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

BRIEF FOR APPELLANT

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CERTIFICATE OF INTERESTED PERSONS

Pursuant to M.R.A.P. 28(a)(1), the undersigned counsel of record certifies that the following listed persons have an interest in the outcome of this case. These representations are made in order that the justices of this Court and/or the judges of the Court of Appeals may evaluate possible disqualification or recusal.

1. HTC Healthcare II, Inc. (Appellant).

2. Thomas L. Kirkland, Jr., Allison C. Simpson, and Andy Lowry, of Copeland, Cook, Taylor & Bush, P.A. (counsel for Appellant).

3. Mississippi State Department of Health (Appellee) and Brian W. Amy (former State Health Officer).

4. Donald E. Eicher, III (counsel for MSDH).

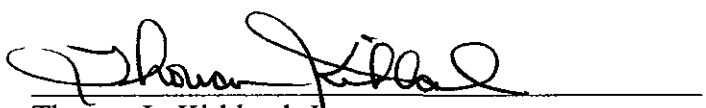
5. George County Hospital (Appellee).

6. Barry K. Cockrell of Baker, Donelson, Bearman, Caldwell& Berkowitz, P.C. (counsel for George County Hospital).

7. The Honorable David Scott (hearing officer).

8. The Honorable Patricia D. Wise (chancellor).

Respectfully submitted,



Thomas L. Kirkland, Jr.
Attorney of Record for Appellant

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STATEMENT OF THE CASE

I. Course of Proceedings Below

This case arises as a challenge by the appellant, HTC Healthcare II, Inc. ("HTC"), to the final order by the State Health Officer granting a Certificate of Need ("CON") for a 60-bed nursing home. The CON was granted to the appellee, George County Hospital ("GCH").

On or about June 1, 2002, HTC and GCH, as well as Delco, Inc., d/b/a Glen Oaks ("Glen Oaks"), filed competing applications for a CON for the 60-bed nursing home facility authorized by the Legislature to be built in George County. Due to the moratorium on nursing-home construction, itself a measure to control Medicaid costs, new nursing home CONs can be granted only upon such express Legislative authorization.

The Mississippi State Department of Health ("the Department") deemed the applications complete on July 2, 2002, and entered them into the CON review cycle, which consists of three steps: staff analysis, hearing during the course of review (if requested), and the final order of the State Health Officer.

In August 2002, the staff analysis was issued, recommending approval of GCH's application and thus denial of HTC's and Glen Oaks' competing applications. The staff analysis found that each application was in compliance with the State Health Plan, the CON Manual, and all rules, procedures, and plans of the Department.

HTC requested a hearing during the course of review, which was held in September and October 2004. The hearing officer requested proposed findings of fact and conclusions of law, and on February 14, 2005, adopted *verbatim* those submitted by GCH, which of course recommended approving GCH's application. On February 24, 2005, the State Health

Officer, Brian W. Amy, adopted the hearing officer's (i.e., GCH's) findings and conclusions, and issued the CON to GCH.

HTC timely appealed the decision granting the CON to the Hinds Chancery Court, which after considering the briefs and oral arguments of the parties, issued its Order and Opinion on June 20, 2005. The chancery court (Wise, J.) affirmed the State Health Officer's decision in all respects except as regarded the issue of the one-year cost to Medicaid of GCH's proposal; on this issue, the chancery court remanded to the Department for additional fact-finding. GCH and the Department moved the chancery court to amend the judgment so as to affirm the CON grant in its entirety, but the chancery court denied this motion on July 11, 2006.

A further hearing was conducted at the Department, which resulted in the State Health Officer's conclusion on December 21, 2006 that the first-year cost to Medicaid of GCH's proposed CON had been done correctly after all. The chancery court went on to affirm the CON in all respects in its Final Judgment issued June 4, 2007. HTC timely filed its Notice of Appeal on June 27, 2007.

II. Statement of Relevant Facts

Senate Bill 2679 of the 1999 Legislative session authorized the construction, expansion, or conversion of nursing home facilities in certain counties, including George County, Mississippi. In response to this enactment, the Department adopted a ten-factor comparative analysis for determining which of two or more competing applications would be awarded any given CON for a nursing home. The Department would award points to each applicant on each factor, and as in the game of golf, the applicant with the lowest points would be the winner.

In the present case, the Department conducted its comparative analysis of the three applications submitted by HTC, GCH, and Glen Oaks, and found as follows:

	George County	***HTC*** (Glen Oaks)	***Glen Oaks*** (HTC)
Size (sq. ft.)	**1** (25,307)	**2** (17,850)	**3** (15,036)
Capital Expenditure	**1** ($369,000)	**2** ($700,000)	**3** ($786,162)
Cost/sq. ft.	**1** ($13.99)	**3** ($52.28)	**2** ($35.85)
Cost/bed	**1** ($6,150)	**3** ($13,102.70)	**2** ($11,667)
Personnel	**2** (75.1)	**3** (57.5)	**1** (82.75)
Medicare %	**2** (46%)	**3** (22%)	**1** (69.44%)
Medicaid cost, 1st yr.	**2** ($364,528)	**3** ($708, 246)	**1** ($133,590)
Per diem Medicaid cost, 1st yr.	**1** ($69.50)	**3** ($73.72)	**2** ($73.20)
Continuum of care?	**1** (Yes)	**1** (Yes)	**1** (Yes)
Signed agreement?	**-1** (Yes)	**-1** (Yes)	**-1** (Yes)
Composite score	**11**	**24**	**13**

Ex. 5 at11.[1] (Note our highlighting the factor for per diem Medicaid cost.) On this basis, GCH's application narrowly won out over HTC's. However, this Court should note that in conducting the foregoing analysis, the Department relied entirely on each application, taking it on its face rather than conducting any independent evaluation of whether the proffered data were in fact correct.

Because the substance of this appeal is to challenge whether the Department relied on substantial evidence in assigning the foregoing point rankings, particular facts pertaining to the issues raised on appeal will be discussed in the Argument.

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[1]Hearing exhibits, which this Court has before it in the 3-ring binders used by the Department, are cited as "Ex." Transcript pages are cited as "T.__," and all cited pages are included in the Record Excerpts at tab D. Record excerpts other than the transcript pages are cited by tab and page number.

SUMMARY OF THE ARGUMENT

When it comes to CON applications, the Department does not exercise the traditional expertise and discretion expected of an administrative agency. Rather, it simply accepts as true whatever an applicant pretends about its proposed project. In the present case, GCH narrowly won the CON over the second-place finisher, HTC, by submitting information in its application that was simply incorrect.

The most glaring and indisputable example was GCH's claim that its per diem Medicaid costs would be $69.50, whereas the truth was that — as GCH admitted at the hearing — those costs would be about $250.00 per day, because GCH as a county-owned facility qualifies for a much higher reimbursement rate than does the privately-owned HTC. At the hearing, GCH pretended that it wasn't subject to this higher rate when it filed its application, but this was demonstrably false. By awarding this factor to GCH, the Department not only threw the CON award to GCH rather than HTC, but it acted in complete disregard of one of the primary goals of the CON laws: the containment of costs.

Similarly, the Department accepted GCH's fabricated figures for size, cost per square foot, and capital expenditure, despite the fact that these numbers bore no relation to reality, stood contradicted by the evidence, and were derived in disregard of the Department's own rules as to how these figures must be calculated. Rubber-stamping GCH's absurd figures resulted in the CON's being awarded, not to the most deserving applicant under the Department's review procedures, but instead to the applicant who was willing to game the system.

Thus, the Department acted arbitrarily and capriciously in awarding the CON to GCH, and this Court should reverse that decision and direct the CON be awarded to HTC.

ARGUMENT

The standard of review of an appeal of a final order of the Department is controlled by Miss. Code Ann. § 41-7-201(2)(f), which provides in part:

> [t]he Order shall not be vacated or set aside, either in whole or in part, except for errors of law, unless the Court finds that the Order is not supported by substantial evidence, is contrary to the manifest weight of the evidence, is in excess of the statutory authority or jurisdiction of [the Department], or violates any vested constitutional rights of any party involved in the appeal . . . .

The Mississippi Supreme Court has found this statute to be "nothing more than a statutory restatement of familiar limitations upon the scope of judicial review of administrative agency decisions." *Miss. State Dep't of Health v. Natchez Cmty. Hosp.*, 743 So. 2d 973, 976 (Miss. 1999). Of course, as the statute states, matters of law are reviewed de novo.

Despite our statutory scheme whereby a trial court, in this case the chancery court, must act as an intermediate appellate court before an administrative decision may be appealed to a proper appellate court, it is well settled that this Court owes no deference to the chancery court's decision, but reviews the matter de novo, as if the chancery court had never ruled. *Miss. Dep't of Health v. S.W. Miss. Reg'l Hosp.*, 580 So. 2d 1238, 1240 (Miss. 1991).

Although the burden of proof rests on the challenger to an agency's action, *Pub. Employees' Ret. Sys. v. Marquez,* 774 So. 2d 421, 425 (Miss. 2000), the reviewing 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." *Id.* at 427. This Court has held that

> it is within the power of the chancellor to reverse the decision to grant the CON if such decision is not supported by substantial evidence. Substantial evidence means more than a scintilla or a suspicion. If an administrative

> agency's decision is not based on substantial evidence, it necessarily follows that the decision is arbitrary and capricious.

Natchez, 743 So. 2d at 977 (citations omitted); *see also Marquez*, 774 So. 2d at 425 (stating "substantial evidence" means "such relevant evidence as reasonable minds might accept as adequate to support a conclusion"). "Arbitrary and capricious" is defined as follows:

> An administrative agency's decision is arbitrary when it is not done according to reason and judgment, but depending on the will alone. An action is capricious if done without reason, in a whimsical manner, implying either a lack of understanding of or **disregard for the surrounding facts and controlling principles**.

Natchez, 743 So. 2d at 977 (citation omitted & emphasis added). An unreasonable decision is thus "arbitrary and capricious" and must be reversed. *Id.*; *S.W. Miss. Reg'l*, 580 So. 2d at 1239-40 ("courts may alter the administrator's action only if convinced it is arbitrary, capricious *or unreasonable*, or is not supported by sufficient evidence") (emphasis added).

In short, the deference extended to administrative agencies is founded on the understanding that they are actively and equitably applying their expertise and professionalism. Where the agency or department is doing no such thing, but ignoring "the surrounding facts and controlling principles," deference will not be extended. While the "'arbitrary and capricious' standard of review is highly deferential, it is by no means a 'rubber stamp.' " *Miss. State Bd. of Nursing v. Wilson*, 624 So. 2d 485, 489 (Miss. 1993) (citing *United States v. Garner*, 767 F. 2d 104, 116 (5th Cir. 1985)).

In addition, "[t]oday's are not ordinary findings." *Omnibank of Mantee* v. *United Southern Bank,* 607 So. 2d 76, 82 (Miss. 1992) (concerning case where court literally signed off on proposed findings of fact and conclusions of law). This case, like the *Omnibank* case, merits a heightened standard of review, because **the Department exercised *no* discretion**

in drafting a considered opinion on the merits, but rather merely adopted verbatim the proposed opinion submitted by GCH.

In *Greenwood Utilities v. Williams,* our Court of Appeals unanimously held that in review of administrative agency decisions, the "usual appellate deference is inapplicable" where the agency "has adopted all but verbatim the proposed findings of a party." 801 So. 2d 783, 788 (Miss. Ct. App. 2001); *see also Chamblee v. Chamblee*, 637 So. 2d 850, 859 (Miss. 1994) (stating in such circumstances the court is to apply a "somewhat jaundiced eye"). The *Williams* court compared such findings to a trial court's adoption of a litigant's proposed findings of fact and conclusions of law; in such cases, the Mississippi Supreme Court has found that it must "engage in much more careful analysis of adopting [sic] findings than in cases where the findings and conclusions have been adopted by the trial judge himself." *Id.* (quoting *Omnibank,* 607 So. 2d at 83). In *Omnibank,* the court stated "common sense suggests our duty of deference to such findings is necessarily lessened" where the chancery court "literally signed off on the proposed findings of fact and conclusions of law. Not one word has been changed." 607 So. 2d at 82-83. Again, the Mississippi Supreme Court expressed its "concern [that] we have been handed a twenty-three page document detailing numerous findings of evidentiary and ultimate fact with the law thereafter declared and applied, and nothing before us suggests any of this except in broad outline is the product of the [trial court's] adjudicatory prowess." *Id.* at 83.

In the present case, the Department accepted a flatly erroneous Medicaid per diem rate that threw the CON to GCH rather than to the deserving applicant, HTC. By rubber-stamping GCH's excuse for this erroneous per diem figure, the State Health Officer forfeited his right to the ordinary deference owed an administrative agency on appeal. This Court need

not and should not accept GCH's excuses at face value merely because the then-State Health Officer could not be bothered to exercise his duty in the present case.

I. GCH's Per Diem Medicaid Rate Was Not Supported by Substantial Evidence.

The principal issue requiring reversal of the CON award to GCH is the fact that its per diem Medicaid rate as stated in its application was not only false, but wildly inaccurate. Rather than $69.50, the per diem was actually about $250.00 — a figure which would have resulted in GCH's being assigned *three* points, not one, and in HTC's being assigned *one* point, not two. The resulting difference in the composite score would have been 13 for GCH and 12 for HTC. Therefore, this single issue is decisive of the entire appeal, and requires that the CON award be reversed and the Department directed to award the CON to HTC.

Whether GCH's per diem rate was incorrectly stated in its application is *not* a disputed issue of fact, on which this Court might be expected to yield deference to the Department. Rather, it is a simple question of law. As a county-owned hospital, GCH qualifies for the "upper payment limit" (UPL), which reimburses the facility for the difference between what the state Medicaid program pays for a resident's care, and what the federal Medicare program *would* pay for that same resident. Privately-owned facilities, like HTC's or Glen Oaks's proposed nursing homes, do not qualify for the UPL.

None of this was contested at the hearing. Under cross, GCH's administrator, Paul Gardner, admitted all of the following:

- that his facility would qualify for the UPL (T.151);
- that the UPL was "not extended to privately-owned nursing homes" (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).

These admissions by GCH's administrator leave no doubt that the $69.50 per diem Medicaid rate stated in GCH's application was completely false, and that GCH's rate would actually have been *three times* that of HTC.

Unable to deny the fact that it had misstated its Medicaid per diem rate, GCH asserted that it just didn't know about the UPL at the time of its June 1, 2002 application, and that it wasn't effective anyway until after that date. The administrator claimed that the UPL took effect a year and a half before the October 2004 hearing, and thus after the CON application was filed. T.151. The hearing officer, and by adopting his findings, the State Health Officer, bought this excuse. So did the chancery court: "it would not be proper to reopen the application process due to changes which occur subsequently to the date of filing the applications." R.E. B at 3-4.

However, this excuse is both inadequate and incorrect. It is inadequate, because the UPL in question is governed by federal and state regulations of which GCH had more than sufficient advance notice. A federal regulation does not erupt suddenly one day, like Vesuvius. Rather, there are stirrings of the earth well in advance, by way of publication of the proposed and the final rules in the *Federal Register*. The regulation in question is 42 C.F.R. § 447.272, the "Upper Payment Limit Rule." In considering, and rejecting, a challenge brought against the UPL Rule, an Arkansas federal court noted that the rule

> was proposed on November 23, 2001, and finalized on January 18, 2002. It was originally scheduled to take effect on March 19, 2002. The Secretary later scheduled it to take effect on April 15, 2002. This Court, during the oral argument, found and concluded that the effective date is May 14, 2002.

Ashley County Med. Ctr. v. Thompson, 205 F. Supp. 2d 1026, 1029 n.1 (E.D. Ark. 2002). What all these dates have in common, of course, is that they fall *before* June 1, 2002. GCH's excuse is not only inadequate; it is incorrect as well.

GCH cannot argue that it was simply *ignorant* of the UPL Rule at the time it filed its application. Ignorance of the law is no excuse, and a CON applicant cannot be allowed to game the system by filing an application with false data and then justifying itself that it just didn't bother to apprise itself of the actual facts before filing. Allowing such gamesmanship would be arbitrary and capricious in the extreme.

The truth, of course, is that GCH was perfectly well aware of the UPL Rule when it filed the application, and that the testimony of its administrator to the contrary was so frankly incredible that it was an abuse of the Department's considerable discretion to give it any credence. HTC's president, Ted Cain, testified that the UPL's were "common knowledge" by June 2002. T.215. Forced to admit that, in fact, his facility would be getting in excess of $250.00 per day per Medicaid beneficiary, not $69.50 per day per beneficiary, GCH's administrator simply tried to talk his way around the facts.

HTC does not dispute that, under some circumstances, unforeseeable changes might occur after an application was submitted, and that such changes might not properly be allowed to affect the CON process. Such unusual circumstances are best dealt with on a case-by-case basis. However, the present case is not such an instance, because there was nothing unforeseeable about the UPL Rule and its application to GCH.

Moreover, cost containment is one of the two primary purposes of Mississippi's CON policies, according to the State Health Plan. *St. Dominic-Jackson Mem'l Hosp. v. Miss. State Dep't of Health,* 910 So. 2d 1077, 1091-92 (Miss. 2005) (quoting hearing officer). Thus, the

issue of Medicaid per diem costs is not merely one detail of GCH's application, but it goes directly to the core of why the Legislature enacted the CON laws in the first place: to control costs. The Legislative purpose is thwarted when the Department and the State Health Officer cavalierly ignore the facts and the law to rule that an application has the "lowest" per diem Medicaid cost, when in fact that applicant's real costs would be *more than three times* those of its rival applicants.

For the staff analysis to make a mistake by taking GCH's application at face value was bad enough. Worse by far was the decision by the hearing officer, and by the State Health Officer, to ignore the undisputed evidence that the Medicaid per diem asserted by GCH was not only wrong, but *so* wrong that it actually *threw the application to GCH when it should have gone to HTC.* What we have, evidently, is a process wherein the Department and the State Health Officer stubbornly refuse to acknowledge facts, but rather insist on standing by their erroneous staff analysis, no matter what. (A problem only exacerbated by the verbatim adoption of GCH's proposed findings of fact.) That is arbitrary, that is capricious, that is disregard for settled law — in short, that is exactly the type of conduct for which this Court can, and must, reverse the decision below.

II. The Department Lacked Substantial Evidence Relating to GCH's Construction Costs.

While the Medicaid cost per diem provides a sufficient basis to overturn the Department's decision, other issues exist that highlight the Department's erroneous decisions. In particular, GCH was able to submit an application with implausible, even ridiculous, figures, which were unquestioningly accepted by the Department, which simply takes as gospel whatever an applicant claims, instead of conducting its own fact-finding. The present

case is an example of how this blind faith leads to abuses that frustrate the purposes of the CON laws and the State Health Plan. A decision is not based on substantial evidence, and is thus arbitrary and capricious, if it disregards "glaringly obvious evidence" which conflicts with that decision. *DeGeorge v. Oakes*, 740 So. 2d 312, 315 (Miss. 1999). This follows directly from the rule already cited above, that an agency acts arbitrarily and capriciously when it acts in disregard of the facts.

A. Size (square feet)

According to the Department's scoring methodology, the entity that proposes to build the largest facility wins the lowest point — "bigger is better." The following is the suggested size of each proposed facility in square feet as contained in the Application and the points allocated by the Department: GCH, 25,307 (one point); HTC, 17,850, (two points); Glen Oaks, 15,038 (three points). Of course, facility size is related to and supplies the numbers for other factors, namely, capital expenditure, cost per square foot and cost per bed. For example, size helps to determine capital expenditure. In turn, capital expenditure is used to calculate cost per square foot and cost per bed (capital expenditure/60 beds = cost per bed). Thus, it's particularly important that the Department exercise its fact-finding powers to ensure that an applicant's claimed square footage is reasonable and plausible.

In its application, GCH sought to win on all four of the above-referenced factors, size, capital expenditure, cost per square foot and cost per bed, based upon its skewed numbers and its disregard for the Plan's requirements and direct mandates from the CON Manual.

To achieve its size, GCH stated that its project will encompass a total of 25,307 square feet of space on the campus of George County Hospital ("the Hospital"). This includes 7,487 new square feet and 17,820 existing square feet which allegedly will require

minor renovations or none at all. Ex. 2. However, based upon GCH's own schematic drawing, the facility will actually consist of 7,487 square feet of new construction and 12,276 square feet of space in the existing Hospital, for a combined total of 19,764 square feet as opposed to 25,307. Ex. 12. The GCH administrator, Gardner, testified that the additional 5,543 square feet of space comes from other general areas of the Hospital, such as dietary space, a utilization area, business offices, an administration area, a material management building, and the maintenance building which he alleges the Hospital will share with the nursing facility. T.111-12. GCH *arbitrarily* determined it would be allocating approximately twenty-five percent (25%) of this 40,000 square feet area to the nursing facility. T.112, 128.

GCH should not be allowed to arbitrarily choose a percentage and simply say its nursing facility will share additional space in common areas of the Hospital. GCH supplemented its application to utilize additional Hospital space in an effort to increase its size while lowering or not increasing its capital expenditure. T.109. The fact is that the Department had no substantial evidence from which to determine the *actual* square footage of the project, as opposed to GCH's ballpark guess.

Even if GCH's change in size did not change the scoring of the size factor, it is important for two reasons. First, the change in size changes the cost per bed, cost per square foot and GCH's capital expenditure, as set forth above. Second, GCH's purported use of the Hospital's existing space to reduce its capital expenditure is misleading. Admittedly, GCH has limited space to accommodate the proposed 60 nursing beds. T.120. GCH intends that 34 of its 53 hospital beds, *more than half of its bed complement*, will be used for nursing home beds, even though those 34 hospital beds are currently in use by hospital patients.

T.109, 119, 120-23. This action will leave only 19 hospital beds for the Hospital's current patients, and the Hospital's average daily census is 20.68 patients. Ex. 9, T.70.[2] As Rachel Pittman stated, testifying for the Department, this is the average number of patients the Hospital has per day over a period of time. T.70.

While GCH argues it will not begin using all of the 34 hospital beds at once, it still poses an interesting and expensive problem that the Department failed to consider. The GCH administrator admitted under oath that, if GCH is successful in obtaining this nursing-home CON, GCH will then address the issue of its displaced hospital patients and consider whether it will apply for a new CON to add on to the hospital side or if it will discontinue some services. T.123-24. While GCH argues this potential second CON for the hospital is a separate issue, it is a fact, according to Paul Gardner, that GCH will need more space if it is granted this CON and desires to continue to provide all current services and maintain its current bed space. T.124-25. This grant of the CON to operate the 60 nursing home beds, will cause the Hospital to have to increase its size, and therefore, incur additional construction costs to accommodate its existing patients.

The Department failed to consider the imminent impact on existing hospital patients should this CON be granted to GCH. It also allowed GCH to arbitrarily choose a percentage to increase its total square footage without requiring any basis for that choice. Since the Department failed to adequately consider these issues and instead relied upon unsupported testimony and arbitrary evidence, the Department's decision should be overturned.

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[2] Paul Gardner, administrator for GCH, testified later that the Hospital would have 27 acute care beds remaining, and he testified that the average daily census accounts for babies so that the demand for adult care beds is approximately 18 per day. T.245. As shown by the citations in the text, however, these claims are not supported by the evidence.

B. Capital Expenditure & Cost Per Bed

The capital expenditure factor is related to three of the ten factors (capital expenditure, cost per square foot, and cost per bed). T.65-66. Thus, an applicant who achieves the lowest capital expenditure automatically achieves the lowest cost per bed since the capital expenditure is simply divided by the number of beds. T.39. The following outlines the projected total capital expenditure and cost per bed as contained in the Applications and the points awarded by the Department for the three applicants:

- GCH, Total Capital Expenditure, $369,000 (one point); Cost Per Bed, $6,150 ($369,000/60 beds) (one point);
- HTC, Total Capital Expenditure, $700,000 (two points); Cost Per Bed, $11,667 ($700,000/60 beds) (two points);
- Glen Oaks, Total Capital Expenditure, $766,162 (three points); Cost Per Bed, $13,102 ($766,162/60 beds) (three points).

Because the capital expenditure and cost per bed points are derived directly from the capital expenditure of a project, the feasibility of both will be discussed in terms of the feasibility of the capital expenditure.

GCH alleges its capital expenditure for the project will be $369,000.00. Ex. 2. However, Rachel Pittman testified for the Department that one could not tell from looking at the GCH application whether the capital expenditure was for new construction only, or new construction and renovation. T.73. She testified she would assume the cost was for all new construction. T.73.

A significant amount of testimony at the hearing was dedicated to the feasibility, adequacy and accuracy of the projections made by GCH. Most notably, in addition to

discrepancies caused by its inflated square footage, GCH failed to include adequate costs for renovation. While GCH concedes that its project will include the use of 12,276 existing square feet of space, it alleges that space *will not have to be renovated.* Ex. 12. However, the premise that GCH could simply begin using 12,276 square feet of current hospital space without any renovation is absurd. There was ample testimony at the hearing which demonstrated at least a portion of the 12,276 square feet will have to be renovated to be adequate for a nursing facility. For instance, Charles Gardner, GCH's architect, testified that the existing area would have to have sprinklers installed, at a cost of approximately $20,000.00-$25,000.00 *which was not included in the estimate.* T.163-65, 172. Ted Cain, owner of HTC, testified that the Hospital's current sprinkler system could not be used to sprinkle the facility unless it was designed to handle extra space at the time it was installed because it would not have adequate water capacity. T.221-22. GCH did not specifically address this issue, but simply said that regardless of whether the CON was granted it was going to sprinkle the remaining portion of the Hospital. T.237-38.

There was also testimony that GCH's project lacked the space or failed to meet nursing home requirements. Specifically, GCH did not identify special care rooms; an adequate number of activity rooms; or space for a social service office or administrator's office. T.208-10. GCH alleges it will make this space available by setting off private rooms and allowing the residents to use the waiting areas of the nursing home to visit. T.234-35, 242. Further, Paul Gardner admitted the application did not adequately address the issue of day room space. T.242. GCH states that the social service office will be located in the Hospital along with the nursing home administrator's office, but admits this was not shown in the application. T.236-37, 243. Moreover, the Mississippi State Board of Nursing Home

Administrators, which makes policies for administrators around the State, states that administrators must be *on the premises* and that means *in the facility*. T.211-12, Ex. 23. GCH's proposal to have a "nursing home administrator" who works in an office *outside the nursing home* is simply unacceptable and should have been roundly rejected by the Department. Instead, we are told that the CON decision is made without regard for whether the facility meets licensure requirements — that is, without regard for *whether the facility can legally function*. It would be difficult to conduct CON review in a manner more open to abuse, gamesmanship, and deceit.

GCH has also failed to include its cost for implementing a nurse call system. Cain testified that the call system, as well as, the fire system, must be detached from the Hospital, and that his fire alarm and nurse call system at another facility cost approximately $75,000.00 - $80,000.00. T.219-220. GCH claimed that it added a new call system about three to five years old which will be converted (at what cost?) to the nursing home area, and that the fire system will be expanded. T.238-39, 247. Cain also testified that the facility would have to have fire walls between the nursing home and Hospital, which do not appear to be included in GCH's proposal, as well as double-egress two-hour fire doors on the corridors. T.223, 240. While Cain did not have an estimate, he testified that the higher the rating, the higher the cost. T.224.

Given all these necessities, the notion that GCH could conduct all these renovations for a cost of only *$2,500.00* was indeed "totally unreasonable," as Cain testified. T.225.

Furthermore, testimony was presented that Covington County's capital expenditure for its proposed nursing facility, which would have new construction for 28 nursing home

beds, as opposed to GCH's 26 newly constructed beds, would cost nearly double what GCH proposed, at $746,177.00. T.47, 85-86.

As we've seen, GCH's fantastic lowballing of its capital expenditure also affected the cost per bed for which GCH was also awarded one point. A change in capital expenditure would automatically change the cost per bed; therefore, GCH would gain at least two points for its skewed numbers.

The Department failed to consider the discrepancies in GCH's Application and testimony regarding the total cost for new construction and renovation. Instead, they blindly accepted GCH's assertion that it was not going to perform any renovations and that its new construction costs would be half that of comparable nursing facility additions. Without the renovation costs' being included in its capital expenditure and without accurate new construction cost numbers, GCH's application could not be adequately compared or ranked with its competitors. The failure of the Department to evaluate the evidence presented and calculate the actual capital expenditure was arbitrary and capricious.

C. Cost Per Square Foot (Total Cost)

According to the Department, GCH's projections on its cost per square foot were significantly lower than *any other* CON application currently or previously before the Department. T.67. The following shows the proposed cost per square foot for each facility as contained in the Applications and the point each applicant was awarded by the Department:

- GCH - $13.99 (one point)
- HTC - $35.85 (two points)
- Glen Oaks - $52.28 (three points)

One wonders whether it's possible to build a lemonade stand for $13.99 per square foot, much less a nursing home.

Unfortunately, rather than cast a skeptical eye on this miraculously low figure, the Department simply accepted it. Even worse, the Department ignored its own CON Manual in calculating this cost. The CON Manual delineates a specific formula for applicants to follow when calculating cost per square foot for new construction only, new construction and renovation, or renovation only. Ex. 7. Pittman testified for the Department that the appropriate way to determine the square foot cost is *not* to take the total cost and divide it by the total square footage but to follow the formulas contained in the CON Manual. T.102-03. Edward Kuykendall, an expert for HTC and an architect with Dean & Dean Associates, testified that if a project had a combination of new construction and renovation, the applicable formula for New Construction/Renovation (Prorated Project) should be used. T.186.

Nevertheless, Pittman testified that in the present case, the Department simply divided the capital expenditure by both the new construction square footage and the square footage of the existing space to credit GCH for its use of existing space. T.90. However, that is not the formula specified in the CON Manual. In the competitive process, each applicant must follow the rules and regulations prescribed by the Department to adequately be subjected to the comparative analysis. The Department's use of this alternate formula was arbitrary and capricious, since it was not based on any rule or regulation of the Department but simply concocted by GCH and the Department.

GCH proposes new construction with no renovation. Ex. 2. The formula for calculating cost per square foot for new construction with no renovations is as follows:

Cost per square foot = (A + C + D + E + F + G)/Square Feet

where A = New Construction, C = Fixed Equipment, D = Site Preparation, E = Fees, F = Contingency, and G = Capitalized Interest. Ex. 7. However, the formula used by GCH for new construction (no renovation involved) is as follows:

319,000 + 2,500 + 20,000 + 10,000/25,307 sq. ft. = $13.89 per sq. ft.

Ex. 21. This formula is for new construction *only*. However, as discussed above, GCH's total square feet, 25,307, includes both new construction, 7,487 square feet, and 17,820 square feet of existing space, T.33, some of which will have to be renovated as above discussed.

Under the correct method for calculating its cost per square foot, GCH should only utilize its new construction space, 7,487 square feet, in the formula. For example, HTC will involve new construction of 17,850 square feet attributed solely to the nursing facility. In addition, HTC plans to build additional, useable space for personal care and assisted living facilities. Yet, to be fair and consistent with the intent of the Department and the comparative analysis factors, the additional square footage for these services, personal care and assisted living, is not included in the size of the facility. Including additional space results in an applicant's receiving a falsely low point for this factor.

GCH has maintained that its low cost per square foot is due to the fact that it will not be incurring any cost or minimal cost for renovation and that it will only incur new construction costs for 7,487 square feet. Since that is the case, GCH's cost per square foot should be calculated as follows including only the actual new construction amount, 7,487:

319,000 + 2,500 + 20,000 + 10,000/7,487 sq. ft. = $46.95 per sq. ft.

Ex. 22. The difference is a material one. Under GCH's and the Department's concocted formula, GCH wins the lowest point. However, using the mandated formula as contained in the CON Manual and including the actual number for only new construction, HTC would get the winning, lowest point. GCH's cost would increase by $32.96, for a total of $46.95 per square foot, while HTC's cost per square foot remains at $35.85.

At the hearing, GCH tried to argue that it did not have to follow the Department's formula since it should allegedly get credit for using existing space. T.36, 90. Whatever GCH's self-serving reasoning, the fact remains that the CON Manual requires applicants to calculate cost per square foot based upon very specific formulas concerning whether the project is new construction, renovation, or a combination of both. Ex. 7. An applicant must follow the applicable formula in the CON Manual to derive its cost per square foot calculation. T.64. This is particularly true in the competitive process where all applicants should be evaluated on the exact same criteria, applied in the exact same manner. GCH failed to comply with the rules and regulations of the Department, and therefore, its Application should not have been considered in substantial compliance. In any event, the Department should have required GCH to utilize the correct formula, and therefore, based on the outcome, awarded HTC the lowest point for this factor.

Furthermore, while it is clear that GCH did not follow the formula set forth in the CON Manual, there was further evidence that GCH's numbers are incorrect and even unbelievably low which the Department should have at the very least questioned. In comparing GCH's proposed numbers to the Means Building Construction Cost Data ("Means Data") used by the Department to evaluate the reasonableness of construction

projections, it is evident that GCH's numbers are unreasonably, impossibly low. Ex. 10, T.79-80.

Here, the red flag for GCH is that its costs are significantly, even abnormally below, the *low* end of comparable cost construction data. Pittman testified the Department *simply accepts* what an applicant submits and compares it to the Means Data to determine if it is in the low, medium or high range. T.77. Pittman further admitted that the Department did not send anyone to try and determine whether or not GCH's proposed costs were reasonable. T.65.

The low range according to the Means Data for cost per square foot for nursing home projects is $71.50, the median $92.00, and the high $114.00. T.79. GCH's purported cost per square foot is $13.99, which is only 19.5% of the lowest range of the Means Data for nursing home construction. Furthermore, as stated above, a project similar to size in Covington County had a capital expenditure of nearly double GCH's proposed capital expenditure. T.47, 85-86. Pittman testified that while the numbers were compared, no action was taken and no question was raised as to GCH's extremely abnormal projections. T.80.

GCH uses a distorted total square footage for its cost calculations by combining its new construction square footage and its existing square footage. This distortion leads to unrealistic projections which fall well below the established norms. Because GCH failed to substantially comply with CON mandates and directives governing calculations for cost per square foot and since when its projections are reviewed using the correct formula GCH's cost per square foot exceeds HTC's cost per square foot, GCH cannot be awarded the lowest point.

The failure to adequately review GCH's unreasonable projections is arbitrary and capricious. Pittman testified the Department did not conduct any independent examination as to GCH's projections, but that it simply accepted them as presented. T.65. One has to wonder why GCH did not simply claim $5.00 a square foot, or $1.00, or two cents — no matter how preposterous the number, the Department simply accepts it, abdicating the exercise of the expertise and discretion on which the Legislature and the courts normally rely. The Department's disregard of the obvious facts regarding GCH's cost per square foot was arbitrary and capricious, and therefore, the CON award should be overturned.

CONCLUSION

For all the reasons stated above, 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 ***18th*** day of January, 2008.

HTC HEALTHCARE II, INC.

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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:

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