

PROVIDER REIMBURSEMENT REVIEW BOARD HEARING DECISION

98-D48

PROVIDER -Mariner Health
Care/Liberty Health Care - 1994
Occupational and Speech Therapy Group
Appeal

DATE OF HEARING-
September 23, 1997

Provider Nos. See Appendix I

Cost Reporting Period Ended -
See Appendix I

vs.

INTERMEDIARY -
Mutual of Omaha Insurance Company

CASE NO. 97-0050G

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ISSUE:

Did the Intermediary properly adjust the Providers' occupational and speech therapy costs?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

The Providers in this group appeal are Medicare-certified skilled nursing facilities ("SNFs") that are owned and operated by the separate proprietary corporations of Mariner Health Care ("Mariner") and Liberty Health Care ("Liberty").¹ All of the Providers are freestanding SNFs which are located in the states of Texas, Oklahoma, Georgia, Florida and Virginia. 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. The issue in this group appeal concerns the 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 concept 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 2007 freestanding and hospital-based SNFs which it serviced covering a total of 26 states. The cover letter transmitting the questionnaire included the following explanation for conducting the survey:²

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

¹ See Appendix I - Schedule of Providers in Group.

² Intermediary Exhibit I-1/Providers Exhibit 2.

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 data for the five different regions were entered on separate spread sheets, with the SNFs arrayed from the highest hourly contract/salary rate to the lowest.³ 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 as follows:⁴

<u>Region</u>	<u>Annual Salary Rates</u>		<u>Hourly Contract Rates</u>	
	<u>OT</u>	<u>ST</u>	<u>OT</u>	<u>ST</u>
East	\$53,000	\$51,000	\$104	\$104
Southeast	\$65,000	\$52,000	\$112	\$112
Midwest	\$45,500	\$45,000	\$100	\$100
Southwest	\$51,500	\$49,500	\$110	\$110
West	\$66,200	\$55,000	\$104	\$104

In implementing its survey results to the audit process, the Intermediary selectively applied the established prudent buyer benchmarks to SNFs that were either subject to on-site reviews or subject to focused reviews of OT and ST costs. The SNFs which were subject to focused reviews were selected on the basis of the combined amount of OT and ST costs claimed on their Medicare cost reports. 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.⁵ 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.⁶

³ Intermediary Exhibit I-2.

⁴ Intermediary Exhibit I-4.

⁵ Intermediary Exhibit I-3.

⁶ 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 therapy/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.

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

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.

As a result of the Intermediary’s application of the audit program for OT and ST services, all of the Providers participating in this group appeal had their contractual OT and ST costs reduced to the amounts which the Intermediary believes would 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 service.

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 Southwest region was \$51,500 and \$49,500 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 Haltom Convalescent Center (“Haltom”), one of Mariner’s SNFs participating in this group appeal.⁷ The computation of the Intermediary’s audit adjustment to the ST costs incurred by Haltom is as follows:

• Number of ST Treatments Reported	11,775
• Computed Hours of Therapy Services Required [11,775 Treatments x 15/60 (15 Minutes Time Unit)]	2,944
• Number of FTE Speech Therapists Required [2,944 Hours ÷ 1500 (Annual Therapy Time per Therapist)]	1.963
• Allowable ST Costs [1.963 FTE x \$49,500 (Annual Salary Rate-Southwest region) x 1.618% (Fringe Benefit Factor)]	\$157,192
• ST Costs Claimed by Haltom	\$305,200
Allowable ST Costs	<u>157,192</u>
ST Costs Disallowed by Intermediary	<u>\$148,008</u>

⁷ Intermediary Exhibit I-4.

The Providers in this group appeal 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 amounts of Medicare reimbursement in controversy is approximately \$2,686,000.

The Providers were represented by Glen P. Hendrix, Esquire, and Tracy M. Field, Esquire, of Arnall Golden & Gregory, LLP. The Intermediary's representative was Marshall J. Treat, Senior Appeals Consultant, Mutual of Omaha Insurance Company.

PROVIDERS' CONTENTIONS:

The Providers contend that the Intermediary's adjustments to their OT and ST costs were derived from an improper determination and application of the Medicare program's reasonable cost doctrine. They argue that the general principle set forth under 42 U.S.C. § 1395x(v)(1)(A) states the following:

The reasonable cost of any service shall be the cost actually incurred, excluding therefrom any part of the 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 for various types or classes of institutions, agencies, and services; . . .

42 U.S.C. § 1395x(v)(1)(A).

With respect to determining the reasonable cost of OT and ST services, the statutory provision of 42 U.S.C. § 1395x(v)(5)(A) states that, if a provider furnishes such therapy services under arrangement with a contractor, reimbursement shall not exceed the salary cost which a provider could pay an in-house employee for the same work, "as the Secretary may in regulations determine to be appropriate." *Id.* Consistent with the statute, HCFA has promulgated regulations at 42 C.F.R. § 413.106 which state that reasonable costs are based on the "prevailing salary" paid by providers in the same geographical area. However, the regulation further states that "prior to the beginning of a period to which a [salary equivalency] guideline will be imposed, a notice will be published in the Federal Register establishing the guideline amounts to be applied to each geographical area by type of therapy." *Id.* While salary guidelines have been issued for physical and respiratory therapy, the Providers point out that HCFA had not published salary equivalency guidelines for OT

and ST services for the fiscal years at issue in this case.⁸ The regulation at 42 C.F.R. § 413.106(c)(5) goes on to state that “[u]ntil a guideline is issued for a specific therapy or discipline, costs are evaluated so that such costs do not exceed what a prudent and cost-conscious buyer would pay for the given service.” *Id.* The Providers advise that the application of the referenced prudent buyer rule is codified at 42 C.F.R. § 413.9(c)(2) which states:

The costs of providers’ services vary from one provider 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) (emphasis added).

The Providers argue that, in applying the foregoing principle, intermediaries must arrive at truly comparable bases for comparison in determining whether the actual costs of a particular provider are out of line. Accordingly, the Intermediary cannot impose a salary equivalency guideline, but rather must determine whether the Providers’ costs in the instant case are substantially out of line with other institutions in the same area which are similar in size, scope of services, utilization and other relevant factors.

The Providers argue that the Intermediary’s audit program establishes salary equivalency guidelines for OT and ST services in violation of 42 C.F.R. § 413.106. Under that regulation, a salary equivalency guideline is one which limits costs to “an amount equivalent to the prevailing salary and additional costs that would reasonably have been incurred by the provider . . . had such services been performed by such person in an employment relationship, plus the cost of other reasonable expenses incurred by such person in furnishing services under such an arrangement.” The Intermediary’s audit program fits that definition by specifically stating that “costs will be limited to the cost of salaried therapists required to provide therapy hours incurred, using the prevailing salary rates per the occupational/speech therapy survey plus a fringe benefit and expense factor of 61.8 percent.”⁹ In further support of this contention, the Providers refer to a letter dated July 7, 1997, wherein a field auditor for

⁸ Salary equivalency guidelines have been proposed by HCFA for occupational and speech therapists, however, those guidelines have not been finalized. Upon adoption, they will have only prospective effect, and will not be applicable to the cost reporting periods at issue in the instant case.

⁹ Providers Exhibit 2.

the Intermediary advised one of the Providers in this appeal that “[a]djustments were necessary to revise occupational and speech therapy costs to a salary equivalency as prudent buyer efforts were not supported.”¹⁰ (emphasis added).

While the Intermediary contends that its audit program merely sets a “benchmark” and not an “absolute limit”, the Providers note that the Intermediary’s limits are even more absolute than HCFA’s salary equivalency guidelines. Whereas the regulation at 42 C.F.R. § 413.106(e)(2) states that a Provider can obtain relief from the salary equivalency guidelines if it can demonstrate “unique circumstances” or “special labor market conditions,” the only documentation the Intermediary will consider is contemporaneous documentation generated during the cost reporting period at issue that demonstrates efforts to hire salaried therapists. The Intermediary will not even consider a cost-benefit analysis which is prepared after the period at issue which shows that directly employing therapists would not have been economical. Once the audit program’s “decision tree” slots the provider into the salary rate category, there is no way out of this categorization. The Intermediary’s audit program absolutely limits costs to an amount that purports to be equivalent to the salary costs that would have been incurred by a provider in an employment relationship.

The Providers contend that the Intermediary’s requirement that providers must present proof of their efforts to hire in-house, salaried therapists is invalid. There is no such requirement in the Medicare Act, regulations or the manual instructions. Moreover, the regulations at 42 C.F.R.

§ 483.45(h), which set forth the requirements for participation in the Medicare program, allow SNFs the choice between employing therapists and contracting with an outside resource. In addition, the development of an in-house program was not feasible for the Providers in the instant case. While the home offices of each of the Providers considered developing in-house therapy departments, they concluded that this would be neither feasible nor economical. In support of this conclusion, the Providers cite various articles from newspapers and periodicals which acknowledge the shortage of therapists to fill vacancies in several sectors of the country.¹¹ The Providers’ management staffs were aware of this shortage and also recognized they lacked the resources and expertise to hire therapists in such a competitive market. The Providers note that the use of recruiting firms would have generated sizeable and recurring recruiting fees considering the high turnover rate among therapists. Further, the establishment of an in-house therapy department was considered in 1993 by the predecessor home office and was turned down by management for the following reasons:¹²

1. Lack of expertise at corporate office and facility setting.

¹⁰ Providers Exhibit 35.

¹¹ Providers’ Post-Hearing Brief - pages 23-24.

¹² See Inter-Office Memo, Providers Exhibit 40.

2. Difficulties with hiring therapists - none of our facilities are located in urban areas.
3. Who will train the therapists?
4. Dealing with the high rate of turnover (and sick calls) and yet providing the required continuity of care.
5. Upsetting salary structure of facility Administrator, DON, etc.
6. In-house staffing is a fixed expense while contracted therapy is variable (ie: same staffing of in-house therapists in periods of reduced utilization).
7. Space limitations of our current facilities for required supervisory positions.
8. Additional insurance cost and difficulties with obtaining such coverage for a company our size.
9. Litigation matters:
 - (a) Hiring outside “experts” reduces the likelihood of litigation; and
 - (b) Share the risk of litigation cost with contracted therapy company.
10. Tremendous cash flow reduction due to paying bi-weekly instead of 90-120 days after services provided.

Given the lack of resources, it was deemed that such an investment would not be prudent without first undertaking a successful “trial run” with an outside contractor. The Providers further point out that their action was also consistent with HCFA’s instructions to the regional offices that intermediaries must take into account “supply and demand and local recruitment efforts for therapist” in making prudent buyer determinations.¹³ Consistent with these instructions, the Providers made the prudent decision that they lacked the infrastructure, industry contacts, and economies of scale to recruit therapists in a cost-effective manner.

The Providers also argue that an in-house therapy program would not have been cost-effective due to their fluctuating demand for therapists. Based on a review of therapy utilization at their facilities for a twelve month period, it would have been inefficient for any facility to lock itself into the fixed costs of employing therapists. The review showed monthly fluctuations at specific facilities ranged from 17 occupational therapists in a given month to a requirement of only 11 in other months of the same year. Similar fluctuations existed in speech therapy utilization for the Providers participating in this group appeal. Given these fluctuations, the

¹³ HCFA Memorandum, dated July 21, 1995 - Providers Exhibit 20.

Providers believe they acted as prudent buyers, and made the correct decision to allow contractors to assume the risks of fluctuating demand for therapy services, rather than employ too many therapists for certain months of the year. Accordingly, the Providers conclude that they saved the Medicare program money by not directly employing therapists.¹⁴

In further support of their position that they were prudent buyers in obtaining OT and ST services, the Providers cite the Board's decision in Eagle Healthcare - 1993 Prudent Buyer Group Appeal v. Aetna Life Insurance Company, PRRB Dec. No. 97-D83, July 17, 1997, Medicare and Medicaid Guide (CCH) ¶ 45,504, rev'd by HCFA Admin. Dec., September 12, 1997, Medicare and Medicaid Guide (CCH) ¶ 45,727 ("Eagle"). The Providers state for the record that the proper standard was set forth in the Board's decision in Eagle, and that the prudent buyer standard set forth in the HCFA Administrator's reversal of that decision is not in accordance with federal law and regulations. In reversing the Board's decision in Eagle, the HCFA Administrator upheld the intermediary's audit program which identified a number of therapy companies serving multiple providers in each market area which could conveniently and economically provide quality therapy services to the SNFs. The intermediary then set the standard rates based on the rates those therapy companies were charging.

Whereas the Board's decision in Eagle held that the prudent buyer instructions clearly relate to the substantially out-of-line standard in 42 C.F.R. § 413.9, the Administrator's decision emphasized that a prudent buyer "is one who not only refuses to pay more than the going price for an item or service, he also seeks to economize by minimizing costs." (HCFA Pub. 15-1

§ 2103). Accordingly, the mere fact that a provider's costs are in line with those of its peers does not, in itself, necessarily satisfy the prudent buyer rule; the provider must also demonstrate that it sought to obtain the best possible price. However, the Administrator also recognized that the best possible price was not necessarily the cheapest price, and that quality concerns and other factors could justify contracting with a higher-priced company.

The Providers assert that their OT and ST costs are not only allowable under the substantially out-of-line standard, as conceded by the Intermediary,¹⁵ they also satisfy the prudent buyer standard established by the HCFA Administrator in the Eagle decision. The Providers claim that there is no dispute that: (1) their costs were below the going rate; and (2) they sought to economize by minimizing costs. In support of their contention, the Providers refer to the deposition of the Intermediary's Appeal Manager, wherein it was conceded that the Providers' therapy costs were not substantially out of line with other institutions in the same

¹⁴ See Providers Exhibits 21, 22, 23, 24 and 42.

¹⁵ Tr. at 303-305.

area which are similar in size, scope of services and utilization.¹⁶ This affirmation was amply supported by the Intermediary's survey data and the Providers' analyses of the data for the various regions included in the survey.¹⁷ As to the minimization of their costs, the Providers note that the low rates paid for therapy services were not fortuitous, but were driven by their efforts to minimize costs by factors unrelated to Medicare reimbursement. At the hearing, the Providers' witness testified that all of the Providers were seeking to expand their managed care programs, and that by the end of 1994, Mariner's predecessor had forty managed care contracts, most of which were on a fixed fee or capitated basis.¹⁸ Accordingly, the Providers had a strong incentive to economize on therapy costs.

As further evidence of their efforts to minimize their costs, the Providers refer to the affidavits and statements submitted by former management personnel of the home office and one of their suppliers which provide documentary and testimonial proof of competitive bidding.¹⁹ Further, the Intermediary's witness conceded that the Providers had sought to minimize their costs by (1) competitive bidding; (2) seeking volume discounts; (3) obtaining more and better services for the same price; (4) tracking outcomes and seeking shorter lengths of stay for patients; and (5) negotiating and bargaining down rates from suppliers based upon a survey of what other providers were paying for contracted services.²⁰ Given this testimony, the Providers believe there should be no question that they not only refused to pay more than the going price for therapy services, but also sought to economize by minimizing cost.

The Providers further argue that they were also prudent buyers under the audit program approved by the HCFA Administrator in the Eagle decision. In Eagle, the intermediary determined the contract therapy rates paid by freestanding SNFs in each provider's Metropolitan Statistical Area ("MSA"). The intermediary then identified a number of therapy companies serving multiple providers in each market which could conveniently and economically provide quality therapy services to the SNFs, and used the rates charged by these companies as its prudent buyer benchmarks. Providers that demonstrated they sought economical vendors and acted as prudent buyers were exempted from these benchmarks.

Consistent with the HCFA Administrator's decision in Eagle, the Providers analyzed the

¹⁶ Providers Exhibit P-47, pp. 200-201.

¹⁷ Providers Exhibits P-25 and P-37.

¹⁸ Tr. at 95-123.

¹⁹ Providers Exhibits P38 - P40.

²⁰ Tr. at 289-290.

survey responses received by the Intermediary on a MSA-by-MSA basis.²¹ Of the seven MSAs relevant to this appeal, only one included a freestanding SNF respondent that reported hiring in-house therapists, and that provider relied substantially on contract therapists. Based on this analysis, the Providers believe the contract therapy rates paid by other SNFs in the Providers' MSAs confirm that they acted as prudent buyers. For instance, for the Providers operating in the MSAs for Oklahoma City, Houston and Fort Worth/Arlington, there were no therapy companies serving multiple providers that were charging lower rates than those paid by the Providers. While a few lower-priced therapy companies served a single provider in these MSAs, these suppliers would not have satisfied the criterion in Eagle that the companies setting the benchmark rates serve multiple providers in each market. The Providers point out that, in the MSAs for two of its Providers, the Intermediary's survey yielded no responses and, thus, the Intermediary has no data upon which to make a prudent buyer adjustment. The only data available for these markets are the surveys conducted by the Providers themselves.²² With respect to the MSA for Atlanta, the Providers advise that there were two lower-priced therapy companies serving at least two providers. However, neither was an acceptable alternative. In one instance, the home office had previously dealt with the supplier and was concerned about the company's ethics. The other was a small therapy company with confined operations and was not in a position to meet the therapy needs of the Providers in that service area.

In addition, the Providers argue that its home office had previously used local therapy companies in several markets and had experienced quality assurance and accountability problems. By contracting nationally, the home office was able to ensure that all of its SNFs received therapy at a reasonable price. The wisdom of this approach is demonstrated by the rate paid by one of the Providers in the Oklahoma City MSA where there were 23 SNFs and 12 hospitals competing for therapists.²³ According to state licensing board records, only seven occupational therapists and 100 speech therapists resided within a reasonable driving distance, and even the contract therapy supplier for one of the Providers was unable to entirely staff the facility with its own employees.²⁴ Nevertheless, this Provider paid only \$100 per hour for therapy services, whereby the median rate paid by other providers in the Oklahoma City MSA was \$120.²⁵ In summary, it is the Providers' opinion that they acted as prudent buyers and paid the best possible price.

²¹ See Providers Exhibits P78-P84.

²² See Providers Exhibits P37.

²³ Tr. at 265.

²⁴ Id.

²⁵ See Providers Exhibit 25.

In response to the Intermediary's argument that the court's decision 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) ("New Jersey") supports its audit program, the Providers contend that the Intermediary's reliance on that case is misplaced for two reasons. First, the court in New Jersey upheld physical therapists salary guidelines where:

the effect of the guidelines is to provide for automatic payment of physical therapy costs when they do not exceed the adjusted rate charged by salaried therapists; when they do not exceed the adjusted rate charged by a 'prudent buyer'. If the costs exceed these amounts, however, Prudential requires the provider to demonstrate that the additional costs are reasonable. In other words the guidelines establish a level of costs which Prudential will pay without additional proof of their reasonableness.

New Jersey at 505 (emphasis added).

The guidelines under consideration in the New Jersey case were, in effect, safe harbors -- the provider was assured of reimbursement if its costs were below the benchmark, but reimbursement was not precluded if its costs exceeded that amount. By contrast, the Intermediary's salary rates in the instant case constitute absolute limits on costs. Second, the Providers point out that the New Jersey case was decided in 1974 prior to HCFA's promulgation in 1975 of the salary equivalency regulation at 42 C.F.R. § 413.106. As previously mentioned, that regulation unambiguously provides that salary equivalency guidelines shall only be imposed prospectively; must be based on statistically valid data; and must be published in the Federal Register.

Lastly, the Providers argue that the Intermediary's audit program understates the cost of employing therapists because the formula applied and its component variables do not give a representative picture of the actual costs involved in the utilization of therapists. The Providers list the following reasons why the Intermediary's prudent buyer determinations should not be relied upon to calculate a facility's allowable cost:

A. The Intermediary's Survey is Flawed

In support of this contention, the Providers refer to the testimony of their witness, a former HCFA statistician, who testified that the Intermediary's survey was not valid or representative.²⁶ In addition, HCFA also concluded that the Intermediary's survey was flawed in its notice of proposed salary equivalency limits for occupational and speech therapists wherein it noted that the Intermediary's survey included "only a small percentage of records

²⁶ Tr. at 219.

contain[ing] information on wage rates for full-time employed therapists.”²⁷ Another threshold problem identified by the Providers is the survey questionnaire itself which includes several ambiguous and undefined terms. Because of the use of such undefined terms as “average annual salary” and “per hour” cost of contract therapy, each respondent must speculate as to an appropriate methodology to calculate critical information for the survey.

B. The Respondents’ Survey Responses are not Consistent with their Cost Reports

The Providers contend that the data compiled from the Intermediary’s survey of salaried therapists cannot be verified. Pursuant to a Freedom of Information Act request for copies of each survey respondent’s cost report Worksheet A, the Providers received cost report data that are summarized in Providers Exhibit P28. For 13 facilities which reported employment of therapists, the Intermediary did not produce cost reports for verification. Accordingly, of the total survey responses, only 43 that reported employing occupational therapists and only 30 that reported employing speech therapists were even potentially verifiable. Of the 43 respondents that reported employment of occupational therapists, 14 included no OT salary expense in their cost reports. With respect to the 30 respondents that indicated they employed speech therapists, 12 indicated no ST salary costs in their cost reports. If the cost reports do not support the survey data, the Providers believe the survey responses should have been discarded.

C. The Intermediary has not Considered the Cost Differential Between Freestanding and Hospital-Based SNFs

Most of the Intermediary’s salary data for employee therapists consists of survey responses from hospital-based SNFs [At least 63 (over half) of 116 respondents for occupational therapists and 49 (42 percent) of 86 facilities for speech therapists]. Since only 8.5 percent of SNFs are hospital-based on a national level, and since 85 percent of the SNFs that did not respond to the survey were freestanding facilities, the Providers suggest that there was a significant bias of ascertainment for the study. The Providers maintain that it costs more to employ a therapist in a freestanding facility than it does in a hospital-based SNF. This opinion was sustained by HCFA in a June 21, 1995 memorandum to its regional offices which recognized that “[i]t may cost more to hire and retain therapists in non-hospital settings.”²⁸ Moreover, the Intermediary’s own survey evidences the wage differential between therapists employed by hospital-based and freestanding SNFs as follows:²⁹

²⁷ Fed. Reg. 14,856 (March 28, 1997) - Providers Exhibit P5.

²⁸ Providers Exhibit 20.

²⁹ See Providers Exhibit 33.

Average OT/ST Salaries by
Category of SNF

	<u>Hospital-Based</u>	<u>Freestanding</u>	<u>Variance</u>
Occupational Therapy	\$45,521	\$60,628	\$15,107
Speech Therapy	\$39,986	\$46,539	\$ 6,553

Given the bias variances in survey responses and average salaries between hospital-based and freestanding SNFs, the Providers contend that the hospital-based salaries should be inflated if they are to be included in the Intermediary's salary rate determinations.

D. Insufficient Data Exist for Establishing Prevailing Salaries

The Providers argue that it was improper for the Intermediary to extrapolate salary amounts from the survey data due to the small number of SNF respondents that actually employed therapists. Of the 1,036 facilities that responded to the survey, only 116 reported that they directly employed occupational therapists and only 91 had on-staff speech language pathologists.³⁰ Accordingly, over 90 percent of the respondents to the survey used contract therapists rather than salaried employee therapists. If hospital-based SNFs are eliminated, only 55 respondents had employed therapists. Further, with the exclusion of SNFs that used contract therapists in addition to employing therapists, this leaves only 33 freestanding SNFs that claimed to rely exclusively upon directly-employed occupational therapists and 24 freestanding SNFs that indicated using only employed speech therapists. The Providers insist that even these figures are inflated because the cost reports for many of these respondents did not support their survey responses. After taking all these factors into consideration, the Providers determined that, of 837 freestanding SNF respondents, only 21 and 12 responses can be verified as relying exclusively upon employee occupational therapists and speech therapists, respectively. These data are not sufficient to develop prevailing full time salary figures for 26 states.

E. The Intermediary's Geographic Regions are too Broad

The Providers point out that the Intermediary's process for dividing the country into geographic regions was based on where it "felt" that states "should go", and that the procedure followed had little basis in logic or geography. The regions do not include contiguous states and do not reflect labor market conditions. By lumping together survey data from disparate markets and failing to distinguish between urban and rural areas, the Intermediary has violated the provisions of 42 C.F.R. § 413.9(b)(1) which require a comparison of institutions in the same area.

³⁰ See Providers Exhibit 30.

F. The Intermediary has not taken into Account All Costs of Employing Therapists

The Providers contend that the prevailing salary computed by the Intermediary does not take into account the recruiting costs that must be incurred when employing therapists. Given the nationwide shortage of therapists, employers were routinely paying 25-35 percent placement fees to recruiting firms in order to hire therapists. Other expenses that were excluded involved signing bonuses and relocation expenses. Further, the Intermediary made no allowances for travel expenses, supplies, supervisory responsibilities, and other costs which are allowed under the prospective salary equivalency guidelines established by HCFA.

G. The Intermediary Overestimated the Efficiency of Employee Therapists

The Providers argue that the Intermediary's formula greatly overestimates the productivity of therapists because it is premised upon a therapist providing 1,500 hours per year of direct patient care. This equates to an efficiency standard of 72 percent, which the Intermediary obtained from uncorroborative general conversations with different industry people. The Providers point out that a study performed by HCFA revealed that only 44.8 percent of an occupational therapist's time is spent directly providing therapy.³¹ This study further shows that only 43.9 percent of a speech language pathologist's time is spent directly on therapy. Using HCFA's efficiency standard, the proper figure in the denominator of the Intermediary's formula is 932 hours (2,080 hours x 44.8 percent) for occupational therapists and 913 hours (2,080 hours x 43.9 percent) for speech therapists.

The Providers conclude that the Intermediary's audit program established de-facto salary equivalency guidelines which have not been promulgated and published in accordance with federal law and regulations, and also constitutes an unlawful retroactive rule. The Providers assert that they acted as prudent buyers by contracting for therapy services at a price below the going rate after determining that directly employing therapists was not feasible or cost effective. Since the Intermediary's survey does not reflect the true costs of employing therapists, the Providers request that the Intermediary's audit adjustments be reversed.

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 as 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 costs or customary charges, which include 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

³¹ HCFA time study obtained at a meeting of the National Association of Subacute Care and the American Health Care Association - Tr. at 155.

“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” Id.

The regulations at 42 C.F.R. § 413.9(c)(2) provide 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 as set forth under 42 C.F.R. § 413.106 in disallowing the OT and ST costs at issue. Unlike the salary equivalency rates, the OT and ST contract rates and salary rates established by the survey 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 believe 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.³²

The Intermediary contends that it did not apply its audit program retroactively, as alleged by the Providers. The audit program that was applied was a rewritten version of the National Audit Program dealing with therapy costs which was released in 1985 and was applicable to all types of therapies.³³ Under the “General Comment” of the audit program, the intent of the review process was set forth as follows:

Under the regular Medicare payment system, a provider is reimbursed for the reasonable costs of services provided by physical, occupational, speech and other therapists for services performed. The cost is limited to (1) amounts equivalent to the salary and other costs that would have been incurred by the provider if the services had been performed in an employment relationship plus (2) an allowance to compensate for other costs incurred in furnishing services under arrangements. In the audit steps which make up this section, steps may not address a specific type therapy but it should be noted that it applies to all types of therapy.

Id.

The Intermediary argues that its audit program and the prior version contain similar steps and attributes which have been available for an extended period, and that the prudent buyer principle has been available to intermediaries since the beginning of the Medicare program.

As to the Providers’ contention that they did consider hiring in-house salaried therapists, the Intermediary observes that this claim has never been substantiated. During the audit, the Providers were asked if they ever considered hiring therapists in lieu of contracting with outside suppliers. In each case the response was “no”. The Providers have subsequently brought forth various undated memos regarding this subject and have attempted to explain the circumstances on a global basis. However, the Intermediary states that this has not been conclusive. The Intermediary also rejects the Providers’ claim that they did not have the capital to invest in establishing an in-house therapy program. When one considers the dollar adjustments for the few Providers involved in this group appeal, the Providers could have

³² The hourly contract rate was applied to a SNFs’ OT and ST costs only if, first, the SNF was able to produce documentation that it considered hiring a salaried therapist and, second, the SNFs contract rate with its outside supplier exceeded the Intermediary’s applicable hourly contract rate and the SNF failed to demonstrate that a lower rate was not available.

³³ Intermediary Exhibit I-11.

saved a great sum of money with an up-front investment in salaried therapists which would have generated pay backs to themselves and the Medicare program in the long run.

The Intermediary is aware of HCFA's June 21, 1995 memo to the regions which instructed intermediaries to consider the supply and demand of local recruitment efforts for therapists.³⁴ However, the Intermediary argues that these efforts must be real, they must be timely; not retro-active and not the results of therapy contractors. The Providers in this group appeal have had experience with two major contractors from 1993 to the present, and both have drawn from the same pool of therapists available in their locales. Once it is demonstrated that the Providers failed to consider the possibilities of hiring salaried therapists, the Intermediary insists that it makes no difference under the prudent buyer principle whether the Providers obtained high, medium or low contractor costs.

In response to the Providers' contention that the survey was flawed and did not contain clear instructions, the Intermediary believes that the survey was self explanatory. With respect to the requested salary data, the survey was conducted during 1996 and asked for annualized amounts. With respect to the part-time salary amounts, the Intermediary points out that such amounts were considered both as part of the survey or totally excluded. In either instance, the use of the 75th percentile produced the same benchmark amount. The survey data was taken at a specific period of time with the direct salary costs taken from the quarterly and annual reports submitted to the Internal Revenue Service. As to the Providers comment that survey data was not in agreement with the cost reports of the survey respondents, the Intermediary advises that the cost report data obtained by the Providers through "Freedom of Information" would have been for 1994 and 1995 data. Thus, a direct match of data would not have been possible as concluded in the Providers' position paper. Since the survey data were only being used to establish benchmarks for comparison purposes, audits and certifications were not necessary as would be the case in establishing salary equivalency amounts. The Intermediary believes that the survey data is the best data available, and should be used until the Providers can demonstrate that better data is available.

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 Insurance Co. of America, 502 F. 2d 500 (D.C. Cir. 1975).³⁵ 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 appeal 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

³⁴ Providers Exhibit 20.

³⁵ Intermediary Exhibit I-7.

affirmed that the intermediary did not set a ceiling on the providers’ costs, but merely set a guideline for determining the reasonableness of those costs.

In response to various contentions raised by the Providers at the hearing before the Board, the Intermediary argues that it correctly applied the substantially out-of-line regulation at 42 C.F.R.

§ 413.9(c)(2) through the performance of a survey to establish the going rates or salary benchmarks to which individual providers could be compared. In this regard, such factors as location, size of the facilities and acuity of services were all considered in making the necessary adjustments. As to the statistical validity of the survey, the Intermediary notes that there is no requirement in the regulations or manual instructions which requires the survey results to be statistically sound. The Intermediary agrees that the Providers paid 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 Intermediary does contend that the Providers’ costs for these services were substantially out of line with the costs incurred by those SNFs who hired salaried occupational and speech therapists. The provisions of 42 C.F.R. § 413.9(c)(2) does not prohibit this kind of comparison. Moreover, the denial of such a comparison would mean that the more expensive contract rate incurred by providers to furnish OT and ST services to their patients is acceptable.

In summary, the Intermediary concludes that its survey was designed to afford as many providers as possible to respond with salary or contract information. The responses were placed in a database and arrayed from high to low with benchmarks established at the 75th percentile for determining reasonable costs. The resulting survey information was deemed to be the best available unless a provider could produce its own survey information to support changes to the adjustments. The Intermediary believes that it has properly adhered to the law, reasonable cost regulation, and the Medicare program’s prudent buyer principle in adjusting the Providers’ OT and ST costs, and requests that the Board uphold its adjustments.

CITATION OF LAW, REGULATIONS AND PROGRAM INSTRUCTIONS:

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

- § 1395f(b) - Requirements Relating to Provision of Services in Skilled Nursing Facilities
- § 1395x(v)(1)(A) - 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 Insurance Co. of America, 502 F. 2d 500 (D.C. Cir. 1995).

Eagle Healthcare - 1993 Prudent Buyer Group Appeal v. Aetna Life Insurance Company, PRRB Dec. No. 97-D83, July 17, 1997, Medicare and Medicaid Guide (CCH) ¶ 45,504, rev’d by HCFA Admin. Dec., September 12, 1997, Medicare and Medicaid Guide (CCH) ¶ 45,727.

5. Other:

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 case, 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 rates for OT and ST services, as set forth on page three of this decision, 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 applicable contract rates in determining the amount of allowable costs reimbursable under the Medicare program.

The Board finds that the cost adjustments at issue in the instant case 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.³⁶ 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).³⁷ Accordingly, the Board views the Intermediary's survey and its application to the Providers in the instant case 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 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

³⁶ Intermediary Exhibit I-1/Providers Exhibit 27.

³⁷ Providers Exhibit 5.

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. Since 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.³⁸ 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.³⁹ 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.⁴⁰

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 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),⁴¹ 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

³⁸ See 62 Fed. Reg. 14,858 (March 28, 1997) - Providers Exhibit 5.

³⁹ 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.

⁴⁰ Intermediary Exhibit I-10/Tr. at 155.

⁴¹ Providers Exhibit 5.

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 salary rates which it used as benchmarks 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. 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 contract rate benchmarks for OT and ST services obtained from outside contractors. Based on a substantial survey response from SNFs that utilized contracted services, the Intermediary compiled the survey data and arrayed the reported contract rates from the highest to the lowest rate per hour for OT and ST services.⁴² Using the 75th percentile of the range of contract rates, the Intermediary established hourly contract rates for OT and ST services which it utilized as benchmarks for its reasonable cost determinations. The Board finds these rates to be the more appropriate rates for the Intermediary's application of the prudent buyer principle. Given the fact that the record in the instant case does not contain reliable and verifiable 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 applicable regional hourly contract rate established by the Intermediary for OT and ST services consistent with the proper application of the prudent buyer principle.

⁴² Intermediary Exhibit I-2.

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 this case. 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 rates is based on the most reliable evidence presented by the parties in the instant case.

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 applicable hourly contract rate for OT and ST services as determined by the survey data for the five separate regions involved in this group appeal.

Board Members Participating:

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

Date of Decision: May 08, 1998

FOR THE BOARD:

Irvin W. Kues
Chairman