 774 So. 2d 421, 425 (Miss. 2000). No reasonable person, having heard GCH's administrator admit under oath that his reimbursement with the UPL would be $250.00 more than HTC's, could take on faith unexplained Medicaid calculations that themselves seem based on the rates in effect on the application date, and that do not appear to have taken the UPL into account.

We also remind this Court that its review is not confined to looking at the evidence that the Department happened to find plausible: the appellate court "must look at the full record before it in deciding whether the agency's findings were supported by substantial evidence," and in its review, "it is not relegated to wearing blinders."*Marquez,* 774 So. 2d at 425, 427. Unfortunately, by restricting its gaze to the per diem rates on the day of the

application's filing (or of the "supplemental" filing, 28 days later), the Department itself wore blinders that kept it from looking to *what the actual costs were indisputably going to be*, according to GCH itself.

In light of that undisputed admission that GCH would get $250.00 more per diem than HTC could, there simply was not any "substantial evidence" on which the Department could reasonably base its conclusions.

The Department, and in particular the State Health Officer (as the entity empowered to grant or deny a CON), must follow the State Health Plan, including the directive to make cost containment one of the principal goals in evaluating need for a project. Whatever the general effectiveness of looking to the per diem rates as of the date of the application, in the unusual case (like this one) where then-existing regulations set a change that will be in effect when the CON is granted, cost containment is not served by the Department's wearing blinders or by stubbornly persisting in its "date of application" standard in flat contradiction to what the surrounding facts clearly and undeniably are.

The relief sought by HTC here hinges on the Department's "point system" for awarding a CON to competing nursing-home applications. Because the award of one point to GCH for its incorrect per diem figure should have been replaced by three points (for the highest per diem rate), and because HTC would then have been the winner in that category with only one point, HTC should have totaled 12 points against GCH's 13 points.

Therefore, HTC should have been granted the CON under the Department's own rules for determining which competing applicant should be awarded the CON for nursing-home beds. This Court should therefore reverse and render for HTC.

In the alternative, this Court could reverse the grant of the CON and remand for the Department to make its decision on the basis of the correct per diem rates, with the UPL taken into account.

II. Substantial Evidence Does Not Support the Construction Figures Set Forth by GCH.

As regards the issues raised at issue II of HTC's initial brief, and responded to at part D of the argument in the response brief, HTC stands by the arguments set forth therein.

III. Appellees Have Conceded That a Heightened Standard of Review Applies.

Regarding the issue of the correct standard of review for this Court, which Appellees address at part E of their argument, we reply only to take note that Appellees do not in fact anywhere contest that a heightened standard of review is proper in this case, given the adoption by the hearing officer (and then by the State Health Officer), verbatim, of GCH's proposed findings and conclusions.[2] They merely contend that, even under that standard of review, they prevail.

For the reasons shown particularly at Issue I, above, that is not the case, and this Court should indeed look at the reasoning that GCH wrote for the hearing officer "with a jaundiced eye," particularly where the hearing officer (and, by adopting the hearing officer's decision, the State Health Officer) casually accepts GCH's position on the per diem issue. This is not a case where the Department closely considered the two contenders' positions on

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[2]GCH clearly continues to take pride of authorship in the opinion it wrote for the hearing officer, inasmuch as GCH cannot resist using much of the same language in its brief to this Court. See, for example, GCH Brief at 31 n.6, which repeats verbatim (and without quotation marks) the footnote that GCH wrote for the hearing officer's February 14, 2005 decision at page 16, note 3. A copy of the decision written for, and signed by, the hearing officer is attached to this brief as Appendix C, and this Court can readily determine that most of the argument on the per diem issue in GCH's brief is simply copied from the same source. Why not, after all? GCH wrote it in the first place.

the per diem issue and then came to its own conclusion. Rather, this is a case where the Department failed to exercise its own expertise and judgment, preferring instead to sign onto "findings" that were found for it by GCH itself. Deference to administrative agencies is not a matter of superstition and taboo, but rather is soundly based on those agencies' "expertise and the faith we vest in them." *Hill Bros. Constr. & Eng'g Co. v. Miss. Transp. Comm'n*, 909 So. 2d 58, 64 (Miss. 2005) (quoting *McGowan v. Miss. State Oil & Gas Bd.*, 604 So. 2d. 312, 323 (Miss. 1992)). Where an interested party's advocacy is substituted for that expertise, this Court's faith should not be carelessly bestowed.

This Court should satisfy itself on the proper findings as regards the per diem issue, without an undue deference to a Department that, as a matter of record, shirked its responsibility to contain our State's rising healthcare costs.

CONCLUSION

For all the reasons stated above and in Appellant's principal brief, the State Health Officer's grant of the CON to George County Hospital should be reversed, and this Court should direct that the CON be awarded to HTC Healthcare II, Inc.

Respectfully submitted, this the *2d* day of May, 2008.

HTC HEALTHCARE II, INC.

By: _____
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Counsel for Appellant

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CERTIFICATE OF SERVICE

The undersigned counsel hereby attests that he has caused the foregoing document to be served via United States mail (postage prepaid) on the persons listed below:

The Honorable Patricia D. Wise
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So certified, this the *2d* day of May, 2008.

Andy Lowry

Andy Lowry

APPENDICES TO REPLY BRIEF

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June 28, 2002

VIA HAND DELIVERY

RP

Harold B. Armstrong, Chief
Division of Planning and Resource Development
Mississippi State Department of Health
570 E. Woodrow Wilson
Jackson, MS 39216

Re: CON Review #NH-CB-0602-036
George County Hospital
60 Skilled Nursing Beds in George County, Mississippi
Revised Capital Expenditure: $ 369,000

Dear Mr. Armstrong:

We have enclosed the original and three (3) copies of a Supplement to Certificate of Need Application for the above referenced project. This Supplement includes "substitution" pages and exhibits for the Certificate of Need Application filed by the Applicant on June 1, 2002. Included in the Supplement are the items requested by the Mississippi State Department of Health in its request for additional information. Those items are a site approval letter and the admissions policy.

Should you have any questions regarding the enclosures, please contact me or Pam Jacobus of my office. We greatly appreciate your usual courtesies and assistance.

Very truly yours,

BAKER, DONELSON, BEARMAN & CALDWELL

Barry K. Cockrell

BKC:mb
Enclosures

JM BKC 160495 v1
137001-96444 06/28/2002

13. Costs for First Full Year of Operation:

a)	**Total Facility/Service Costs**	$1,473,790
	Less non-allowable costs:	462,241
	Total allowable costs	$1,011,549
	Total Patient Days	14,987
	AVERAGE ALLOWABLE COST PER DAY*	$67.50

* Total allowable costs divided by total patient days.

b) Nursing Homes Only:

Lesser of allowable cost per day plus $2.00 or Medicaid maximum per day ($111.23*)	$69.50
Projected Annual Medicaid Patient Days	X 5,245
ESTIMATED MEDICAID REIMBURSEMENT	$364,528

14. What impact will the project have on the various payors?

	Increased Annual Operating Expense for First Full Year
Medicaid	$ 364,528
Medicare	831,946
Private Pay/Other	277,316
TOTAL	$1,473,790

a. Provide a breakdown of how the proposed project relates to inpatient and outpatient services.

Not applicable.

b. Provide the occupancy rate, Medicaid utilization and Medicare utilization for the three succeeding years after the implementation of the project.

	Year One	Year Two	Year Three
Occupancy Rate	68%	80%	85%
Medicare Utilization	46%	46%	45%
Medicaid Utilization	35%	35%	35%
Other Utilization	19%	19%	19%

13. Costs for First Full Year of Operation:

a)	**Total Facility/Service Costs**	$1,455,943
	Less non-allowable costs:	444,350
	Total allowable costs	$1,011,594
	Total Patient Days	14,144
	AVERAGE ALLOWABLE COST PER DAY*	$71.52

* Total allowable costs divided by total patient days.

b) **Nursing Homes Only:**

Lesser of allowable cost per day plus $2.00 or Medicaid maximum per day ($111.23*)	$73.52
Projected Annual Medicaid Patient Days	X 6,479
ESTIMATED MEDICAID REIMBURSEMENT	$476,336

14. What impact will the project have on the various payors?

	Increased Annual Operating Expense for First Full Year
Medicaid	$ 476,333
Medicare	866,615
Private Pay/Other	168,744
TOTAL	$1,511,692

a. **Provide a breakdown of how the proposed project relates to inpatient and outpatient services.**

Not applicable.

b. **Provide the occupancy rate, Medicaid utilization and Medicare utilization for the three succeeding years after the implementation of the project.**

	Year One	Year Two	Year Three
Occupancy Rate	65%	80%	85%
Medicare Utilization	45%	46%	45%
Medicaid Utilization	46%	46%	46%
Other Utilization	9%	8%	9%

BEFORE THE MISSISSIPPI STATE DEPARTMENT OF HEALTH

CON REVIEW NH-CB-0602-036
GEORGE COUNTY HOSPITAL
ESTABLISHMENT/CONSTRUCTION OF
A 60-BED SKILLED NURSING FACILITY
IN GEORGE COUNTY, MISSISSIPPI
CAPITAL EXPENDITURE: $369,000

HEARING OFFICER'S FINDINGS OF FACT, CONCLUSIONS OF LAW AND RECOMMENDATIONS

As the independent Hearing Officer appointed to conduct the public hearing during the course of review on the above-styled certificate of need ("CON") application, I hereby make the following Findings of Fact, Conclusions of Law, and Recommendations.

I. SUMMARY OF PROCEEDINGS

This proceeding involves the comparative review of three (3) competing CON applications for the construction of a 60-bed nursing facility in George County, Mississippi. In 1999, the Mississippi Legislature authorized the Mississippi State Department of Health (the "Department") to issue certificates of need over the course of four (4) fiscal years for the construction or expansion of nursing facility beds in each county in the State having a need for fifty (50) or more nursing facility beds, as shown in the *Fiscal Year 1999 State Health Plan.* George County was one of the six counties authorized for additional beds during the year 2003. (Exh. 3).

It is undisputed that there is a need for 60 nursing facility beds in George County. (T:29-30). However, the Department can award only a single certificate of need for the establishment of a 60-bed nursing facility in that county. Accordingly, the Department staff utilized a comparative review process for the review and evaluation of the competing applications. According to Ms. Rachel Pittman, Chief of the Division of Health Planning and Resource

Development, the Department staff used the identical process in evaluating more than 100 CON applications filed for nursing facilities over the four-year period. (T:24; 28).

In order to conduct a comparative analysis of the competing applications, the Department staff consistently applied the same comparative review criteria. These criteria are described in the *Mississippi Certificate of Need Review Manual* (the "CON Manual") as follows:

> **Competing Applications:** The factors which influence the outcome of competition on the supply of health services being reviewed. Determination will be made that the entity approved is the most appropriate applicant for providing the proposed health care facility or service. Such determination may be established from the material submitted as to the ability of the person, directly or indirectly, to render adequate service to the public. Additional consideration may be given to how well the proposed provider can meet the criteria of need, access, relationship to existing health care system, availability of resources, and financial feasibility. **In addition, the Department may use a variety of statistical methodologies, including but not limited to, "market share analysis," patient origin data, and state agency reports. In the matter of competing applications for nursing facility beds, the Department will conduct a comparative analysis and make a determination based upon a ranking of all competing applications according to the following factors: size of facility; capital expenditure; cost per square foot; cost per bed; staffing; medicare utilization; total cost to medicaid; per diem cost to medicaid; and continuum of care services. Each factor shall be assigned an equal weight. The application obtaining the lowest composite score in the ranking will be considered the most appropriate application.**

CON Manual at 62 (emphasis added). These comparative review criteria were applied to all of the competing applications for nursing facility CONs, and were used in the comparative analysis of the three applications submitted for a nursing facility in George County.

According to Ms. Pittman, these comparative review criteria were developed to encourage applicants to submit the most cost-effective proposal possible. (T:31-32). One of the primary goals of health planning in the State of Mississippi is cost containment. (T:31). Consequently, one of the Department staff's priorities in reviewing the competing applications

was the cost effectiveness of the proposal being submitted. (T:31). Thus, the Department staff favored applicants proposing to use existing health care facility space for the proposed nursing facilities, in order to achieve greater cost containment. (T:32).

On June 1, 2002, three (3) applications were filed for the construction of a 60-bed nursing facility in George County. The applicants included George County Hospital ("GCH"), a non-profit community hospital owned by George County, Mississippi; HTC Healthcare II, Inc. ("HTC"), a Mississippi proprietary corporation; and Delco, Inc. ("Delco"), a Mississippi proprietary corporation which currently owns a 60-bed nursing home in George County. The Department staff deemed these proposals to be competing applications, and conducted a comparative analysis of the applications, based on the established comparative review criteria.

Upon conducting its comparative analysis of the three (3) competing applications, the Department staff determined that GCH obtained the lowest composite score, based on the designated review factors. Specifically, GCH obtained a composite score of 11, while HTC received a score of 13, and Delco a score of 24. The comparative analysis conducted on the applications by the Department staff is reflected on Attachment II to the Staff Analysis on the GCH application. (Exh. 3). Accordingly, the Department staff recommended approval of the CON application submitted by George County Hospital. This recommendation precluded the approval of the two other applications.

As authorized by Miss. Code Ann. § 41-7-197 and the *CON Manual*, HTC requested a public hearing during the course of review on the GCH application, and the hearing was conducted on September 28, 2004, and October 22, 2004. During the course of the hearing, testimony and exhibits were offered by both parties. Having reviewed and considered this evidence, I am now prepared to issue my report and recommendations in this proceeding.

II. FINDINGS AND CONCLUSIONS ON ISSUES PRESENTED DURING THE HEARING

During the course of the hearing, various issues concerning the competing applications and the comparative review process were raised for review and determination. Each of these issues, as well as my findings and conclusions on each issue presented, are discussed below.

A. Criteria Used in Comparative Analysis

During cross-examination of Ms. Pittman, HTC's counsel raised various questions concerning the methodology employed by the Department staff to review the competing applications on a comparative basis. For example, he questioned the use of a point system, and whether the methodology was dictated by the *CON Manual*. (T:55-56).

As previously discussed, the specific review criteria utilized by the Department staff in conducting a comparative review of these applications were taken directly from page 62 of the *CON Manual*. This section of the *CON Manual* identifies the particular factors that will be used, and states that "[e]ach factor shall be assigned an equal weight." *CON Manual* at 62. The same section mandates that "the application obtaining the lowest composite score in the ranking will be considered the most appropriate application." *Id.*

Obviously, all of the applicants were well aware of the comparative review criteria that would be used by the Department staff in making its analysis and recommendation. The applications were submitted based on these review criteria, and judged accordingly. Clearly, there is nothing improper about the methodology used by the Department staff in reviewing these applications.

Additionally, in the decision of *Attala County Board of Supervisors v. Mississippi State Department of Health*, 867 So.2d 1019 (Miss. 2004), the Supreme Court of Mississippi considered the appeal of a CON awarded during a similar comparative review process concerning the establishment of a 60-bed nursing facility in Attala County. In affirming the

decision of the Chancery Court, which had affirmed the Department of Health's decision to award a CON to Garry V. Hughes, the Supreme Court specifically addressed the Department's use of this same comparative review methodology. The Court held that the methodology utilized by the Department staff in its comparative review of the competing CON applications was not arbitrary or capricious. Further, the Court noted that in previous certificate of need cases, it has emphasized the flexibility and discretion vested in the Department of Health in conducting CON review:

> The methodology used in any given case should not be carved in granite; instead, some flexibility is required. It is prudent to utilize a methodology that will accommodate the various and sundry circumstances found in each individual case.

867 So.2d at 1024, quoting *HTI Health Services of Mississippi, Inc. v. Mississippi State Department of Health*, 603 So.2d 848, 853 (Miss. 1992).

In the same decision, the Court noted that an administrative agency's decision is deemed to be arbitrary "when it is not done according to reason and judgment, but depending on will alone." 867 So.2d at 1024, quoting *Mississippi State Department of Health v. Natchez Community Hospital*, 743 So.2d 973, 977 (Miss. 1999). Further, an action is defined as being capricious when it is "done without reason, in a whimsical manner." *Id.*

There is nothing irrational, arbitrary or whimsical about the methodology used by the Department to conduct its comparative analysis of the competing CON applications. In fact, the Department employed the identical methodology it has consistently used in all comparative reviews of competing nursing home proposals. These criteria are based on the express provisions of the *CON Manual*, and were specifically developed to encourage the submission of cost effective proposals.

In summary, there is no merit to HTC's contention that the methodology employed by the Department was arbitrary, capricious or improper.

B. Continuum of Care

In addition to challenging the Department staff's use of the comparative methodology in general, HTC raised various concerns about the Department's interpretation of these standards. First, HTC suggested that the standard of "continuum of care" in the comparative criteria must be the same as the concept of a "continuing care retirement community," as defined in the *Mississippi State Health Plan.* However, Rachel Pittman was emphatic in her testimony that the two are not the same. (T:59-60). According to Ms. Pittman, the concept of "continuum of care services" as referenced in the comparative criteria, is not the same as a "continuing care retirement community." (T:92-93). Instead, the Department interprets "continuum of care" to refer to various types of health care services that would assist the nursing home residents. (T:93). For example, the acute care services that would be provided by a hospital, such as George County Hospital, would qualify as "continuum of care" because they are beneficial to the residents of the nursing home. (T:93). Accordingly, the Department staff determined that GCH would provide a "continuum of care" by furnishing other health-related services on the same campus, for the benefit of the nursing home residents. (T:93).

It should be noted that the Department staff also awarded a point to each of the other two applicants for agreeing to provide a continuum of care. For example, HTC proposed to construct an adjacent assisted living facility, in order to offer that level of service to the nursing home residents. Similarly, Delco proposed to offer continuum of care, and that proposal was accepted by the Department.

In short, all of the applicants demonstrated, to the satisfaction of the Department staff, that their proposal met the requirement for offering a continuum of care. There is nothing in the regulation to suggest that continuum of care in this context is limited strictly to a continuing care retirement community. In fact, the chief of health planning at the Department repeatedly

testified that this standard was not limited to a CCRC. It would be improper to engraft upon the face of the regulation a meaning or interpretation never intended by the Department staff. Thus, there is no basis for HTC's challenge to the Department's interpretation of the continuum of care standard.

C. Cost Per Square Foot

HTC offered testimony in an effort to show that the Department of Health staff did not properly calculate cost per square foot in reviewing these applications. Specifically, HTC questioned both the manner of calculation, as well as the resulting cost per square foot proposed by George County Hospital.

In explaining the Department staff's calculation of cost per square foot for the GCH proposal, Ms. Pittman testified that the staff started with GCH's proposed total capital expenditure of $369,000, and deducted non-fixed equipment cost of $15,000.00. (T:35-36). This resulted in a total construction cost figure of $354,000. The Department staff then divided $354,000 by 25,370 square feet, which is the amount of space proposed to be utilized for the nursing facility (both existing and new construction). (T:35-36). The result is a cost per square foot of $13.99. (T:36). Ms. Pittman testified that the Department staff used this methodology in order to give credit to an applicant proposing to use existing, already built space for the proposed nursing facility which, as previously discussed, was one of the cost containment approaches encouraged by the Department. (T:35-37).

HTC contends that a different calculation should have been used by the Department in calculating cost per square foot. Ted Cain, the owner of HTC, testified that he felt it would be more appropriate to use the following formula in determining GCH's cost per square foot:

$$\frac{319{,}000 + 2{,}500 + 20{,}000 + 10{,}000}{7{,}487 \text{ (actual)}} = 46.95 \text{ cost per sq. ft.}$$

(Exhibit 22).

Mr. Cain contends that this formula would be a more "apples to apples" comparison to his project, because it compares actual new construction in both applications. (T:205-206). However, the formula proposed by Mr. Cain does not take into account the fact that George County Hospital also proposes to use existing space within the hospital for the proposed nursing facility. The formula proposed by Mr. Cain looks strictly at new construction costs, and ignores the significant amount of already constructed space that George County Hospital will use in operating the nursing home.

As previously discussed, Ms. Pittman testified that the Department of Health's comparative evaluation encouraged the use of existing space in order to achieve cost effectiveness. Clearly, George County Hospital has submitted the most cost effective proposal by virtue of its extensive utilization of existing space.[1] The calculation used by the Department, which resulted in a cost per square foot of $13.99 for the GCH proposal, is not an unreasonable or arbitrary method for taking into account the use of existing hospital space.

In support of his argument, HTC suggests that the CON Manual dictates the use of a specific formula for the calculation of cost per square foot. However, the comparative review criteria developed by the Department of Health staff for the comparative review of nursing facility applications simply states that one of the factors to be considered is "cost per square foot." It does not designate the particular formula to be used for calculating cost per square foot during the comparative review of competing nursing home applications. Consistent with its goal of encouraging cost effective proposals through the use of already constructed space, the Department of Health used a cost per square foot formula which factored in both the cost of new

[1] HTC contends that its proposed nursing facility would be added to a planned personal care/assisted living facility. However, the evidence at the hearing established that the assisted living facility was not in existence at the time HTC's CON application was submitted and, in fact, still had not been constructed at the time of the hearing, more than two years later. (T:226).

construction and the use of existing space. This is a rational analysis used by the Department to further the well-established health planning goal of cost containment.

In prior certificate of need decisions, the Supreme Court of Mississippi has made it clear that the methodologies utilized by the Department of Health in reviewing certificate of need applications are not "carved in granite." *HTI Health Services of Mississippi, Inc. v. Mississippi State Department of Health*, 603 So.2d 848, 853 (Miss. 1992). Instead, the Department staff is accorded flexibility, subject to the requirement that the tools and approaches used by the Department cannot be arbitrary or capricious. "The Department's power is limited only in that its actions may not be arbitrary and capricious." *Mississippi State Department of Health v. Southwest Mississippi Regional Medical Center*, 580 So.2d 1238, 1240 (Miss. 1991). In this instance, the Department staff's method for calculating cost per square foot is not only reasonable, but consistent with its stated goal of encouraging cost-effective proposals. Accordingly, there is nothing arbitrary, capricious or improper about the method used by the Department staff to calculate cost per square foot.

Another issue raised by HTC concerns a comparison of GCH's proposed cost per square foot to the construction costs reflected in the *Means Construction Cost Data* book. Ms. Pittman testified, however, that the *Means Construction Cost Data* does not take into account a situation such as that presented in this case, in which a nursing home proposal involves both new construction and use of existing space. (T:90-91). It is true that George County Hospital's estimated cost per square foot of $13.99 is much lower than the estimated costs shown in the *Means Construction Cost Data*. However, that is a direct result of the previously discussed method used by the Department staff in determining cost per square foot with regard to these competing applications.

Additionally, George County Hospital presented substantial evidence in support of the reasonableness of its projected cost for new construction. Mr. Charles Gardner, a licensed architect who assisted in the formation of the construction costs for the GCH proposal, testified that the Hospital's estimated new construction cost of approximately $42.00 a square foot was reasonable and achievable. (T:159-161). He pointed to a number of factors that would contribute to relatively low new construction costs, such as the flat site, good soil conditions, simple one-story construction, and other factors. (T:157-160). As Paul Gardner, the Hospital Administrator pointed out, the Hospital's estimated new construction cost is actually slightly higher than HTC's calculation. (T:115). Paul Gardner noted that the Hospital planned to save considerable money by acting as its own construction manager and by doing a significant amount of the construction work in-house. (T:115). He further noted that the Hospital's new construction cost per square foot was comparable to projections submitted by other applicants for nursing home CONs. (T:144-146).

In summary, the method used by the Department of Health staff to calculate cost per square foot in reviewing the competitive applications was both reasonable and proper. Additionally, there is substantial evidence in the record to support the reasonableness of the construction costs proposed by George County Hospital. Thus, there is more than adequate support for the Department staff's conclusion that, when all factors are considered, George County Hospital proposed the lowest cost per square foot, and was properly awarded the lowest score under this criterion.

D. Compliance With Licensure Standards

HTC also questioned the Hospital's proposed use of space in the existing facility, and whether this space was in compliance with the applicable licensure regulations for nursing facilities. In addressing this contention, it first should be noted that, as confirmed by

Ms. Pittman, the Department staff does not review CON applications for compliance with licensure standards. (T:93-94). Instead, the CON process focuses on compliance with the *State Health Plan* and the applicable criteria in the *CON Manual*. (T:93). Of course, when the facility is constructed, it must meet the minimum licensure requirements. The successful applicant will be required to construct the facility according to the proposal contained in the CON application, and if the licensure standards cannot be met, the facility will not be licensed.

Although compliance with the licensure regulations is not the focus of a CON hearing, it should be noted that George County Hospital presented substantial evidence to show that the proposed space will comply with these requirements. During his rebuttal testimony, Paul Gardner addressed in detail each of the points raised by HTC with respect to the use of various areas in the Hospital for the nursing facility. Mr. Gardner testified that the Hospital currently has two emergency generators with capacity to handle the new nursing home addition. (T:234). The Hospital's kitchen and food storage areas are in place, and would be used for preparation of meals for the nursing home residents. (T:234). Two of the private rooms in the existing part of the Hospital would be dedicated for special care. (T:234). The Hospital deals with isolation every day, and two of the existing hospital rooms would be designated as isolation rooms. (T:234-235).

Mr. Gardner also testified that available rooms within the Hospital would be used as a utility room and for other purposes in caring and treating for the nursing home residents. (T:235). Additionally, the Hospital has areas available for a dedicated waiting area, lobby areas, activities room and plenty of other space for patients and the members of their family to meet. (T:235). Mr. Gardner stated that the Hospital already has a garbage can cleaning area that meets and exceeds regulatory requirements. (T:235-236). Social services and utilization personnel are

already located in the Hospital and they will also be providing those services for nursing home residents. (T:236).

With regard to questions raised by Mr. Cain concerning an administrator' office, Paul Gardner testified that this office would be located within the hospital building that would include the nursing home. (T:236-237). Accordingly, this arrangement is in compliance with the regulations of the Mississippi State Board of Nursing Home Administrators, which require the offices of the nursing home administrator to be in the nursing facility. (Exh. 23).

Another area addressed by both Paul Gardner and Charles Gardner concerns the sprinkler system. Paul Gardner testified that in 2000, the Hospital completed a 25,000 square foot addition to the facility. (T:237). That area was required to be sprinkled. Mr. Gardner noted that the Hospital plans to sprinkle the other remaining 30,000 square feet of the old existing hospital building, regardless of whether GCH receives a CON for the nursing facility. (T:237-238). In any event, Charles Gardner verified that the total cost of adding a sprinkler system to the nursing facility area would be only $25,000. (T:172).

Paul Gardner also discussed the Hospital's plans for a nurse call system within the nursing facility. Mr. Gardner confirmed that the Hospital's existing nurse call system can be expanded into the new nursing facility area, and that was taken into account in projecting the cost of the project. (T:238). The same would apply to the proposed fire alarm system for the new nursing facility area. (T:238).

The final area had to do with various Life Safety Code issues, including firewalls and double egress doors. Mr. Gardner explained that his Hospital staff is very familiar with those requirements and deal with the State on those issues. (T:239). He confirmed that the Hospital's CON application addresses all life safety code issues, and will be in full compliance with the applicable regulations. (T:239-240).

During his testimony, Paul Gardner explained in detail how George County Hospital allocated the space within the Hospital for purposes of nursing home use. He stated that the Hospital took the square footage associated in the dining and kitchen areas, along with medical records and administrative space. (T:126-127). Additionally, the Hospital has a purchasing building for materials management. (T:127). Mr. Gardner added together these areas that would have a direct relationship with and a direct responsibility to the nursing home, and they totaled approximately 40,000 square feet. (T:127). The Hospital then allocated approximately 25% of that square footage to be attributed to the nursing home project. (T:127). Mr. Gardner viewed this as a conservative estimate. (T:127).[2]

In summary, George County Hospital offered testimony to support the use of various areas of the Hospital for the proposed nursing facility. HTC did not offer any testimony to demonstrate that the Hospital's plans would be in violation of any particular licensure regulation. Accordingly, there is no basis for denying the Hospital's application for any alleged failure to meet these requirements.

E. Personnel Cost

During his cross-examination of Rachel Pittman, HTC's counsel pointed to an alleged discrepancy in the estimated cost of additional personnel projected by GCH. In particular, it was noted that in the Hospital's supplemental submission on page 31, the estimated annual cost of additional personnel was $931,892. (T:96). On the other hand, on page 36 of the submission,

[2] With regard to this issue, it is important to note that even if George County Hospital's total square footage were strictly confined to new construction and the renovated area of the Hospital specifically dedicated to resident care, as shown on Exhibit 12, **George County Hospital would still have the largest size in terms of square footage.** *See* Exh. 12 (Floor Plan which shows 7,487 square feet of new construction, and 12,276 square feet of renovation for resident care rooms and related areas, for a total square footage of 19,763). Accordingly, the discussion of the use of other areas of the Hospital for the nursing home is somewhat academic. Even if only the new construction and the area dedicated to renovation, as shown on Exhibit 12 are used, George County Hospital continues to have the highest amount of square feet (19,763), and the lowest cost per square foot ($17.91), without regard to the use of other areas of the Hospital.

salaries, wages and benefits were projected to be $1,025,081. (T:96-97). Ms. Pittman explained that she assumed that the higher personnel cost number included benefits. (T:97). HTC's counsel then suggested to Ms. Pittman that if the Hospital had used the lower personnel cost number in calculating its Medicaid per diem, its Medicaid cost figures may have been understated. (T:97-98). However, Ms. Pittman testified that she had no factual basis for concluding that the Hospital failed to properly include all salary costs and benefits in calculating the Medicaid per diem. (T:98-99). Accordingly, HTC's argument on this point is pure speculation, and there is no evidence to support such a theory. Moreover, HTC introduced no evidence to demonstrate what, if any, impact this would have had on GCH's Medicaid per diem, even if HTC's speculative theory were true.

F. Impact on Hospital Operations and Costs

During the course of the hearing, HTC suggested that the Hospital's establishment of the nursing home, and use of various space within the Hospital to accommodate the home, could be detrimental to Hospital operations. Additionally, HTC implied that some of the renovation work done over the years within the Hospital facility should somehow be applied to the nursing facility costs. However, HTC failed to present any tangible proof that would support either theory.

In fact, Paul Gardner testified without contradiction or qualification that the Hospital would be able to accommodate the nursing home residents without any adverse impact on Hospital operations. (T:117-125; 245-246). Moreover, Mr. Gardner verified that each of the Hospital renovation projects cited by HTC's counsel was done in the ordinary course of Hospital maintenance, without regard to any future nursing home project. (T:136-138). No evidence to the contrary was offered by HTC.

G. Medicaid Per Diem

Finally, HTC contends that George County Hospital's Medicaid per diem rate is understated, because, as a county-owned hospital, it would qualify for participation in the Medicaid Upper Payment Limit (UPL) Program, which would allow the Hospital to receive additional Medicaid reimbursement for nursing home services. However, this contention is without merit.

Paul Gardner testified that at the time the certificate of need application was submitted, the Medicaid UPL program was not in place. (T:150-152). As a result, the Hospital did not address Medicaid UPL reimbursement in its per diem rate, and should not penalized for subsequent regulatory changes which became effective after the date the CON application was submitted. (T:150-152).

I concur that these applications should be evaluated based on circumstances as they existed at the time the applications were filed on June 1, 2004. Clearly, many factors have changed since the applications were originally filed more than two years ago. For example, construction costs have certainly increased. Nevertheless, it would not be proper to reopen the application process due to changes which occur subsequent to the date of filing of the applications. Such a scenario would be a "moving target" situation without definitive rules and finality to the application process.

In any event, the best answer to this question may be found in calculations provided by the Mississippi State Division of Medicaid ("DOM"), which is the official agency charged with administering the State Medicaid Program. DOM itself projected the Medicaid per diem for each of the three applicants. These Medicaid per diem calculations are reflected in the Staff Analysis of each applicant. According to DOM, the projected Medicaid per diem rate for each of the competing applicants is as follows:

Applicant	Medicaid Per Diem Rate Projected by Division of Medicaid
Delco/Glen Oaks	$102.95
George County Hospital	109.55
HTC	110.62

(Exhibit 3 at page 8; Exhibit 4 at page 8; Exhibit 5 at page 8).

These projections show that the Division of Medicaid itself estimated that George County Hospital would have a lower Medicaid per diem rate than HTC. Although the per diem rates projected by the Division of Medicaid for all competitors were higher than those projected by the applicants themselves, the fact remains that George County Hospital's Medicaid per diem rate was lower than HTC's. This is objective and independent proof with respect to projected Medicaid impact. Accordingly, there is no basis for HTC's contention that GCH's Medicaid per diem would significantly exceed the Medicaid rate of HTC.[3]

H. Real Estate Costs

A final issue to be addressed concerns real estate costs. During cross-examination, Mr. Cain acknowledged that HTC's application did not include any cost of purchasing real estate. (T:226). However, Mr. Cain also identified a real estate contract for the purchase of the real property on which the facility would be located (Exh. 25). This real estate contract reflected a purchase price of $200,000, and Mr. Cain confirmed that this was the purchase price of the property. (T:227-228). It should be noted that the real estate contract is dated June 18, 2002 (Exh. 25), and was submitted to the State Department of Health in response to the Department's request for proof of ownership of the property for the nursing facility. (T:226-227).

[3] It should be noted that although the Division of Medicaid projected Delco to have the lowest Medicaid per diem, that does not alter the scoring results because GCH continues to have the lowest composite score based on this information. Under this scenario, Delco would move into first place in the category of Medicaid per diem, GCH would be second, and HTC would be third. Therefore, Delco would reduce its composite score from 24 to 22, GCH would increase its composite score from 11 to 12, and HTC would increase its composite score from 13 to 14. The end result is the same: GCH has the lowest composite score.

It is clear that this real estate cost of $200,000 should have been included in HTC's capital expenditure for the proposed project. Although HTC may contend that one of the purposes of the land purchase was for the planned construction of an assisted living facility, the fact remains that this purchase was also made for the specific purpose of constructing the nursing facility. Moreover, as previously discussed, the assisted living facility has yet to be constructed.

When this capital expenditure of $200,000 is added to the scoring grid, HTC's proposal falls further behind. Specifically, HTC's score on capital expenditure moves from second place to third place. This results in a composite score for HTC of 14, which is still higher than GCH's score of 11.

III. CONCLUSION AND RECOMMENDATION

The evidence presented during the administrative hearing shows that the Department of Health staff reviewed and evaluated these competitive applications according to the same criteria and methodologies used to evaluate all competing nursing home proposals over a four-year period. Based on those criteria and methodologies, George County Hospital received the lowest composite score among the three applicants. HTC failed to offer any evidence sufficient to demonstrate why that result should be altered or overturned.

Based on my review and evaluation of the evidence submitted, I concur with the findings of the Department of Health staff, and recommend that the application of George County Hospital for a 60-bed nursing facility in George County be approved.

DATED: February 14, 2005.

David K. Scott
Administrative Hearing Officer