

# PROVIDER REIMBURSEMENT REVIEW BOARD HEARING DECISION

98-D39

**PROVIDER -**  
Regency Health Occupational and Speech  
Therapy Group Appeal

Gran Care Occupational and Speech  
Therapy Group Appeal

Provider Nos. See Appendix I & II

**vs.**

**INTERMEDIARY -**  
Mutual of Omaha Insurance Company

**DATE OF HEARING-**  
April 29, 1997

Cost Reporting Period Ended -  
Various  
See Appendix I & II

**CASE NO.** 97-0111G & 97-0112G

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ISSUE:

Were the Intermediary's adjustments to occupational therapy and speech therapy costs proper?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

The Providers that comprise the two group appeals in this decision are Medicare-certified skilled nursing facilities ("SNFs") that are owned and operated by the separate proprietary corporations of Regency Health and Gran Care.<sup>1</sup> All of the Providers are freestanding SNFs located in the state of California. During the fiscal years in contention, the Providers furnished occupational therapy ("OT") and speech therapy ("ST") services to their patients under arrangements with outside contractors, and claimed reimbursement for the charges made by these suppliers on their Medicare cost reports. At issue in these group appeals are disallowances of portions of the costs claimed for the OT and ST services based on the purported application of the Medicare program's prudent buyer principle by Mutual of Omaha Insurance Company ("Intermediary").

The disallowed amounts at issue were based on a survey conducted by the Intermediary in January of 1996, wherein survey questionnaires were sent to 2,007 freestanding and hospital-based SNFs which it serviced. The cover letter transmitting the questionnaire included the following explanation for conducting the survey:<sup>2</sup>

Many Skilled Nursing Facilities (SNFs) are providing Occupational Therapy (OT) and Speech Therapy (ST) services to Medicare beneficiaries under arrangement. Providing for services under arrangement by SNFs is allowable; however, Medicare reimbursement for these services must be made on a reasonable cost basis. The Health Care Financing Administration (HCFA) has not published salary equivalency standards for OT and ST, as it has for Physical Therapy and Respiratory Therapy. It is the responsibility of the intermediary to determine reasonable cost.

We are conducting a survey of SNF providers to establish the rates paid for OT and ST services. Please complete the attached form concerning OT and ST services at your facility and return to us by February 29, 1996.

The first part of the survey questionnaire asked each SNF to report the number of occupational and speech therapists employed (Full-time/Part-time) together with the average annual salary and/or part-time hourly rate. The second part of the questionnaire asked the SNFs to furnish information related to the use of outside contractors. If the facility provided

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<sup>1</sup> See Appendix I & II - Final Schedule of Providers in Group.

<sup>2</sup> Intermediary Exhibit I-1/Providers Exhibit 27.

contracted OT and/or ST services, the SNF was asked to report the name of the contracting firm and the current contracted cost per hour or unit of service for each type of service. The SNF was also asked to define its unit of service and to enclose a copy of its current OT and/or ST contract. The Intermediary received 1,146 responses, of which 1,092 were usable (23 were incomplete and 31 were untimely).

The Intermediary segregated the survey responses into five separate regions of the country: (1) East, (2) Southeast, (3) Midwest, (4) Southwest and (5) West. The West region was comprised of SNFs located in California and Utah, which includes all of the California-based Providers participating in the relevant group appeals for Regency Health and Gran Care. The data for the five different regions were entered on separate spreadsheets, with the SNFs arrayed from the highest hourly contract/salary rate to the lowest.<sup>3</sup> Based on the arrayed data, the Intermediary established benchmarks for its prudent buyer determinations using the 75th percentile of the range of contract/salary rates.

With respect to the West region, the Intermediary received responses from 292 of the 554 SNFs included in the survey (553 California SNFs and one SNF in Utah). Based on its application of 75th percentile for the West region, the Intermediary established a contractual rate benchmark of \$104 per hour for OT and ST services, and an annual salary rate of \$66,200 and \$55,000 for OT and ST services, respectively. An analysis of the data reflected in the survey results for the West region shows the following:<sup>4</sup>

Use of Contractors:

- 275 (94%) out of 292 California SNFs obtained OT and ST services from outside contractors.
- 263 (90%) out of 292 California SNFs obtained OT and ST services exclusively from outside contractors and did not employ full-time or part-time occupational or speech therapists.

Costs of Contracted Services:

- The median cost of OT services obtained from outside contractors was \$100 per hour of OT service.
- 142 (53%) of 269 SNFs paid at least \$100 per hour of OT service.

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<sup>3</sup> See Intermediary Exhibit I-2 for data relating to the West region.

<sup>4</sup> See Providers Exhibits 28, 29, 30 and 35, and testimony of Providers' witness, Tr. at 78-83, and Intermediary's witness, Tr. at 187, 199 and 245.

- The prevailing cost, calculated at the 75th percentile, of OT services obtained from outside contractors was \$104 per hour of OT service.
  - 98 (36%) of 269 SNFs paid at least \$104 per hour of OT service.
- The median cost of ST services obtained from outside contractors was \$100 per hour of ST service.
  - 150 (55%) of 275 SNFs paid at least \$100 per hour of ST service.
- The prevailing cost, calculated at the 75th percentile, of ST services obtained from outside contractors was \$104 per hour of ST service.
  - 99 (36%) of the 275 SNFs paid at least \$104 per hour of ST service.

Employment of Therapists:

- 26 (9%) out of 292 California SNFs employed a full-time occupational therapist.
- 10 (3%) out of 292 California SNFs employed a full-time speech therapist.

In implementing its survey results to the audit process, the Intermediary selectively applied the established prudent buyer benchmarks to 57 SNFs that were subject to on-site reviews and 23 SNFs that were subject to focused reviews of OT and ST costs.<sup>5</sup> The 23 SNFs which were subject to focused reviews were selected on the basis of combined OT and ST costs in excess of \$500,000.<sup>6</sup> In a memorandum to its managers, the Intermediary advised that documentation and review of prudent buyer efforts were required audit steps for OT and ST services furnished under arrangement in addition to the audit steps contained in the standard audit program.<sup>7</sup> The objective of the specific audit program was to ensure that the cost of OT and ST services provided under arrangement did not exceed the cost a reasonable and prudent buyer would be willing to pay for such services. The following detailed procedures were set forth in the Intermediary's audit program for OT and ST services:<sup>8</sup>

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<sup>5</sup> Stipulation of the Parties - Providers Exhibit 34.

<sup>6</sup> Providers Exhibit 31.

<sup>7</sup> Intermediary Exhibit I-3.

<sup>8</sup> Id.

Determination of Prudent Buyer Efforts

1. Obtain documentation of the provider’s prudent buyer efforts. Documentation of efforts to hire salaried therapist is expected. Where salaried therapists could not be hired, documentation of comparisons made by provider between various contract therapy alternatives is expected.
2. If prudent buyer efforts to obtain salaried therapists were not made, costs will be limited to the cost of salaried therapists required to provide the therapy hours incurred, using the prevailing salary rates per the occupational/speech therapy survey plus a fringe benefit and expense factor of 61.8%.

$$\frac{\text{TOTAL THERAPY HOURS}}{1500 \text{ HOURS}} = \text{ALLOWABLE FTEs*}$$

\* Allowable FTE of less than 1 will be allowed as 1 full FTE

3. If salaried therapists were sought and could not be obtained, review the provider’s efforts to obtain contract therapists. If documentation does not support efforts to obtain contract therapists at the lowest possible rate, costs will be limited to the market rate for contract therapists based on the survey rate.

$$\text{TOTAL THERAPY HOURS x HOURLY RATE} = \text{ALLOWABLE COSTS}$$

4. If the provider has adequately documented their prudent buyer efforts to acquire both salaried and contract occupational and speech therapy services, no adjustment will be proposed, even though the rate may exceed the market rate per the survey.
5. If an adjustment is made to occupational and/or speech therapy costs, review all reopenable cost reporting periods to ensure proper application of the prudent buyer principle. Any adjustment will limit costs to the survey rates.

Of the 80 SNFs selected for on-site audits or focused reviews, the Intermediary applied its prevailing salary rates or market rate for contract therapists to 77 SNFs. Two of the selected SNFs were deemed to have adequate documentation of efforts to hire an in-house therapist, and the actual costs of one SNF which obtained OT and ST services from an outside contractor were less than the Intermediary’s annual salary rate.<sup>9</sup>

As a result of the Intermediary’s application of the audit program for OT and ST services, all of the Providers participating in the Regency Health and Gran Care group appeals had their contractual OT and ST costs reduced to the amounts which the Intermediary believes would

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<sup>9</sup> Providers Exhibit 34.

have been paid had they employed salaried therapists to perform these same services. In computing the amount of allowable costs, the Intermediary used a two-step analysis which first computed the number of full-time equivalent (“FTE”) therapists which it believes would have been needed to furnish the OT and ST services to a provider’s patients during the year under review. Relying on the contractors’ therapy logs, the Intermediary determined that a unit of therapy service was equivalent to fifteen minutes of therapy time. Based on the total number of treatments reported during a cost reporting period, the Intermediary multiplied that amount by 15/60 minutes to arrive at total hours of therapy services for the year. Assuming a 40-hour workweek, total annual hours of 2,080 (52 weeks x 40 hours) were used as the maximum available hours. Relying on discussions with SNFs, the Intermediary estimated an efficiency rate of 72 percent for contract therapists, which was deemed to be the amount of time a therapist spent performing hands-on therapy to individual patients. By multiplying the total hours of 2,080 by a 72 percent efficiency rate, an annual total hands-on therapy time of 1,500 hours was determined. This amount was then divided into the total hours of therapy services for the year to arrive at the number of FTE therapists which a provider would need to employ to perform the same services.

In the second step of the computation, the Intermediary multiplied the number of FTE therapists required to perform the service by the annual salary rate established by the survey, which for the West region was \$66,200 and \$55,000 for OT and ST services, respectively. The annual salary rate was increased by a fringe benefit and expense factor of 61.8 percent. This is the same fringe benefit and expense factor applied to contract physical therapy services as published in § 1412.2C of the Provider Reimbursement Manual (HCFA Pub. 15-1). To illustrate its application, the Intermediary presented an example of its methodology with respect to ST costs incurred by Laurelwood Health Care Center (“Laurelwood”), one of the SNFs participating in the Gran Care group appeal.<sup>10</sup> The computation of the Intermediary’s audit adjustment to the ST costs incurred by Laurelwood is as follows:

•	Number of ST Treatments Reported	
	10,530	
•	Computed Hours of Therapy Services Required	2,633
	[10,530 Treatments x 15/60 (15 Minutes Time Unit)]	
•	Number of FTE Speech Therapists Required	
	1.76	
	[2,633 Hours ÷ 1500 (Annual Therapy Time per Therapist)]	
•	Allowable ST Costs	\$177,980
	[2 FTE (rounded) x \$55,000 (Annual Salary Rate) x 1.618% (Fringe Benefit Factor)]	
•	ST Costs Claimed by Laurelwood	\$252,307
	Allowable ST Costs	<u>177,980</u>
	ST Costs Disallowed by Intermediary	<u>\$ 74,327</u>

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<sup>10</sup> Intermediary Exhibit I-4.

The Providers in these group appeals believe that the Intermediary improperly adopted and applied retroactive cost limitations which resulted in the improper disallowance of costs incurred to obtain OT and ST services from outside contractors. Accordingly, the Providers appealed the Intermediary's determinations to the Provider Reimbursement Review Board (Board) pursuant to 42 C.F.R. §§ 405.1835-.1841, and have met the jurisdictional requirements of these regulations. The estimated amount of Medicare reimbursement in controversy is approximately \$2,711,000 for both group appeals at issue. The Providers were represented by Ronald N. Sutter, Esquire, and Christopher L. Keough, Esquire, of Powers, Pyles, Sutter and Verville, P.C. The Intermediary's representative was Tom Bruce, Senior Consultant, Mutual of Omaha Insurance Company.

#### PROVIDERS' CONTENTIONS:

The Providers contend that they are entitled to reimbursement for the actual costs incurred to obtain OT and ST services from outside contractors. Pursuant to the reasonable cost principles set forth under the statutory provisions of 42 U.S.C. § 1395x(v)(1)(A) and the governing regulations at 42 C.F.R. § 413.9, the amount paid for services furnished to Medicare beneficiaries includes the costs actually incurred, however widely they may vary from one institution to another and from time to time for the same provider. The Providers argue that there are only two potentially-applicable exceptions to the requirement that they be reimbursed for the actual costs incurred for the OT and ST services obtained under arrangement. The first concerns the regulatory provisions of 42 C.F.R. § 413.106 which implement the statutory requirement of 42 U.S.C. § 1395x(v)(5)(A). These authorities authorize the adoption of prospective salary equivalency guidelines for limiting the reimbursement of costs incurred to obtain therapy services from outside contractors. The second exception is the substantially out of line limitation under 42 C.F.R. § 413.9(c)(2), which is commonly referred to as the "prudent buyer" principle. The Providers insist that the limits established by the Intermediary are inconsistent with both of the above legal authorities.

The Providers contend that the salary limits applied by the Intermediary are indistinguishable from the regulatory salary equivalency amounts which may only be applied on a prospective basis in accordance with 42 C.F.R. § 413.106. Under the regulation, a specific process is prescribed by which salary equivalency limits may be established for a particular type of therapy service. Among the regulatory requirements are the requisites that HCFA approve and provide advance notice of the separate salary equivalency limits for each type of therapy service. Further, the limits must be published in the Federal Register prior to their application. The Providers assert that HCFA has not approved or published salary equivalency for OT and ST services for the fiscal years in contention. Accordingly, it is the Providers' position that the Intermediary's disallowances reflect the application of illegal salary equivalency limits. Moreover, the Intermediary's salary equivalency limits violate virtually every requirement set forth in the regulations in that:

- (1) The limits are not based on statistically valid survey data;
- (2) The limits have been applied retroactively;
- (3) The limits were not published in the Federal Register;
- (4) The limits do not allow for a travel allowance;
- (5) The limits do not allow for overtime hours; and
- (6) The limits do not allow for supervisory services furnished by an outside contractor.

Recognizing the illegality of its OT and ST limits, the Intermediary offers two theories on why its salary limits are not salary equivalency amounts as prescribed under 42 C.F.R. § 413.106. First, the Intermediary notes that the limits have been only selectively enforced against providers that furnish relatively high volumes of OT and ST services rather than enforced against all providers. Secondly, the Intermediary points out that its salary limits are not absolute ceilings but merely “benchmarks” that are applied where a provider does not have adequate documentation showing that it tried to hire in-house therapists during the year in contention. In response to these allegations, the Providers observe that the Intermediary asserts distinctions without a difference. The Providers argue that selective enforcement of the limits does not transform them into something else. Additionally, the salary regulations have always required HCFA to allow exceptions to the prospectively-established guidelines where specific circumstances or labor market conditions would deem their application to be inappropriate.

As to the Intermediary’s reliance on the court’s decision rendered in New Jersey Chapter, Inc. of the American Physical Therapy Ass’n, Inc. v. Prudential Life Insurance Co. of America, 502 F. 2d 500 (D.C. Cir. 1975), the Providers argue that the salary benchmarks approved in that case were prospectively established with the approval of the Bureau of Health Insurance (HCFA’s predecessor). The court’s decision merely permitted the intermediary to use the benchmarks as a factor in determining whether a provider’s costs are substantially out of line under the limitations set forth in 42 C.F.R. § 413.9(c)(2). Thus, the court’s decision does not support the Intermediary’s retroactive application of unpublished salary equivalency limits in the instant case.

In summary, it is the Providers’ primary position that the Intermediary’s adjustments clearly reflect the application of retroactive salary equivalency limits that were established in 1996 and applied retroactively to 1994. Under the provisions of 42 U.S.C. § 1395x(v)(5)(A) and 42 C.F.R. § 413.106, the Intermediary is not authorized to retroactively apply unpublished

salary equivalency limits on costs incurred to obtain OT and ST services from outside contractors. Further, the regulation at 42 C.F.R. § 413.106(c)(5) requires Medicare intermediaries to follow reasonable cost principles when salary equivalency limits have not been approved by HCFA for a particular type of therapy.

As to the application of the prudent buyer concept, the Providers contend that the Intermediary's adjustments are inconsistent with the reasonable cost principles established under 42 U.S.C.

§ 1395x(v)(1)(A) and the pertinent regulatory provisions in 42 C.F.R. § 413.9. The regulation at 42 C.F.R. § 413.9(c)(2) provides for the payment of actual costs, however widely they may vary from one institution to another. The only limitation to this provision is where a particular institution's costs are found to be substantially out of line with other institutions in the same area that are similar in size, scope of services, utilization, and other relevant factors. The Providers insist that the Intermediary's adjustments violate every requirement of the prudent buyer regulation. While the substantially out of line limitation clearly allows for flexibility in a provider's reasonable costs, the Intermediary's use of a fixed criteria to limit reasonable cost is clearly contrary to the plain meaning of the substantially out of line limitation in 42 C.F.R.

§ 413.9(c)(2). The only exception to the application of the Intermediary's limits was where a provider had documentation from 1994 showing that it tried to hire in-house therapists. The Providers contend that the Intermediary's exception under such limited circumstances does not mean that it is allowing reasonable costs incurred for OT and ST services.

Based on their analysis of the Intermediary's survey data, the Providers contend that the Intermediary has not applied the substantially out of line standard as required under the regulations. The survey data of the 292 California SNFs that responded to the survey showed that 275 (94 percent) of the SNFs obtained ST services from outside contractors, and that 150 (55 percent) of those paid \$100 or more per hour for delivered therapy services.<sup>11</sup> Accordingly, the median cost per ST treatment hour was \$100, and the prevailing cost per treatment hour (calculated at the 75th percentile) was \$104 per hour.<sup>12</sup> The Intermediary's survey also showed that 269 of the California SNFs (92 percent) obtained OT services from outside contractors, and that 142 (53 percent) of those paid \$100 or more for OT services.<sup>13</sup> Thus, the median cost per OT treatment hour was \$100 and the prevailing cost per treatment hour (calculated at the 75th percentile) was \$104.<sup>14</sup> Since the Providers in these group appeals paid an average of \$25 per treatment unit (15 minutes) for OT and ST services

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<sup>11</sup> Providers Exhibits 28 and 35.

<sup>12</sup> Id.

<sup>13</sup> Id.

<sup>14</sup> Id.

obtained from outside contractors, the Intermediary admits that the Providers were paying the going rate and that their costs did not exceed the average costs incurred by SNFs in California for OT and ST services.<sup>15</sup> While the Intermediary presumes that the Provider's costs were higher than they might have been if the Providers had furnished OT and ST services through in-house employees, the Intermediary did

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<sup>15</sup> Tr. at 199 and 245.

not identify a single SNF anywhere that is comparable to any of the Providers in terms of the factors set forth in the regulations.

The Providers insist that the substantially out of line limitation cannot be construed to permit retrospective disallowances of costs that are not in excess of the average costs. Moreover, the Intermediary recognizes that it cannot sustain a position that costs which are equal to, or below, the average are substantially out of line. Consequently, the Intermediary wants to ignore the cost incurred by 95 percent of all California SNFs which contract for OT and ST services at rates that are clearly in line with the Providers' costs. Instead, the Intermediary wants to limit the Providers' costs on the theory that their costs are allegedly substantially out of line with costs incurred by approximately three percent of the SNFs in California that provide OT and ST services through in-house employees.<sup>16</sup>

The Providers argue that there are several flaws in the Intermediary's theory. First, the Intermediary never performed a comparative analysis which showed that the SNFs employing staff therapists in its survey sample are comparable to the Providers in these group appeals in terms of the factors specified in 42 C.F.R. § 413.9(c)(2). Second, the Intermediary has not compared costs comprised of the same basic elements in comparing the Provider's variable costs per hour of delivered therapy treatment to other SNFs' fixed salary costs. Finally, the Intermediary has not even shown that the costs incurred by the few SNFs that employ staff therapists are less than the costs incurred by the Providers.

In order to impose a prudent buyer adjustment under the substantially out of line limitation set forth in 42 C.F.R. § 413.9(c)(2), the Intermediary must specifically demonstrate on a case-by-case basis that a provider's costs are substantially out of line with costs incurred by comparable providers in the same area for comparable services. Instead, the Intermediary applied its salary equivalency limits without regard to the size of providers, scope of services, patient mix and acuity, type and quality of services furnished, or any other relevant factors. At a minimum, the Intermediary should have considered the comparable factors of geographic area, size, scope of service and utilization as required under 42 C.F.R. § 413.9(c)(2). An analysis of the Intermediary's survey data shows a wide divergence of wage costs in the different geographic areas within the State of California. In some instances, the Intermediary did not identify a single SNF that furnished OT and ST services in-house for the metropolitan statistical areas where the Providers in these group appeals are located. In addition, the Providers point out that the sizes of their facilities vary substantially from that of the SNFs in the survey sample that employ therapists in-house. Similarly, many of the Providers in these groups provide atypical services, as evidenced by their shorter than average lengths of stay, complex medical diagnoses of patients, and higher than average ancillary costs.<sup>17</sup> While the Intermediary essentially assumed that each of the Providers is comparable to every other SNF

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<sup>16</sup> Tr. at 23-26.

<sup>17</sup> Providers Exhibits 81-88.

in California, such an assumption is patently false.

The Providers contend that the Intermediary did not compare costs comprised of the same basic elements in accordance with 42 C.F.R. § 413.9(c)(2). Rather than comparing costs that were truly comparable and containing the same basic elements, the Intermediary used salaries and fringe benefit costs paid to in-house therapists and compared them to amounts paid for therapy services furnished under arrangement, which does not include non-productive time. Recognizing this problem, the Intermediary estimated the number of FTE therapists the Providers would have required to furnish therapy services in-house in 1994, rather than determining the actual costs incurred per unit of therapy services for the few SNFs that employed in-house salaried therapists.

In support of their position that the Intermediary's methodology reflects the application of arbitrary averaging and patently false assumptions, the Providers explain how the Intermediary's estimate of FTE therapists required for in-house services are grossly understated. In estimating the number of FTE therapists the Providers would need to furnish in-house therapy services during their 1994 fiscal year, the Intermediary improperly assumed that full-time therapists work 2,080 hours per year, and spend 72 percent of those hours furnishing hands-on therapy services to patients. Further, the Intermediary only credited the Providers with the number of FTE therapists needed to meet patient care requirements in an average month. The Providers argue that the evidence shows that full-time therapists work substantially less than 2,080 hours per year, accounting for paid time off for vacations, holidays, sick time, and the like. Additional non-productive paid time must also be considered for meals and breaks. The Providers argue that the Intermediary's productivity estimate of 72 percent is very high and has not been substantiated by any documentary evidence. The Intermediary admits that its estimate was based merely upon "anecdotal" conversations that were never reduced to writing. The Providers believe the evidence shows that less than 60 percent of hours worked by a therapist are spent furnishing therapy services to patients. The Providers' witness testified that the therapy contractor that he worked for during the period at issue experienced efficiency rates of 60 percent for occupational therapists and 45 percent for speech/language pathologists.<sup>18</sup>

Furthermore, the evidence shows that the Providers' utilization of therapy services fluctuated substantially from month to month.<sup>19</sup> Accordingly, if the Intermediary is going to assess what it would have cost the Providers to furnish OT and ST services through full-time salaried employees, the Providers must be given credit for the number of FTE therapists they would have needed to cover their busiest months, rather than an average month. Moreover, the Intermediary does not dispute the fact that its salary equivalency limits do not reflect, or make allowance for, costs of overtime, part time therapists, or contract therapists needed to

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<sup>18</sup> Tr. at 45, 50-51.

<sup>19</sup> Providers Exhibits 1-13.

supplement the services of in-house therapists.<sup>20</sup> Even if the Intermediary's salary rates and fringe benefit factor were valid, the evidence shows that all of the Providers' costs would have been allowed in 1994 if the number of FTE therapists needed to furnish therapy services in-house had been properly calculated. Accordingly, the Intermediary's basic premise that it is less expensive to furnish therapy services in-house than it is to purchase the services from outside contractors is clearly erroneous.

The Providers insist that the Intermediary's selective enforcement and retroactive application of unpublished salary equivalency limits and vague exceptions criteria are clearly arbitrary and capricious, and also violate the intent of Congress that the Medicare program reimburse SNFs for the costs incurred in providing required OT and ST services.<sup>21</sup> In violation of due process, the Providers were not given fair warning of either the limits or the methodology that would be established and applied to OT and ST costs incurred in 1994. No warning was given as to the type of documentation expected by the Intermediary to qualify for an exception to the limits, nor is there any authoritative requirement for a provider to maintain documentation showing that it tried to hire in-house therapists. Moreover, the Medicare regulations at 42 C.F.R. § 483.45 specifically permit providers to furnish therapy services directly or under arrangements with outside contractors.

The Providers contend that the Intermediary's reliance on the program instructions in HCFA Pub. 15-1 § 2103 is misplaced, and relies heavily on one sentence which states that "a prudent cost-conscious buyer . . . refuses to pay more than the going price for an item or service . . . [and] seeks to economize by minimizing costs." The Providers believe that the Intermediary's interpretation of the program instructions is contrary to the plain meaning of the prudent buyer regulation at 42 C.F.R. § 413.9(c)(2). While the Intermediary assumes that therapy services furnished by in-house employees are less costly than those obtained from outside contractors, there is no evidence to support this assumption. The Intermediary's mistaken assumption derives from its failure to recognize the difference between a fixed salary expense incurred on a paid-hours basis and a variable contract expense incurred on the basis of therapy services actually rendered to patients. Whereas providers that employ therapists incur fixed salary costs even when no therapy services are furnished, the Providers in these group appeals obtained services from outside contractors and only paid for services actually rendered to patients. Unless the costs of in-house services are reflected in terms of delivered units of therapy services rendered to patients, it is impossible to conclude that contract services are more expensive than in-house services. To demonstrate this point, the

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<sup>20</sup> Tr. at 225-227.

<sup>21</sup> Hooper v. National Transportation Safety Board, 841 F. 2d 1150, 1151 (D.C. Cir. 1988).

General Electric Company v. United States Environmental Protection Agency, 53 F. 3d 1234, 1330 (D.C. Cir. 1995).

Providers refer to Intermediary Exhibit 11 which summarizes the salary expense incurred by a few California SNFs which employed in-house therapists. The exhibit shows that various SNFs incurred sizeable amounts of salary costs for occupational and speech therapists. However, Intermediary Exhibit 14, which summarizes the SNFs' charges for OT and ST services, shows that these same providers had minimal or no charges for either types of therapy. Thus, it clearly would have been less costly for all of those SNFs to obtain therapy services from an outside contractor.

The Providers argue that the evidence in the record shows that the amount they paid for therapy services obtained from outside contractors was almost certainly less than the costs they would have incurred to furnish therapy services through in-house employees.<sup>22</sup> The Providers contend that all of their costs would have been allowed for the years in contention if the Intermediary (1) had properly given the Providers credit for the number of FTE therapists they would have needed to cover patient care needs in their busiest months, and (2) had properly considered the facts that a full-time therapist typically works no more than 1,808 hours per year and spends approximately 58.5 percent of those hours furnishing therapy services. By way of example, the Providers point out that a full-time occupational therapist who works only 1,808 hours per year and spends 60 percent of those hours furnishing hands-on therapy services to patients would furnish a total of only 1,085 hours of therapy service per year. If that figure is divided into the Intermediary's salary equivalency amount of \$107,116 for OT services (i.e., average salary of \$66,200 multiplied by the 1.618 percent fringe benefit factor), this produces a salary and benefit cost of \$98.72 per hour of therapy service. While this amount is right in line with the costs incurred by the Providers in these group appeals, the Providers note that even this amount is understated because it does not reflect certain other costs. In addition to the above costs, SNFs would incur substantial costs to recruit and retain qualified therapists, and would acquire other expenses associated with management and supervision. Moreover, the above salary and benefits amount does not reflect the higher fringe benefit and expense factor computed by HCFA in the notice of proposed salary equivalency limits for OT and ST, which are 71.86 percent and 74.5 percent, respectively.<sup>23</sup> Accordingly, the Providers conclude that it is no less expensive to provide therapy services in-house than it is to provide these services under arrangements with outside contractors.

In summary, it is the Providers' position that the Intermediary's disallowances of OT and ST costs are contrary to the Medicare Act, regulations and program instructions, are not based upon substantial evidence, are arbitrary and capricious, and are otherwise contrary to law. The Providers costs were not substantially out of line with the costs incurred by other SNFs in California for comparable services. Accordingly, the Intermediary's adjustments should be reversed.

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<sup>22</sup> See Providers Exhibits 89-91.

<sup>23</sup> See 62 Fed. Reg. 14,869 (March 28, 1997) - Providers Exhibit 80.

INTERMEDIARY'S CONTENTIONS:

The Intermediary contends that its adjustments to the Providers' OT and ST costs were made in accordance with the law, the reasonable cost regulations, and the Medicare program's prudent buyer policy set forth in the manual instructions. Under the provisions of 42 U.S.C. § 1395f(b), payments to SNFs for services rendered to Medicare beneficiaries are the lesser of reasonable cost or customary charges, which includes the provision of OT and ST services furnished to SNF inpatients. Reasonable cost is defined under 42 U.S.C. § 1395x(v)(1)(A) as "the cost actually incurred, excluding therefrom any part of incurred cost found to be unnecessary in the efficient delivery of needed health services, and shall be determined in accordance with regulations establishing the method or methods to be used, and the items to be included, in determining such costs . . . ."

The regulation at 42 C.F.R. § 413.9(c)(2) provides guidance in the application of the reasonable cost principle as follows:

The costs of providers' services vary from one institution to another and the variations generally reflect differences in scope of services and intensity of care. The provision in Medicare for payment of reasonable cost of services is intended to meet the actual costs, however widely they may vary from one institution to another. This is subject to a limitation if a particular institution's costs are found to be substantially out of line with other institutions in the same area that are similar in size, scope of services, utilization, and other relevant factors.

42 C.F.R. § 413.9(c)(2).

The Intermediary argues that the regulation serves as the foundation for the prudent buyer principle manualized at HCFA Pub. 15-1 § 2103 which states that "[t]he prudent and cost-conscious buyer not only refuses to pay more than the going price for an item or service, he/she also seeks to economize by minimizing cost." It is the Intermediary's contention that the Providers did not seek to minimize their OT and ST costs and, consequently, may not be paid for the portion of these costs which have been determined to be in excess of the reasonable allowable amount in accordance with 42 C.F.R. § 413.9.

Contrary to the Providers' allegation, the Intermediary insists that it did not impose salary equivalency rates in disallowing the OT and ST costs at issue. Unlike the salary equivalency rates, the established OT and ST contract rate of \$104 and salary rates of \$66,200 and \$55,000 are not absolute limits on the Providers' costs, but merely benchmarks for the determination of reasonable costs. As part of its audit of the OT and ST costs, the Intermediary asked the Providers to furnish documentation which would demonstrate that they sought to minimize these costs. The Intermediary advises that it was willing to consider any documentation the Providers had evidencing that their decisions to purchase OT and ST

contract therapy services were based, at least in part, on a desire to minimize cost. If the hiring of OT and ST therapists was considered by the Providers, but either none were available or there was no need for a full-time therapist, the Intermediary states that it was willing to weigh this documentation in its prudent buyer determination. While the Intermediary was even willing to consider the use of contracted services if the Providers believed the quality of these services would be better than those furnished by salaried therapists, the Providers furnished no such documentation. The Intermediary believes that it afforded the Providers an opportunity to demonstrate through their prudent buyer efforts that the costs they incurred for OT and ST services were reasonable. It was only when the

Providers were unable to furnish the necessary documentation that the Intermediary imposed the OT and ST salary benchmarks of \$66,200 and 55,000, respectively.<sup>24</sup>

The Intermediary contends that, based on its comparison of the Providers' contract rates with the salaries paid to occupational and speech therapists in California, the costs of contract OT and ST services purchased by the Providers for the cost reporting periods under appeal were clearly excessive. The Intermediary points out that its survey results indicate that there were SNFs in California that hired full-time occupational therapists for salaries ranging from \$42,981 to \$89,150, and full-time speech therapist for salaries ranging from \$30,000 to \$76,000. Using the Laurelwood facility as an example, the Intermediary computed an annual compensation amount of \$137,134 for one FTE occupational therapist based on the application of its methodology to the invoice costs and number of treatments reported by Laurelwood.<sup>25</sup> Even if the top salary in the survey of \$89,150 is multiplied by an employee benefit and expense factor of 61.8 percent, the result of \$144,245 is barely more than the contract rate paid by Laurelwood. The Intermediary further notes that the compensation amount would be substantially higher if the costs and hours of OT assistants and aides were removed from the computation. Given the fact that the top salary rate of \$89,150 is 24 percent higher than the next highest salary of \$72,000 in the California survey, it is the Intermediary's conclusion that the amount paid by Laurelwood is clearly not reasonable. The Intermediary's notes that the other Gran Care Providers in the group appeal contracted with outside contractors who were even more expensive than Laurelwood's supplier, and that the comparable amounts for the Regency Health Providers are equally unreasonable.

In response to the Providers' contention that the Intermediary failed to analyze the factors set forth in 42 C.F.R. § 413.9(c)(2) in making its prudent buyer determinations, the Intermediary notes that it separated the survey responses into five separate regions of the country. The relevant region in these group appeals is the west region which is comprised almost entirely of SNFs located in California. Twenty-eight SNFs in the west region employed salaried OT and/or ST therapists, and 23 of these facilities are located in or within a 50 mile radius of three major metropolitan areas. Given the locations of the Providers in the group appeals at issue, the Intermediary indicates that had it segregated the survey responses into the three metropolitan areas and identified the 75th percentile of OT and ST salaries for each area, the vast majority of the Providers' OT and ST costs would have still been reduced. However, the Intermediary strongly believes that the entire state of California is the proper geographic area for the purpose of determining the reasonable cost of OT and ST services at issue.

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<sup>24</sup> The \$104 contract rate was applied to a SNF's OT and ST costs only if, first, the SNF was able to produce documentation that it considered hiring a salaried therapist and, second, the SNF's contract OT and/or ST rate exceeded \$104 and the SNF failed to demonstrate that a lower rate was unavailable.

<sup>25</sup> See Intermediary's Position Paper, Page 11 and Intermediary Exhibit I-9.

As to the allegation that consideration was not given to the relative size, scope of services, and utilization of the SNFs in the survey, the Intermediary states that its analysis shows that the average bed counts of the SNFs in the survey are not substantially different from the average bed counts of the Providers in the group appeals. The Intermediary also believes that the scope of services is also comparable because both the surveyed SNFs and the Providers furnished skilled nursing and rehabilitative services. With respect to utilization, the Intermediary refers to HCFA Pub. 15-1 § 2102.1 which defines utilization for purposes of determining reasonable cost as follows:

Utilization, for this purpose, refers not to the provider's occupancy rate but rather to the manner in which the institution is used as determined by the characteristics of the patients treated (i.e., its patient-mix, age of patients, type of illness, etc.).

HCFA Pub. 15-1 § 2102.1.

The Intermediary contends that the Providers have produced no utilization documentation, nor have they explained why their respective patient mixes made the hiring of OT and ST therapists infeasible. Based on a comparison of the charges, the Providers on average furnished more OT and ST services than the SNFs in the survey. The Intermediary believes that these higher charges, as one measure of utilization, would have made it more cost effective for the Providers to employ OT and ST therapists. Nonetheless, the Intermediary states that the burden of proof is on the Providers to demonstrate that the higher utilization of OT and ST services in their facilities rendered the comparison with the surveyed SNFs invalid.

The Intermediary further argues that the hourly contract rates paid by the Providers are well in excess of the OT and ST hourly rates published by the Office of the Actuary, HCFA, as reflected in Part A Regional Intermediary Letter ("RIL") No. 95-08, dated May 17, 1995.<sup>26</sup> A clarification to RIL No. 95-08 was made on June 26, 1995, with the issuance of RIL No. 95-11,<sup>27</sup> which states in part:

The data included in RIL 95-08 reflects hourly wage amounts based on the Bureau of Labor Statistics' (BLS) 1989 and 1991 surveys of hospital industry wages for occupational and speech-language pathology services in major metropolitan areas and have been updated for inflation as of October 1, 1995. The amounts include adjustments for fringe benefits and expenses a non-employee therapists [sic] might incur in maintaining an office . . . . The amounts have also been increased by 5 percent to take into account that a large

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<sup>26</sup> Intermediary Exhibit I-5.

<sup>27</sup> Intermediary Exhibit I-6.

portion of contracted services are provided by skilled nursing facilities and that it may cost more to hire and retain therapists in non-hospital settings. The amounts do not include adjustments for overtime, administrative or supervisory services, aides and assistants, equipment and supplies. The travel column is based on one half of the hourly wage amounts and it is to recognize a therapist's costs associated with travel time to a provider's site or patient's home.

RIL No. 95-11.

Again using Laurelwood as an example, the Intermediary points out that the hourly rate for OT services from Table I of RIL No. 95-08 for the state of California is \$44.50. Multiplying this rate by a 2,080 hour full-time work year yields a yearly compensation amount of \$92,560 for one occupational therapist. Even assuming the therapist traveled to Laurelwood six days a week for fifty-two weeks a year, the additional travel allowance would be \$6,942. Exclusive of overtime and the provision of supervisory services, the use of the data from RIL No. 95-08 would yield a total amount of \$99,502 as the reasonable cost for one FTE occupational therapist. Based on this computation, the Intermediary maintains that the \$137,134 amount actually paid by Laurelwood for the services of a therapist is clearly not reasonable.

The Intermediary does not dispute that the Providers were paying the going contract rate for OT and ST services, and that the Providers' costs for these services were not substantially out of line with the costs incurred by other SNFs who also contracted for the same service. However, the Intemediary does contend that the Providers failed to consider a lower cost alternative, and that their costs for contracted OT and ST services were substantially out of line with the costs incurred by those SNFs who hired occupational and speech therapists. The reasonable cost regulation at 42 C.F.R. § 413.9(c)(1) holds that "payments to providers of services should be fair . . . to the contributors to the Medicare trust funds . . . ." Accordingly, when a provider fails to consider lower cost alternatives, despite the fact that other similar providers in its area also failed to consider lower cost alternatives, then payment by the Medicare program for the portion of the claimed costs in excess of reasonable costs is unfair to the contributors to the Medicare trust funds. The Intermediary also notes that the excessive costs paid by the Providers for contract OT and ST services also means higher charges to the Medicare beneficiary. Since services furnished under arrangements by a SNF are covered under Part B of the Medicare program, beneficiaries must pay 20 percent of the approved charges for covered services. The inflated costs for these services are passed on in the form of higher coinsurance amounts, which requires these beneficiaries to bear part of the burden of the Providers' failures to consider the lower cost alternative of employing the occupational and speech therapists directly.

In further support of its position, the Intermediary cites the court's decision in New Jersey Chapter, Inc. of the American Physical Therapy Ass'n, Inc. v. Prudential Life Ins. Co. of

America, 502 F. 2d 500 (D.C. Cir. 1975).<sup>28</sup> In that decision, the court ruled that the intermediary properly applied the reasonable cost regulations and the prudent buyer concept when it established an adjusted rate based upon the compensation paid to salaried therapists in order to evaluate the reasonableness of the amounts paid for contract physical therapy services. The Intermediary believes the similarities between that court case and the current appeals are striking in that those providers were also permitted to demonstrate that they were acting as a prudent buyer when they contracted for the services. In its decision, the court also affirmed that the intermediary did not set a ceiling on the providers' costs, but merely set a guideline for the determination of the reasonableness of those costs.

In response to the Providers' argument that the salary rates apply an improper productivity assessment, the Intermediary maintains that 1500 hours is the best estimate of productive time for both occupational and speech therapists. The Intermediary recognizes that the proposed rule published by HCFA in 62 Fed. Reg. 14,858 (March 28, 1997) assumes a 1,808-hour work year in computing the proposed salary equivalency limits for occupational and speech therapists. While HCFA's determination takes into consideration vacation and sick leave, the Intermediary notes that there are indications in the record that occupational and speech therapists work more than a 40-hour week. Should the Board decide to use the 1,808-hour work year, then the Intermediary believes the Board should increase this number by ten percent to reflect a reasonable estimate of overtime hours.

As to the Providers' allegation that the Intermediary failed to make a proper substantially out of line determination because it did not compare providers that were similar in size, scope of services, utilization, and other factors, the Intermediary points out that the Providers' witness admitted that these factors had no impact on the hourly charge made by the contract therapy companies to the Providers.<sup>29</sup> As to the Providers' criticism of the Intermediary's fringe benefit and expense factor and failure to consider recruitment costs, the Intermediary contends that it used the best available data. The Intermediary states that it expected the Providers to produce estimates of the additional costs they would have incurred had they actually employed the therapists. While such estimates and documentation were never produced, the Intemediary advises that it was and remains willing to review the Providers' cost estimates and supporting documentation.

#### CITATION OF LAW, REGULATIONS AND PROGRAM INSTRUCTIONS:

1. Laws - 42 U.S.C.:

§ 1395f(b)	-	Requirements Relating to Provision of Services in Skilled Nursing
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<sup>28</sup> Intermediary Exhibit I-7.

<sup>29</sup> Tr. at 165-166.

Facilities

§ 1395x(v)(1)(A)

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Reasonable Cost

- § 1395x(v)(5)(A) - Therapy Services Furnished Under Arrangement
2. Regulations - 42 C.F.R.:
- §§ 405.1835-.1841 - Board Jurisdiction
- § 413.9 - Cost Related to Patient Care
- § 413.106 - Reasonable Cost of Physical and Other Therapy Services Furnished Under Arrangements
- § 483.45 - Specialized Rehabilitative Services
3. Program Instructions - Provider Reimbursement Manual, Part I (HCFA Pub. 15-1):
- § 1412.2C - Fringe Benefit and Expense Factor Adjustment
- § 2102.1 - Reasonable Cost
- § 2103 - Prudent Buyer
4. Case Law:
- New Jersey Chapter, Inc. of the American Physical Therapy Ass'n., Inc. v. Prudential Life Ins. Co. of America, 502 F. 2d 500 (D.C. Cir. 1995).
- Hooper v. National Transportation Safety Board, 841 F. 2d 1150, 1151 (D.C. Cir. 1988).
- General Electric Company v. United States Environmental Protection Agency, 53 F. 3d 1234, 1330 (D.C. Cir. 1995).
5. Other:
- Part A Regional Intermediary Letter No. 95-08.
- Part A Regional Intermediary Letter No. 95-11.
- 62 Fed. Reg. 14,851, 14,858, 14,869 (March 28, 1997).



FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

The Board, after consideration and analysis of the controlling law, regulations and manual guidelines, the facts of the cases, parties' contentions, documentary evidence, testimony presented at the hearing, and post-hearing briefs, finds and concludes that the Intermediary's audit adjustments based on the application of the prudent buyer principle are not supportable under the salary rate methodology and factors utilized in making the reasonable cost determinations. While the Board rejects the Intermediary's application of the survey determined salary rates in making its prudent buyer determinations, the Board considers the application of the hourly contract rate of \$104 for OT and ST services, as derived from the survey data for the West region, to be an acceptable determination of reasonable costs under the governing regulatory provisions set forth in 42 C.F.R. § 413.9. It is the Board's conclusion that the Providers' costs for OT and ST services obtained from outside contractors should be limited to the contract rate of \$104 in determining the amount of allowable costs reimbursable under the Medicare program.

The Board finds that the cost adjustments at issue in the instant cases concern reasonable cost determinations which the Intermediary applied to the Providers' cost reports as part of its audit/settlement of the cost reporting periods at issue. Based on the facts and evidence presented, the Board finds no supportable basis for the Providers' argument that the adjustments at issue involve the Intermediary's retroactive application of the salary equivalency guidelines pursuant to the regulatory provisions of 42 C.F.R. § 413.106. The Board finds no evidence in the record which would support the premise that the Intermediary's survey was authorized and performed under the rules and procedures of 42 C.F.R. § 413.106, and that the survey results would be universally applied by HCFA in limiting the amount of costs for OT and ST services furnished to providers of services under contractual arrangements with outside suppliers. The Board notes that the cover letter which transmitted the survey questionnaire acknowledges that HCFA has not published salary equivalency standards for OT and ST services and, thus, it is the responsibility of the intermediary to determine reasonable cost.<sup>30</sup> Moreover, the Board points out that HCFA is in the process of establishing specific salary equivalency guidelines for OT and ST services furnished under arrangements through the proposed rules promulgated in 62 Fed. Reg. 14,851 (March 28, 1997).<sup>31</sup> Accordingly, the Board views the Intermediary's survey and its application to the Providers in the instant cases as a method of determining reasonable costs pursuant to 42 C.F.R. § 413.9.

It is the Board's opinion that the adjustments at issue concern the determination of reasonable costs. Accordingly, the application of the prudent buyer principle by means of a survey is a

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<sup>30</sup> Intermediary Exhibit I-1/Providers Exhibit 27.

<sup>31</sup> Providers Exhibit 80.

relevant and viable technique for establishing the excess and unnecessary costs incurred by the Providers for OT and ST services obtained under arrangements with contractors. For purposes of applying the prudent buyer principle, the Board finds the Intermediary's survey of salary data reported by SNFs that employed occupational and speech therapists was both adequate and corroborative. The collected salary data were properly arrayed, and the Intermediary's use of the 75th percentile of the range of salaries was a reasonable and acceptable application of the data. However, the Board finds the Intermediary's subsequent manipulation of the salary survey data through the use of abstract and unsupported computation factors renders its prudent buyer determinations ineffective and invalid.

In computing the amount of allowable costs based on the salary rates, the Intermediary determined an annual total hands-on therapy time of 1,500 hours per FTE. This amount was determined based on the assumption that a full-time therapist works 2,080 hours per year, and spends 72 percent of those hours furnishing hands-on therapy services to patients. As pointed out by the Providers, the use of 2,080 hours assumes no paid time off for vacations, holidays or sick time. The Board finds the Intermediary's use of 2,080 available hours per year is not only incompatible with the reality of normal employment conditions, it is also inconsistent with HCFA's use of 1,808 hours in computing the proposed salary equivalency guidelines for occupational and speech therapists.<sup>32</sup> As explained in the Federal Register, the use of 1,808 hours is based on the therapists' time in the facility, and was computed based on 2,080 hours (40 hours/week x 52 weeks; a standard work year) less 15 vacation days, 10 sick leave days and 9 holidays, equal to 34 days, or 272 hours. HCFA advised that the data on leave benefits come from an employee benefits survey conducted by the Bureau of Labor Statistics.<sup>33</sup> As to the use of a 72 percent factor to estimate the productivity of therapists, the Board observes that the Intermediary accepted this factor based on discussions with SNFs in conjunction with the performance of its survey. In the absence of documentary evidence to support the use of this factor, the Board finds no reason to accept its application based on anecdotal conversations. Moreover, the staff time measurement study that emanated from the resource utilization groups (RUGs), which HCFA is developing for purposes of establishing a prospective payment system for SNFs, shows that the time spent furnishing direct therapy services to patients is 44.8 percent for occupational therapists and 43.9 percent for speech therapists.<sup>34</sup>

In addition to the above factors, the Intermediary also utilized a fringe benefit and expense factor of 61.8 percent, which was the published 1982 rate for physical therapists in HCFA

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<sup>32</sup> See 62 Fed. Reg. 14,858 (March 28, 1997) - Providers Exhibit 80.

<sup>33</sup> U.S. Department of Labor, Bureau of Labor Statistics: Employee Benefits in Small Private Establishments, 1992, Bulletin 2441, US Government Printing Office, May 1994, pp.10-20.

<sup>34</sup> Providers Exhibit 33/Tr. at 128-129.

## Pub. 15-1

§ 1412.2C. While the Intermediary believes this was the best data available to estimate these costs, the Board notes that this rate is notably lower than the rates proposed by HCFA in developing the salary equivalency guidelines for occupational and speech therapists. In the proposed rules set forth in 62 Fed. Reg. 14,869 (March 28, 1997),<sup>35</sup> a breakdown of the components which make up the cost categories for the various types of therapy services is presented in Table III - Therapy Specific Adjusted Hourly Salary Equivalency Input Price Indexes (Basic Period: Fourth Quarter 1995 = 100.000). An analysis of the weights assigned in this table reflects a fringe benefit and expense factor of 71.86 percent for OT (41.814 Fringe Benefit/Overhead ÷ 58.186 Wages) and 74.5 percent for ST (42.696 Fringe Benefit/Overhead ÷ 57.304 Wages). Given the fact that the data developed by HCFA reflects statistically valid data which encompasses in-depth survey data from various national organizations and government agencies that maintain information for the health care industry, the Board necessarily gives great weight to the validity and accuracy of such data. Accordingly, it is the Board's conclusion that the more recent fringe benefit and expense factors developed by HCFA for application of the salary equivalency guidelines under 42 C.F.R. § 413.106 are the best available data in the instant cases.

Through the application of the above factors to the salary data obtained from its survey, the Intermediary determined a salary rate which it used as the benchmark for applying the prudent buyer principle. However, because of the inaccuracies and erroneous assumptions that were amassed in the factors and methodology applied by the Intermediary, it is the Board's opinion that the Intermediary did not prove its case under the prudent buyer principle. As demonstrated by the analyses displayed in Providers Exhibits 89 - 91, corrective modifications to the Intermediary's factors and methodology yield results which totally negate the Intermediary's reasonable cost determinations. In light of the Intermediary's failure to produce supportable and valid data for the critical factors used in its calculations, the Board is not convinced that the Intermediary has correctly determined that the employment of in-house therapists was less costly than the Providers obtaining therapy services under contractual arrangements with outside suppliers. In reaching this judgment, the Board does not reach any determination regarding the assumed productivity of the in-house therapists. The evidence shows that the Intermediary used elements of data that were clearly false and, thus, has not demonstrated that the Providers were imprudent buyers in obtaining OT and ST services for their patients under contractual arrangements.

While the Intermediary did not prove its case under the salary rate prudent buyer principle, the Board finds that the Intermediary's survey did produce reliable and supportable data for the establishment of a contract rate benchmark for OT and ST services obtained from outside contractors. Based on a substantial response from California SNFs that utilized contracted services, the Intermediary compiled the survey data and arrayed the reported contract rates

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<sup>35</sup>

Providers Exhibit 80.

from the highest to the lowest rate per hour for OT and ST services.<sup>36</sup> Using the 75th percentile of the range of contract rates, the Intermediary established an hourly contract rate of \$104 for OT and ST services as the benchmark for its reasonable cost determinations. The Board finds this rate to be the more appropriate rate for the Intermediary's application of the prudent buyer principle. Given the fact that the records in the instant cases are void of any documentary evidence which would demonstrate that the Providers were prudent and cost conscious buyers who sought to minimize the costs associated with the OT and ST services purchased under arrangement, the Board finds that the Providers' allowable costs for such services should be limited to the Intermediary's hourly contract rate of \$104 for OT and ST services consistent with the proper application of the prudent buyer principle.

The Board is aware of the Intermediary's acknowledgement that the Providers were paying the going contract rate for OT and ST services and, thus, the Providers costs would not be deemed to be substantially out of line with costs incurred by other SNFs that also contracted for the same services. However, the Board believes that the application of the prudent buyer principle must also be considered in making reasonable cost determinations under the Medicare program, and that its application is relevant based on the facts presented in the instant cases. Consistent with the reasonable cost provisions set forth in 42 C.F.R. § 413.9 and HCFA Pub. 15-1 § 2103, it is the Board's conclusion that the employment of the prudent buyer principle through the application of the hourly contract rate is based on the most reliable evidence presented for the two group appeals in this decision.

#### DECISION AND ORDER:

The Intermediary's adjustments to the Providers' OT and ST costs based on the application of the prudent buyer principle determined under the survey salary rates were not proper and are reversed. The Intermediary's application of the prudent buyer principle should be based on the hourly contract rate of \$104 for OT and ST services as determined by the survey data for the West region.

#### Board Members Participating:

Irvin W. Kues  
James G. Sleep  
Henry C. Wessman, Esquire

Date of Decision: April 14, 1998

#### FOR THE BOARD:

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<sup>36</sup> Intermediary Exhibit I-2.

Irvin W. Kues  
Chairman

Concurring Opinion of Henry C. Wessman

In frustration, I write to concur with my colleagues on this decision. I am frustrated because, while the Intermediary completed an acceptable comparative study to get to the “prudent buyer” prong of reasonable cost, they did not carry their methodology to the point of proving that prong due to failure to produce statistically valid data on three critical factors: percentage level of work efficiency; acceptable hours in a work-day, work-year; and a verifiable administrative overhead percentage. Absent solid evidentiary data on these factors, failure on the part of the Provider to be a “prudent buyer” cannot be demonstrated. Neither can the “substantially out of line” prong of reasonable cost be met, due, in part, to “false positive” readings absent the evidentiary data identified supra.

But the facts and practical reality of this decision are troublesome. That reality infers that it is acceptable, as an occupational therapist or speech therapist, to be involved in productive work for only 35 minutes or less every “working” hour, or a total of 4.06 productive hours per “working” day (58.5% work efficiency) for only 6.95 hours/day (1,808 hours/work year) with a significant 71.86 to 74.5% overhead add-on. These numbers do not even register on the work ethic “prudence” scale.

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Henry C. Wessman, Esquire  
Board Member