

STATE OF NEW YORK : DEPARTMENT OF HEALTH

IN THE MATTER
OF THE APPEAL OF

SARATOGA COUNTY MAPLEWOOD MANOR
Audit #07-4424
Medicaid ID [REDACTED]

Pursuant to Part 519 of Title 18 of the Official Compilation of
Codes, Rules and Regulations of the State of New York

DECISION
AFTER
HEARING

Before: William J. Lynch
Administrative Law Judge

Held At: NYS Department of Health
433 River Street
Troy, New York 12180

May 20, 2011
September 27, 2011
November 1 and 2, 2011
December 2, 2011
April 3 and 4, 2012

Record closed: June 21, 2012

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JURISDICTION

The Saratoga County Maplewood Manor (“Appellant” or “Maplewood Manor”) requested this hearing pursuant to Section 519.4 of Title 18 of the Official Compilation of Codes, Rules and Regulations of the State of New York (“NYCRR”) to appeal from a determination of the State of New York Office of the Medicaid Inspector General (“the OMIG”) to recover alleged overpayment of reimbursement by the Medical Assistance for Needy Persons Program (“Medicaid”), plus interest.

FINDINGS OF FACT

The following Findings of Fact were made after a review of the entire record in this matter. Numbers in parentheses refer to transcript page numbers or exhibits. These citations represent evidence found persuasive by the Administrative Law Judge in arriving at a particular finding. Conflicting evidence, if any was considered and rejected in favor of the cited evidence.

1. Maplewood Manor is a 277 bed skilled nursing facility located in Ballston Spa, New York, owned and operated by Saratoga County. The governing body of Maplewood Manor is the Saratoga County Board of Supervisors (T. 289-292).
2. Nursing facilities in New York State are reimbursed by Medicaid on a per diem basis (T. 26).
3. The rate consists of four separate components – direct, indirect, non-comparable and capital (10 NYCRR 86-2.10[b][1][ii]).
4. The first three of those components (the direct, indirect and non-comparable costs) constitute a facility’s operating rate (10 NYCRR 86-2.10[b][2]).
5. During the rate years in issue, Appellant’s operating costs were based upon costs incurred in 1983 and trended forward for inflation using factors set by the Department of Health Bureau of Long Term Care Reimbursement (“BLTCR”) (T. 26; 10 NYCRR 86-2.10[b][2]).

6. Maplewood Manor first opened in 1973 and reached its current size in 1979. By the early 2000s, the boilers and air conditioning units had begun to wear out, and the lighting in the facility needed to be improved. In addition, Maplewood Manor's backup generator did not provide service to some of the power outlets and lighting fixtures in the facility and did not provide any service to the kitchen (T. 292, 296).

7. Saratoga County sought out proposals to upgrade the equipment at Maplewood Manor and to conserve energy. Following its review, a Committee of the Saratoga County Board of Supervisors recommended that a proposal submitted by Siemens for the construction of a cogeneration project be accepted (T. 293-294, Ex. 19, pp. 41-48; Ex. 20, pp. 3-9).

8. A cogeneration plant is a system of generating electricity and utilizing the byproduct which is heat. The heat byproduct can be used to heat the building in the colder months and to cool the building in the warmer months through the use of an absorption chiller (T. 460-461).

9. A cogeneration plant does not simply produce electricity. The purpose of cogeneration is to gain efficiency by utilizing the heat generated in the process of converting natural gas to electricity (T. 475).

10. The fuel that drives the generators of a cogeneration plant is natural gas. Prior to the construction of the cogeneration plant, Maplewood Manor had purchased natural gas for its boilers (T. 300, 451).

11. An administrative review Certificate of Need ("CON") application for a cogeneration project at Maplewood Manor was submitted by letter dated August 2, 2001, from Siemens to Dave McNamara, Associate Architectural Estimator for the New York State Department of Health (Ex. 20, p. 14).

12. The Health Department's Division of Health Facilities Planning which oversaw the CON process was familiar with cogeneration projects at the time and dealt with other cogeneration project

applications prior to the CON submitted by Maplewood Manor (T. 487, 497-498).

13. During the early 2000s, the Department of Health looked favorably on the development of cogeneration plants because they had the positive environmental effect of conserving energy and because they extended the useful life of facilities and made them more efficient (T. 499-500).

14. Maplewood Manor was not the first facility to obtain CON approval for a cogeneration project. Genesee County contracted with Siemens to design and build a cogeneration plant, and its CON application was approved (T. 347-350; Ex. P).

15. The BLTCR increased Genesee County's reimbursement rate to add on the capital costs of its cogeneration project (T. 348-349; Ex. R, S, T).

16. On October 4, 2001, the Department of Health, by Wayne M. Osten, Director, Office of Health Systems Management ("OHSM"), notified Maplewood Manor that its CON application to upgrade lighting, renovate its HVAC system and construct a cogeneration plant had been reviewed and approved at a capital cost of \$3,952,000, pursuant to 10 N.Y.C.R.R. 710.1 (Ex. C).

17. By letter dated October 11, 2002, Maplewood Manor advised the Bureau of Architecture and Planning and the BLTCR that the project was 89 per cent complete and requested a rate revision that included the capital costs for the project. A Schedule of Certified Costs and supporting schedules was also submitted (Ex. D).

18. On October 21, 2002, Thomas Jung, in his capacity as the Director of the Review and Analysis Group in the Department's OHSM notified Maplewood Manor that its schedule of certified costs had been reviewed, revised and approved in the amount of \$3,319,658 (Ex. E).

19. The BLTCR acknowledged Maplewood Manor's rate appeal request by letter dated November 4, 2002 (Ex. F).

20. By letter dated October 30, 2003, the BLTCR advised Maplewood Manor that its 2002 and

2003 Medicaid rates had been revised to reflect the lease payments for the capitalized lease effective December 1, 2002, for the project which included upgrading of facility lighting, renovation of the HVAC system and the construction of an on-site cogeneration plant (Ex. H).

21. By letter dated January 20, 2005, Mr. Jung advised Maplewood Manor that its final schedule of certified costs dated August 23, 2003 had been reviewed and revised again and had been approved in the amount of \$3,745,136 (Ex I).

22. The BLTCR was copied on the relevant correspondence (Ex. O).

23. Maplewood Manor submitted subsequent rate appeals relating to the capital costs of the cogeneration project dated November 29, 2006 (Ex. J), November 9, 2007 (Ex. K), and January 2, 2009 (Ex. L) which were approved.

24. After construction of the cogeneration plant, Maplewood Manor purchased more natural gas which was now also used to operate the cogeneration plant, and Maplewood Manor purchased less electricity (T. 300-302).

25. The OMIG conducted an audit of the Medicaid rates for Maplewood Manor for the period of December 1, 2002 through December 31, 2006. On March 4, 2009, OMIG issued an audit report which alleged that the BLTCR had made an error when it determined that Maplewood Manor's Medicaid rate should be increased to include reimbursement for the capital cost of Maplewood Manor's cogeneration project. An administrative hearing regarding that audit report scheduled for June 1, 2009 was cancelled because OMIG indicated that it intended to review its findings.

26. OMIG issued a revised final report on July 29, 2010. The report again alleged that the BLTCR had made an error when it determined that Maplewood Manor's Medicaid rate should be increased to include reimbursement for the capital cost of the cogeneration project as well as the other audit adjustments. The audit determined that Medicaid payments for the capital costs of the cogeneration plant were overpayments (T. 43; Ex. 3).

ISSUE

1. Did the BLTCR incorrectly include the cost of the cogeneration plant in the capital cost component of the Appellant's reimbursement rate?

SIGNIFICANT RULINGS

Maplewood Manor brought a motion requesting that the OMIG's revised final report be dismissed as void and unenforceable, asserting that no regulation supported the OMIG's rescission of its original draft and final reports or issuance of its revised draft and final reports. Maplewood Manor contended that the OMIG had exceeded its authority and failed to abide by its own regulations. I denied the motion because the OMIG's statutory authority to assure the accuracy of promulgated rates of payment granted pursuant to Public Health Law §§ 30-32 and Social Services Law § 368-c, can only be reasonably read to include the issuance of audit reports regarding Medicaid payment rates as well as the rescission of final audit reports which the OMIG must revise in order to accurately reflect the law and regulations.

Maplewood Manor also contended that the OMIG's disallowances relating to a cogeneration project must be overturned as a matter of law because a rate appeal approved by the BLTCR concerning that project was a dispositive and final determination of the Department. Pursuant to 18 NYCRR 517.3(a), however, rates granted by the BLTCR are provisional until audited or until the time for audit has passed. When conducting an audit, the OMIG auditors do not have the authority to substitute their judgment for the BLTCR's in determining the rate setting methodology, but they do have the authority to correct mistakes made by the BLTCR during the rate setting process. Therefore, I denied Appellant's request to overturn the disallowances based solely on the existence of non-adjudicatory rate appeals approved by the BLTCR.

ANALYSIS AND CONCLUSIONS

A residential health care facility's costs are reimbursed through per diem rates set by the Department. The direct, indirect and noncomparable cost components comprise the operating portion of a residential health care facility's Medicaid rate. The fourth component of a facility's Medicaid rate is the capital cost component. The operating portion and the capital cost component of a residential health care facility's Medicaid rate are calculated separately and then combined to determine a facility's Medicaid reimbursement rate.

In October 2002, the Department approved Appellant's schedule of certified costs in the amount of approximately \$3.3 million, and the BLTCR acknowledged Appellant's initial rate appeal requesting the inclusion of the capital costs for the cogeneration plant in its Medicaid reimbursement rate. In 2005, the Department reviewed and approved Appellant's final schedule of certified costs in the amount of approximately \$3.7 million. The BLTCR approved Appellant's initial rate appeal and subsequent rate appeals filed in 2006, 2007 and 2009 regarding the inclusion of capital costs for the cogeneration plant in its Medicaid reimbursement rate.

This audit reviewed the capital costs approved by the Department and included in the Appellant's Medicaid rate for the period from December 1, 2002 through December 31, 2006. In a November 2007 email, the OMIG told the BLTCR that the addition of a capital cost associated with the cogeneration project to the Medicaid rate provided the facility with duplicate reimbursement for its electricity. The email further stated that this duplicate reimbursement analysis had been affirmed in a hearing related to the audit of another facility, *Daughters of Sarah*. Since the Appellant's costs for natural gas and electricity were included in the operating portion of the Appellant's rate, the OMIG contended that the capital cost component associated with the cogeneration project which the

BLTCR had added to Appellant's Medicaid rate should be disallowed. The OMIG email also asked whether the BLTCR could support the OMIG's position if called upon to do so. In April 2008, Alfred Fargione, a rate setter in the BLTCR, sent a reply email stating that he believed the methodology proposed by OMIG would keep the BLTCR in accord with the *Daughters of Sarah* hearing decision (Ex. N).

The issue in *Daughters of Sarah* related to a facility which contracted with an outside vendor for laundry and linen services and included that expense in its 1983 base year operating costs. In 1993, the facility replaced the laundry contractor with an in-house laundry by purchasing linens and purchasing or renting equipment. When the facility included those capital costs in its annual cost reports, the OMIG auditors determined that incorporating both the 1983 laundry contractor costs and the in-house laundry expense constituted duplicate reimbursement. When that matter was brought to an administrative hearing, the Chief Health Care Fiscal Analyst of the BLTCR, Henry Cassidy, testified that he would not have included any in-house laundry costs in the capital component of the provider's rate if he had known about the inclusion of the 1983 laundry contractor costs in the indirect component of the rate. The Administrative Law Judge ("ALJ") found Mr. Cassidy's emphatic testimony convincingly demonstrated that he mistakenly included in-house laundry costs in the capital component of the Medicaid rate. The ALJ also noted that Mr. Cassidy's testimony was corroborated by evidence in the record which showed that the audit disallowances were required by the BLTCR rate setting methodology, including a 1999 memorandum from the Director of BLTCR, Carl Dembrosky.

In this hearing, the OMIG apparently viewed converting natural gas to electricity as a service provided to Maplewood Manor by the utility company. The OMIG analogized this service to the service provided by the laundry contractor in the *Daughters of Sarah* case and determined that the cogeneration project was analogous to the expenses associated with the in-house laundry in

Daughters of Sarah which was determined to be a duplicate reimbursement.

Maplewood Manor contended that the BLTCR had approved increases in its Medicaid rate because the cogeneration project was a capital expense which permitted the facility to utilize the heat byproduct resulting when natural gas is combusted to produce electricity. As a result of the capital costs expended on the cogeneration plant, Maplewood Manor now purchases less electric, purchases more natural gas, and uses the heat byproduct of the cogeneration plant to supply heating and cooling for the building. The facility has always purchased energy from the utility company. That expense was included in its 1983 base year operating costs because the facility purchased both natural gas and electricity from the utility company at that time, and the facility has continued to purchase these two forms of energy since the completion of the cogeneration project.

The issue to be determined in this case is whether the BLTCR increased Maplewood Manor's rate for its capital expense on the cogeneration project by mistake. The OMIG auditors do not have the authority to substitute their judgment for determining the Medicaid rate setting methodology . OMIG offered the testimony of two witnesses from the BLTCR to support its position that the various individuals in the BLTCR who approved Appellant's rate increases made a mistake regarding the rate setting methodology when they allowed the inclusion of capital expenses for the cogeneration plant. The first was Kenneth Ferro who was the healthcare fiscal analyst in the BLTCR responsible for setting the capital portion of Maplewood Manor's rate from 2003 to 2007 and including the capital costs for the cogeneration project. Mr. Ferro testified that he believed at that time that Appellant was entitled to the capital costs for the project since the Department had approved the costs. He further stated that the rate appeals which included the capital costs for the cogeneration project were approved by his supervisor at the time, Noreen Ravish. Mr. Ferro testified, however, that he came to believe that he had made an error after a conversation with Mr. Fargione, which took place when this administrative hearing proceeding began in 2011. In his testimony, Mr.

Ferro stated:

And so, you know, we were talking about it, and [Mr. Fargione] says , you know, [the cogeneration project]'s supposed to replace NIMO, basically, right? (T. 270).

In essence, Mr. Ferro's testimony demonstrated that he accepted and adopted Mr. Fargione's opinion that adding the cogeneration project's capital costs provided duplicate reimbursement for the provider's utility expenses which were already a part of the operating portion of the rate.

The second witness from the BLTCR who testified on behalf of the OMIG's position regarding the rate setting methodology was Mr. Fargione. Mr. Fargione had not handled any of the rate appeals in question, but he was the author of the April 2008 email which supported the OMIG's intention to extend their understanding of *Daughters of Sarah* to the cogeneration audit (Ex. N). Regarding his 2008 review of the Appellant's file, Mr. Fargione testified that:

So after looking at the rate sheets and the overall – what had taken place, it looked to me like a matter of duplicate reimbursement. We were already paying in the operating portion of the rate for the full value of their utilities, but the cogeneration plant produces electrical services. So I suppose the provider might have been Niagara Mohawk in those days or whatever. But the truth is that their bill, which was part of the operating portion of the rate, included everything that would have been the cogeneration plant (T. 173).

In sum, Mr. Fargione's opinion appears based on his belief that the capital expenses associated with construction of the cogeneration plant was merely a duplicate reimbursement for the facility's electrical services which was already part of the operating portion of Appellant's Medicaid reimbursement rate.

Appellant countered that the cogeneration project was a not substitution for its utility expense. Instead, it was a capital expense which permitted the facility to utilize the heat byproduct resulting when natural gas is combusted to produce electricity. As a result of the capital costs expended on the cogeneration plant, Maplewood Manor now purchases less electric, purchases more natural gas, and

uses the heat byproduct of the cogeneration plant to supply heating and cooling for the building. The facility has always purchased energy from the utility company. That expense was included in its 1983 base year operating costs because the facility purchased both natural gas and electricity from the utility company at that time, and the facility has continued to purchase these two forms of energy since the completion of the cogeneration project.

The OMIG contends in its brief that there is no evidence in the record of this hearing that anyone within the BLTCR gave the matter the “requisite level of consideration to exercise its judgment” on whether the capital costs should be reimbursed until Mr. Fargione’s April 2008 review. However, the Appellant established in this record through documentary evidence that the BLTCR and the OHSM, including Kenneth Ferro, Noreen Ravish, Henry Higgitt, Kathy Gill, Mark Van Guysing and Wayne Osten all approved reimbursement of the capital costs of the cogeneration plant. Appellant also offered the testimony of Thomas Jung who was the Director of the Bureau of Architectural and Engineering Facility Planning as well as the Director of the Bureau of Financial Analysis and Review in the early 2000s (Ex. V). Mr. Jung was later appointed as the assistant director and then the director of the entire Division of Health Facilities Planning, a position which he held until March 2011. I found Mr. Jung’s testimony to be forthright and credible. Mr. Jung established that the Department looked favorably on the development of cogeneration plants during the early 2000s because these projects helped conserve energy and could extend the useful of other equipment such as the boilers at the facilities.

I conclude that the record in this proceeding can be distinguished from the *Daughters of Sarah* determination. In *Daughters of Sarah*, the ALJ indicated that the record contained the emphatic testimony of a BLTCR Chief Fiscal Analyst who testified that he would not have included the capital expense for an in-house laundry if he knew that the expense for a laundry contractor was included in the operating rate. The ALJ further indicated that the Chief Fiscal Analyst’s testimony was

corroborated by a memorandum written by the Director of the BLTCR. In the matter before me, I found the testimony of the two BLTCR employees to have been based upon a methodology suggested by the OMIG and resting on a premise that a cogeneration plant was merely a substitute for the facility's electrical expense which was included in the operating portion of its reimbursement rate. There was no testimony or evidence suggesting that the BLTCR was unaware that the Appellant's utility expense was included in its operating rate. To the contrary, I find it highly improbable. Further, the testimony offered by the OMIG attempting to establish that the cogeneration project was a substitution for the Appellant's utility expense was not persuasive because the record establishes that the Appellant still has an operating expense for its utilities.

Based on the record before me, I find that the BLTCR approved a rate increase for the cogeneration plant as a capital expense and could have reasonably done so consistent with its methodology because the cogeneration plant permitted the facility to utilize the heat byproduct resulting when natural gas is combusted to produce electricity and to extend the facility's useful life. In spite of the OMIG's contention to the contrary, I find that this issue was sufficiently raised by the Appellant in its response to the draft audit report wherein the Appellant states that the capital costs for the construction of the cogeneration plant were not duplicative of the utility operational expenses.

Finally, the testimony of the two BLTCR employees was not corroborated by any documentary evidence from upper level management. However, documentary evidence in this record does establish that the BLTCR had previously approved a cogeneration project for the Genesee County Nursing Home. In addition, the fact that the BLTCR has not removed the capital costs of the cogeneration plant from the Appellant's Medicaid rate several years after the OMIG brought its opinion of erroneous duplication to the BLTCR's attention is further evidence that disallowance of the capital costs for the cogeneration plant is not required by the BLTCR's methodology.

Accordingly, I conclude that Appellant has established that the BLTCR made a knowing, purposeful and discretionary decision to allow the capital costs for the cogeneration project. Therefore, audit adjustment 7 is reversed.

Appellant withdrew its objection to audit adjustment 1 and 2 (T. 15, 68).

Audit adjustments 3 and 4 are sustained. Regarding adjustment 3, the BLTCR included interest on the capitalized lease in addition to the lease payments to Siemens as capital costs in the 2006 rate year. Regarding adjustment 4, the BLTCR included fixed equipment depreciation on the capitalized lease in addition to the lease payments in the 2004 rate year. Maplewood Manor offered no evidence that the facility was entitled interest or depreciation in addition to the lease payments. Accordingly, the OMIG properly disallowed adjustments 3 and 4 as duplicate reimbursements of capital costs already included in the facility's rates in the form of lease payments to Siemens, correcting an error made by the BLTCR.

Audit adjustment 5 is sustained. Maplewood Manor did not challenge the OMIG's assertion that oxygen expense is considered an operating expense and therefore disallowed from property.

Audit adjustment 6 is sustained. Maplewood Manor did not challenge the OMIG's assertion that the facility was unable to provide documentation for oxygen concentrators for the 2004 rate year. Consequently, this unsubstantiated expense was disallowed.

Having sustained audit adjustment 3 which disallowed interest expense, audit adjustment 8 must also be sustained. Since Maplewood Manor's interest expense was disallowed, the offset of investment income against interest expense must be reversed.

DECISION: Audit adjustments 1, 2, 3, 4, 5, 6 and 8 are sustained. Audit adjustment 7 is reversed.

This decision is made by William J. Lynch, who has been designated by

the Commissioner of the New York State Department of Health to make such decisions.

Dated: January 16, 2013
Menands, New York

William J. Lynch, Esq.
Administrative Law Judge