IN THE MATTER OF THE APPEAL OF
WATERVIEWS NURSING HOME AND TWIN
OAKS NURSING HOME.

Initial Decision: October 21, 1980
Final Decision: March 4, 1981

Approved for Publication by the Division of Medical Assistance
and Health Services: May 6, 1985

SYNOPSIS

Petitioner contested the long term care facilities review guidelines
established for them in the areas of capital facilities—allowance square
foot adjustment, inflation factor, mortgage insurance, housekeeping
costs and a late filing penalty.

The administrative law judge assigned to the case found that under
existing CARE guidelines both petitioners had an excessive appraised
value due to the established square footage limitation per bed. The
judge determined that the square footage requirement as applied to
both petitioners was unreasonable since both petitioners had done
everything possible to reduce their square footage and any reasonable
standard would allow a nursing home to conform its operation to that
standard. In addition, the judge concluded that a retroactive reim-
bursement for a shortfall in recovery of costs caused by an un-
reasonably set inflation factor should be allowed. The judge denied
increased reimbursement for mortgage insurance and housekeeping
costs since the methods used to arrive at such figures were found to
be reasonable. The judge did determine that Waterview Nursing
Home should be allowed to recover its late filing fee since an inade-
quate review of Waterview’s request for an extension had taken place.

Upon review, this initial decision was modified by the Division of
Medical Assistance and Health Services. The Division noted that
federal requirements mandated a procedure to insure that payments
for services under the Medicaid Program not be in excess of reason-
able charges and in furtherance of that requirement reasonable fee
schedules had been adopted. Such schedules had been determined
after a comparison of industry-wide costs and like all agency regu-
lations were entitled to a presumption of reasonableness.

The Division determined that petitioners had failed to overcome
this presumption in relation to the square foot adjustment regulation.
Petitioners had failed to demonstrate the statistical invalidity of the
reimbursement rates in this area since no testimony had been pres-
mented from experts in nursing home economics or statistics, nor had any evidence been presented to support the invalidity of the inflation factor or on the losses allegedly due to the factor.

The Division affirmed the judge's findings as to the mortgage insurance, housekeeping costs and late filing penalty.

James J. Shrager, Esq., for petitioners (Hannoch, Weisman, Stern, Besser, Berkowitz & Kinney, attorneys)
Robert J. Haney, Deputy Attorney General, for the Division of Medical Assistance (James R. Zazzali, Attorney General of New Jersey, attorney)

Initial Decision

McGEE, ALJ:

Pursuant to the Long Term Care Facilities Rate Review Guidelines (CARE Guidelines) the Department of Health set rates effective January 1, 1978 and September 1, 1978. Petitioners objected to the adequacy of those rates and pursued remedies within the Department of Health throughout 1979. Specifically, petitioners sought a Level I and Level II review within the agency. Petitioners were not satisfied with the review process, so at some point the agency determined these matters to be contested cases and transmitted these cases to the Office of Administrative Law for determination on December 28, 1980 (Waterview) and January 28, 1980 (Twin Oaks).

The two matters were consolidated within the Office of Administrative Law and a prehearing conference was held on April 14, 1980. After some difficulty with the discovery process, a hearing was held on July 14, 1980. Due to delay in the receipt of the transcript, briefs were delayed with the last brief being received on October 2, 1980.

CFA Square Footage Adjustment

Pursuant to the CARE guidelines, the agency multiplied the number of beds times the reasonable square footage per bed times the reasonable appraised value per square foot and thus developed the appraisal limit applicable to Waterview, and Twin Oaks nursing homes. When the total appraised value was compared to the appraisal limit, it was shown that both nursing homes had an excessive appraised value. For Waterview the excess in appraised value was due to square footage limitation per bed. For Twin Oaks, the excess in appraised value was due to the square footage limitation per bed, but also due to the reasonable value per square foot in the absence of the square footage
per bed limitation.

First with regard to Twin Oaks, Twin Oaks argues that when the nursing home was built it was necessary to submit the design and related specifications to the Department of Health. It argues further that because the Department of Health approved that design and related specifications, it is unfair now to say that Twin Oaks should have designed its nursing home differently. Petitioner further argues that there is nothing it can do to operate more efficiently. In effect it is stuck with the design of the building and, short of tearing down part of the building, there is no way to change that design.

Petitioner's arguments apply both to the square footage per bed limitation (allegedly petitioner has built too many square feet) and to the appraised value per square foot (allegedly petitioner has spent too much money per square foot). I will first discuss the square footage limitation and then the appraised value per square foot limitation.

The inability of petitioner to change its total square footage with regard to Twin Oaks was explored on the record. Petitioner was asked if it could close off a dayroom or change to dormitory or barracks style accommodations for its Medicaid patients. Petitioner replied that closing off a dayroom would not change its appraised value and the dormitory style accommodations would be forbidden by federal law which requires that Medicaid patients be given the same treatment as other patients.

Petitioner's witness was further questioned on the number of single rooms it has available. Petitioner replied that when the nursing home was first built there were a greater number of single rooms. Operating experience with the nursing home showed a greater need for double rooms, so petitioner moved to convert its single rooms to double rooms. This conversion was only partially successful because the zoning board refused to allow the complete conversion without additional increase in parking space. Additional parking space was not available.

From the foregoing, I conclude that Twin Oaks has done all that is possible to reduce its square footage. The question then becomes whether a square footage limitation is, therefore, invalid.

The CARE guidelines prescribe a series of goals in the introduction. The pertinent goal is as follows:

To comply with the Federal requirements for a reasonable cost related formula.

42 U.S.C.A. 1396a(a)(13)(E) provides in relevant part:
Effective July 1, 1976 the payment of the Skilled Nursing Facility and Intermediate Care Facility services provided under the plan on a reason-
able cost-related basis, as determined in accordance with methods and standards which shall be developed by the State on the basis of cost-
funding methods approved and verified by the Secretary.

It is apparent that the overriding criteria to be applied to any cost adjustment is the criterion of reasonableness. Reasonableness, if it is to be fairly interpreted, should be applied in both directions. Medicaid should not have to reimburse excessive costs and the nursing home should have reasonable opportunity to conform its operation to the cost guidelines imposed by CARE.

Evidence has indicated that Twin Oaks has done all it can to make its operation more efficient with regard to the CARE guidelines relating to square footage. However, the evidence assumes that Twin Oaks’ original business decision to build the nursing home with the present square footage was reasonable and prudent. To clarify, it could have been that Twin Oaks was built according to a design similar to other nursing homes built at that time or Twin Oaks may have built its facility on a grander scale hoping to attract a carriage trade that never materialized. In the first instance, Twin Oaks’ square footage would be the product of historical architectural notions while in the second instance Twin Oaks may have made a bad business judgment. On the basis of this record, I can not say that Twin Oaks made an imprudent business decision. I believe an assumption that the square footage of Twin Oaks is due to historical architecture notions is warranted. Further, the trend in modern architecture is toward smaller working and living space. Twin Oaks, which according to the Department of Health’s appraisal has spent a large amount of money per square foot, has not spent that money on overly excessive square footage.

In conclusion, Twin Oaks has proven that it has done all that is possible to reduce its square footage. A reasonable cost-related standard would allow a nursing home to conform its operation to that standard. The square-footage standard does not allow a nursing home to conform to the standard so, therefore, it is unreasonable.

With regard to Waterview, the same arguments were made concerning the Department of Health’s approval of the original design and the inability of Waterview to reduce its square footage. Testimony indicated that there are no single rooms that could be converted to double rooms. As I have decided with regard to Twin Oaks, I decide here that the square footage requirement as applied to Waterview is unreasonable.

Finally, with regard to the appraised value per square foot (too
much investment per square foot), which is applicable to Twin Oaks only, the petitioner also engages in the assumption that its original business decision to build Twin Oaks was not imprudent. This assumption I do not believe is warranted. The Department of Health appraised each nursing home presumably by the same criteria at the same point in time. The appraisal of Waterview showed an appraised value per square foot of approximately $42. The appraisal limit as set by the Department is $43. Twin Oaks’ appraised value per square foot is approximately $55. There seems to be no apparent reason, given the equality of treatment by the Department of Health appraisal, that Twin Oaks should be so abnormally high. I, therefore, do not find that the limitation of appraised value per square foot as applied to Twin Oaks is unreasonable.

The appropriate percentage factors to be applied to the appraised value are 100 percent for Waterview and 77.55 percent for Twin Oaks. The above percentages are in effect applied to three items of cost. These items are: 1) the Capital Facilities Allowance; 2) Building Property Taxes; and 3) Insurance. The effect is to allow 100 or 77.55 percent of these costs.

Inflation Factor

After the reasonable cost limits or screens are applied to a nursing home, the result is a reasonable level of cost on an historical basis. To these historical costs the Department then applies an inflation factor to allow for increases in cost taking place during the time the rates will be in effect. Petitioner argues that the inflation formula is arbitrary and unreasonable and further that petitioner should be compensated retroactively for any underestimate of the costs due to the inflation factor. The Department argues that a retroactive rate adjustment is precluded by the principle of prospectivity in rates and further that over time the inflation factor will work to petitioner’s benefit as well as its detriment because petitioner will be allowed to retain any extra monies produced by an overestimate of inflation.

First, petitioner claims the inflation factor formula applied in this case is unreasonable. Petitioner cites the testimony of its witness in this regard and also the recent promulgation by the federal government of a different method for determining the inflation factor. It is my belief that it makes little difference what factor is used. The inflation factor is a mere prediction of the future. Like all predictions it is prone to error. Parenthetically, I note that petitioner did not submit proofs of the inaccuracy of the present formula over a number
of years. Petitioner also did not propose an alternative method. The fact remains, however, that in this instance the inflation factor was in error.

The principal argument petitioner makes is that there should be a retroactive rate adjustment for underestimated inflation factors. The Department revealed that the inflation factor is determined through the use of historical data. It conceded that in periods of increasing inflation the inflation factor will underestimate the actual inflation rate, however, the Department maintained that in periods of decreasing inflation the formula will overestimate actual inflation. The result over time, it is argued, is a fair result.

I do not believe the result over time is fair. My understanding of economics is that inflation increases more easily than it decreases. In order to reduce inflation, the federal government must pursue Draconian economic policies which are difficult politically as well as economically. I will, therefore, allow the petitioner to recoup the amount of its losses due to the erroneous application of the inflation factor.

The conceptual objection, that to allow a retroactive adjustment violates the principle of prospectivity of rates, is not a valid objection. The rate set by the application of the inflation factor has to be based on one of two theories:

1. The rate is reasonable because the inflation factor tracks the actual inflation rate, or
2. The rate is reasonable because the inflation factor formula is reasonable without regard to the actual inflation rate.

Under the first theory, if actual inflation is different from that predicted by the inflation factor, the original estimate is unreasonable because it did not track the actual rate. The original Medicaid rate was, therefore, unreasonable and a retroactive adjustment is necessary or the Department would have set and allowed an unreasonable rate. Under the second theory, if there is a difference between the actual and predicted inflation rate, the rate is only reasonable if the inflation factor is reasonable. In order for the rate to be reasonable it must be related to cost. It can not be related to future costs, as those costs are unknown. Further, in a period of increasing inflation the inflation factor formula admittedly does not track actual inflation or actual costs. Under the second theory the inflation factor is not cost related.

To argue that the principle of prospectivity precludes a retroactive adjustment, is to argue that unreasonable rates are permissible or that non-cost related rates are permissible. The principle of prospectivity must clearly give way to these other considerations.
Mortgage Insurance

This issue involves the proper category in which this expense should be placed. Petitioner argues that this expense is a property related expense which should be kept separate from the other property screens. It is beneficial to Medicaid because it results in reduced cash flow and, therefore, should be separately reimbursed. The Department argues that this is a capital related expense, which has the effect of reducing the overall cost of capital. It further argues that petitioner obtains the benefit of this reduction, if its historical capital costs are less than the Capital Facilities Allowance.

I believe the Department's arguments are valid. Mortgage insurance allows a nursing home to decrease the percentage of high cost equity capital in its capital structure, thus lowering the overall cost of capital. The ability of a nursing home to use the alternative method of calculating its historical cost of capital is a reasonable method of reflecting the lower costs obtained through mortgage insurance. I, therefore, reject the petitioner's position with regard to this expense.

Housekeeping Costs (Waterview only)

Petitioner states that the CARE guidelines permit the allocation of more nursing care costs to those patients requiring more intensive nursing care such as SNF and ICF level A patients. Petitioner then reasons that the CARE guidelines should also permit the allocation of more laundry, linen and housekeeping costs to these patients as they also require more intensive housekeeping care. The effect of this adjustment would be to raise the screen for SNF and ICF Level A patients. There is some confusion in my mind, however, as to whether the allocation would lower the screen to all other patients.

Notwithstanding the confusion, the Department testified that Twin Oaks and Waterview were about average in terms of the patient mix. Further testimony indicated that the screen was determined by taking the median plus 10 percent. The allowance of the extra 10 percent would account for any unique differences such as a slight departure from the average patient mix. Finally, testimony indicated that there were practical difficulties involved in redesigning the computer program and establishing benchmarks with which to weigh housekeeping costs.

It is the decision here that petitioner has not proved any extraordinary departure from the average patient mix and that the 10 percent allowance above median cost is sufficient to account for any slight differences in the patient mix that may exist. I will, therefore, disallow petitioner's proposed housekeeping adjustment.
Late Filing Penalty (Waterview Only)

Petitioner maintains that the late filing penalty was unrelated to the injury done to the State, was excessive ($85,000) and was not based on the particular circumstances of petitioner's case. It was generally admitted that a 15-day extension was granted to a late-filing nursing home, but a strict policy of no further extensions was followed after the grant of the initial 15-day extension. Actually no inquiry was made as to the reasons for a second extension. I believe there was not adequate review of petitioner's second request for extension and, therefore, will undertake such a review herein.

Petitioner's witness testified that there were a series of management changes: fiscal and bookkeeping personnel left, labor strife existed, and a new computer system required months of debugging. Petitioner's witness was questioned as to why it was not possible to circumvent all of these internal problems by hiring a consultant who would work outside the normal management structure. Petitioner's witness replied that they in fact had a consultant working on the computer which appears to have been the essential difficulty.

It seems reasonable that a computer-based bookkeeping operation could not function with a broken-down computer. Petitioner seems to have responded to this problem in a reasonable way by bringing in an outside consultant. There appears to be little else petitioner could have done to solve its problems with regard to the late filing. I, therefore, find petitioner has demonstrated sufficient reason for the second extension that was summarily denied. I will disallow the late filing penalty.

After a review of the record and having observed the demeanor of the witnesses, I hereby FIND that:

1. The square footage limitation per bed is unreasonable.
2. The assumption that petitioner's investment per square foot in Twin Oaks Nursing home was prudent, is not warranted.
3. The inflation factor, in order to be reasonable, should provide for the retroactive reimbursement of any shortfall in cost recovery (or overrecovery) due to the inflation factor.
4. Mortgage insurance is properly categorized as a capital cost reimbursement through the application of the Capital Facilities Allowance.
5. Housekeeping costs should not have an intensity factor applied to them as the Department's formula for allowance of these costs is reasonable.
6. Petitioner, Waterview Nursing Home, could not meet the filing
deadline by reason of a computer failure.

7. Petitioner pursued a reasonable and prudent course in trying to solve its computer failure problem by hiring a consultant and therefore demonstrated a valid reason for a filing extension.

Based on the foregoing, I CONCLUDE that:

1. The proper percent of total appraised value to be used in the determination of the Capital Facilities Allowance, Insurance and Property Taxes is 100 percent with regard to Waterview and 77.55 percent with regard to Twin Oaks.

2. Petitioner is entitled to retroactive reimbursement for the shortfall in the recovery of costs caused by the inflation factor which amount is to be determined by the party's accountants.

3. Mortgage Insurance is to be included in the Capital Facilities Allowance and no increased reimbursement is therefore allowable.

4. Housekeeping costs are not be to intensified and therefore no increased reimbursement is allowable.

5. Petitioner, Waterview Nursing Home, be allowed to recover the $85,000 late filing penalty.

Accordingly, it is hereby ORDERED that:

1. The parties make the appropriate calculations in accordance with the conclusion set forth herein and petitioner be entitled to increased Medicaid reimbursement as determined by those calculations.

**FINAL DECISION BY THE DIRECTOR OF THE DIVISION OF MEDICAL ASSISTANCE AND HEALTH SERVICES, THOMAS M. RUSSO:**

This matter is before the Director as the result of hearing requests filed by Petitioner Waterview Nursing Home on December 28, 1979 (Waterview) and by Petitioner Twin Oaks Nursing Home on January 28, 1980 (Twin Oaks).

Because of similar issues of fact and law, both cases were consolidated and a hearing was held on July 14, 1980.

**JURISDICTION**

In accordance with the "Medical Assistance and Health Services Act, N.J.S.A. 30:4D-1 et seq., the Commissioner of the Department of Human Services is responsible for administering the New Jersey Medicaid Program through the Division of Medical Assistance and Health Services, N.J.S.A. 30:4D-4.
Under this statutory scheme, the Commissioner of Human Services has exclusive authority to establish reasonable rates of reimbursement for health care services covered under the Program, N.J.S.A. 30:4D-7(b), Atty. Gen. F.O. 8-1976.

The Division of Medical Assistance and Health Services is charged with administering the day-to-day operations of the New Jersey Medicaid Program including the reimbursement of service providers, N.J.S.A. 30:4D-4.

The role of the Department of Health is limited to assisting the Department of Human Services in developing rates of reimbursement for long term care facilities participating in the Medicaid Program.

In this matter, the petitioners challenged the validity of the Medicaid “Cost Study, Rate Review Guidelines and Reporting System for Long-term Care Facilities” (CARE) set forth in N.J.A.C. 10:63.3 et seq. Therefore, the authority to render a final agency decision rests with the Division of Medical Assistance and Health Services.

**MEDICAID PROGRAM**

Medicaid is a cooperative federal-state program for the purpose of providing medical assistance on behalf of certain indigent, aged, blind and disabled persons whose income and resources are insufficient to meet the costs of necessary medical services. 42 U.S.C. 1396. The Medicaid Program is jointly funded by the State and Federal Government and is administered by the State.

Due to the presence of federal funding, when a state elects to participate in the Medicaid Program, it must adhere to certain federal statutory and regulatory requirements.

One of the many federal requirements is that state Medicaid Programs provide methods and procedures to assure that payments for services under the plan are not in excess of reasonable charges consistent with efficiency, economy and quality of care. 42 U.S.C. 1396a(a)(30).

To comply with the above requirement the New Jersey Legislature at N.J.S.A. 30:4D-7 authorized the Commissioner of Human Services to issue necessary rules and regulations and to do all things necessary to maximize federal participation in the New Jersey Medicaid Program consistent with fiscal responsibility within the limits of funds available for any fiscal year. The Commissioner is further empowered to adopt fee schedules with regard to medical assistance benefits and otherwise to accomplish the purposes of the New Jersey Medical Assistance Program.
The Medicaid Program provides assistance to eligible persons by entering into contractual agreements with members of the health care industry whereby the providers of services agree to furnish care to Medicaid patients in return for payment by the state Medicaid agency.

It should be noted that service providers are not required to participate in the State's Medicaid Program, however, if they choose to participate, they must agree to conform to both state and federal law and to accept payment in accordance with the state Medicaid Plan provisions.

**LONG TERM CARE FACILITY REIMBURSEMENT REGULATIONS N.J.A.C. 10:63-3**

The above-cited regulations, effective February 19, 1974, see 6 N.J.R. 14(b), 6 N.J.R. 117(c), established a methodology to determine prospective per diem rates of reimbursement for LTC facilities providing care to Medicaid patients.

These regulations remained intact until July 1, 1977 when they were amended to comply with federal regulations 45 C.F.R. 250.30 et seq., which mandated that state Medicaid programs adopt a "reasonable cost related" reimbursement system. The above-mentioned federal regulations were enacted to implement an amendment to the Social Security Act, 42 U.S.C. 1396a(a)(13)(E), requiring that certain Medicaid providers be reimbursed on a reasonable cost related basis. By enacting this requirement Congress intended to deal with the problem of some LTC facilities being overpaid while others were being underpaid for comparable services.

The amended state regulations establishing a reasonable cost-related reimbursement system became effective on December 29, 1977. The reasonable cost-related reimbursement regulations are commonly known as the CARE Manual.

In order to control rising health-care costs, a state Medicaid program must adopt a reimbursement methodology which bears a relationship to reasonable costs. In other words, a State must determine which costs are reasonable and therefore reimbursable.

Reasonable costs were determined by a comparison of industrywide costs to establish a statistically valid limitation on the reimbursement of various cost centers.

If a facility incurs a cost above the reasonable cost-related limitation, it may be reimbursed at a level lower than its actual cost because the extraordinary cost is statistically unreasonable. This result may occur because the purpose of a "reasonable cost-related" reim-
bursement system is to exclude the use of federal and state funds to pay for excessive and unreasonable costs.

**BURDEN OF PROOF**

It is a generally accepted principle of law that a rebuttable presumption of reasonableness attaches to a regulation duly promulgated by a state agency. It is an equally well-established corollary, that the person challenging an agency regulation has a heavy burden of demonstrating that the regulation has no substantial support on the facts. *Brotherhood of R.R. Trainmen v. C.R.R. of N.J.*, 47 N.J. 508, 16-17 (1966).

Therefore, the petitioners have the burden of proving that the regulations in issue are arbitrary, capricious or unreasonable. *In re: Public Hearings, 142 N.J. Super. 136, 156 (App. Div. 1976). See also, N.J. Guild of Hearing Aid Dispensers v. Long, 75 N.J. 544, 561 (1979).*

**CAPITAL FACILITIES ALLOWANCE (CFA) SQUARE FOOTAGE ADJUSTMENT**

Based upon his full review of the record, it is the Director's opinion that the petitioners did not meet their burden of proving the invalidity of the regulations in issue.

The heart of the issue is the statistical validity of the screens calculated by the Department of Health for the purpose of establishing a reasonable cost-related rate of reimbursement for the various property components of nursing home costs.

In presenting their case in chief, the petitioners relied upon the testimony of Irving Sendar and Allan D. Rosenberg.

Mr. Sendar is a licensed nursing home administrator, a certified public accountant in the State of New York and one of the owners of the nursing homes involved in this appeal.

Mr. Rosenberg is a certified public accountant and a health care consultant who assists nursing homes in the preparation and submission of cost-report forms.

Mr. Rosenberg under cross examination testified that he has "an understanding of the way nursing homes receive their rate, but that is not an area of expertise in terms of how the rates were determined themselves." Therefore, Mr. Rosenberg conceded that he was not an expert in the primary issue of the case, to wit, the reasonableness of methods by which the rates were determined. Therefore, his testimony is entitled to little, if any, weight.

It should be noted that the petitioners present no other testimony
from either experts in nursing home economics or statistics.

It is the Director's further opinion that the administrative law judge seriously misconstrued the purpose and operation of a reasonable cost-related reimbursement system.

Specifically, the purpose of a "reasonable cost-related" reimbursement system is to control rising health care costs by excluding excessive and unreasonable cost from reimbursement under the Medicaid Program. The system is intended to exclude certain excessive costs regardless of how or why they were incurred.

Furthermore, the record clearly substantiates the reasonableness of the present rate determination system. This was established by Charles Lydon, an expert in nursing home rate determinations from the Department of Health, who testified that a peer review of square feet per bed was made in 1977 and 10 percent was applied to the median. The peer review excluded nursing homes with less than 20 percent Medicaid occupancy and those not meeting safety standards. The purpose of the limitation on square feet was to "eliminate the Medicaid programs and taxpayer dollars paying for unreasonable amounts of square feet, unreasonable capital costs in the building of nursing homes." The $43.00 per square foot limitation was also derived from a similar peer review based upon appraised replacement values, including old and new facilities. Lydon further testified that the use of the medians plus 10 percent can result in 80 percent of the nursing homes falling within the screens, depending upon how tightly the homes cluster around the median. A percentage of reimbursement of real estate taxes and property costs results from a comparison of actual appraised value with allowed square feet per bed, times the number of beds, times $43.00.

It is the Director's further opinion that petitioners' argument that the Department of Health is estopped from saying that Twin Oaks should have designed its nursing home differently, because it approved the original design and specifications, is without merit. This opinion is based upon the fact that the Department of Health only approves designs for compliance with minimum square footage requirements.

In this case Twin Oaks chose to exceed the minimum square footage requirements for reasons of its own. It was in no way required to exceed the Department of Health minimum square footage requirements.

Thus, for the reasons stated herein it is the Director's decision that the square footage screens as applied to both Twin Oaks and Waterview are reasonable.
Furthermore, with respect to the issue of too high an investment per square foot, which is applicable to Twin Oaks only, the Director concurs in the reasoning of the administrative law judge.

**INFLATION FACTOR**

With respect to the issue of the unreasonableness of the inflation factor, it is the Director's opinion that the petitioners did not meet their burden of proving the invalidity of the regulation in issue.

The record is devoid of any evidence to support the allegation of the inaccuracy of the present inflation formula. Furthermore, the petitioners never quantified the losses they allegedly attributed to the application of the inflation factor regulation. *N.J.A.C.* 10:63-3.18.

The deficiency of the record on this issue is further substantiated by the statement of the judge where he indicated:

petitioner did not submit proof of the inaccuracy of the present formula over a number of years. Petitioner also did not propose an alternative method.

Despite the lack of evidence, and the petitioners' failure to show specific damages resulting from the application of the regulation, the judge nevertheless ruled in petitioners' favor.

In so ruling, the judge failed to accord the regulation in issue the presumption of validity to which it is entitled.

The court's ruling on this issue was totally arbitrary because it was unsupported by the evidence and based solely upon the personal economic beliefs of the trier of fact.

Furthermore, the record indicates that the inflation factor formula contained in *N.J.A.C.* 10:63-3.18 is reasonable because it is based upon components which reflect the nationwide trend of inflation. Specifically, the Medicaid inflation factor is based upon two factors:

1. Average hourly earnings of manufacturing employees in New Jersey as published by the Bureau of Labor Statistics (weighted 60 percent).
2. The consumer price index as published by the Bureau of Labor Statistics (weighted 40 percent).

Because New Jersey has a prospective reimbursement system, no adjustment will be made to the inflation factor if actual inflation exceeds the estimate. However, if the actual inflation rate decreases, nursing homes are not required to reimburse the difference.

Furthermore, Ms. Lydon testified that the base level expenses will incorporate actually experienced inflation into the next year's rate. Lydon further testified that, retroactive inflation adjustments, as sug-
gested by the petitioners, would violate the prospective rate-setting system.

The petitioners' proof on this issue consisted of a recitation of two alternative methods of reimbursement. First, the petitioners' witnesses discussed the nursing home reimbursement system of the State of New York, which provides for a retroactive adjustment in the inflation factor if there is a significant deviation between the estimated trend and actual inflation. Secondly, the petitioners' witnesses discussed a "market basket index" system used by the federal Medicare program to establish skilled nursing facility rates of reimbursement.

Under the "market basket index" system, adjustments are made if the actual rate of cost increases exceeds the estimate by a certain percent.

Parenthetically, it should be noted that the "market basket index" system has been suspended by federal authorities.

In evaluating the record it is clear that the existence of alternate reimbursement systems does not constitute a basis for finding the present system unreasonable. This opinion is further substantiated by the fact that the petitioners did not prove any loss caused by the application of the present system.

Furthermore, the Medicaid Program's refusal to retroactively adjust for deviations in the inflationary trend is a primary element of the prospective reimbursement system which attempts to contain health care costs and thereby prevent the continuing inflationary spiral.

Thus, for the reasons stated herein, it is the Director's decision that the inflation factor regulations (N.J.A.C. 10:63-3.18) are reasonable.

MORTGAGE INSURANCE

With respect to the issue of mortgage insurance expense, it is the Director's opinion that this is a capital-related expense. Therefore, the Director concurs in the judge's reasoning and affirms the court's recommended decision to disallow petitioners an adjustment on this item.

HOUSEKEEPING COSTS

The issue of an adjustment for those items categorized as "housekeeping costs" pertains only to petitioner Waterview Nursing Home.

Based upon his full review of the record, the Director concurs in the judge's reasoning and affirms the court's recommended decision to disallow the petitioner an adjustment on this item.
LATE FILING PENALTY

The issue of the late filing penalty pertains only to petitioner Waterview Nursing Home.

The record clearly indicates that there were a multiplicity of factors which contributed to the petitioners' late submission of the cost studies. Specifically, the petitioner experienced a change in administrators, key fiscal and bookkeeping personnel left the facility, there were protracted labor problems and a malfunction of the computer system.

The petitioners' witnesses gave credible testimony that the above problems made the timely submission of the cost studies virtually impossible.

The Director also takes note of the fact that the State incurred no injury because of the late filing of the cost studies.

In consideration of the facts of this specific case, the imposition of an $85,000.00 penalty is excessive and unjustified.

The Division has the right to establish a time limitation for the filing of cost studies.

The regulation mandating a deadline for the filing of cost studies is directly related to the substantial interest of the State in establishing rates of reimbursement for Medicaid long term care facilities.

Nevertheless, the regulation relating to the time of filing of cost studies must yield to the principles of equity to avoid an injustice where the facts of a specific case so demand.

Therefore, the Director affirms the judge's recommended decision to disallow the late filing penalty.

FINDINGS

The Director, Division of Medical Assistance and Health Services, having reviewed and considered the entire in this matter, including the transcript of the proceedings, the initial decision of the administrative law judge and the exceptions and cross-exceptions thereto and the briefs filed on behalf of both parties, makes the following findings of facts:

1. The square foot per bed limitation, N.J.A.C. 10:63-3.6, as applied to both petitioners, was reasonable.

2. The appraised value per square foot limitation, as applied to petitioner Twin Oaks, is reasonable. The petitioners' uniqueness is compensated for in the 10 percent allowance above the median.

3. The petitioners failed to meet their burden of proving the invalidity of the regulations pertaining to the limitation of square
feet per bed and the appraised value per square foot limitation.
4. The inflation factor calculation, N.J.A.C. 10:63-3.18, as applied
to both petitioners was reasonable.
5. The petitioners presented no competent evidence on this issue
and were unable to show any loss caused by the application
of the inflation factor regulation.
6. The Mortgage insurance expense is properly categorized as a
capital financing cost and is reimbursable through the Capital
7. The Medicaid Program's reimbursement formula for items
categorized as "housekeeping costs" is reasonable.
8. Petitioner Waterview Nursing Home was unable to meet the
cost study filing deadline due to a multiplicity of factors.
9. The petitioner applied for, but was denied, a filing extension.
10. The State sustained no injury due to petitioners' late filing of
the cost studies.
11. $85,000 is an excessive penalty and the principles of equity
require that this penalty be disallowed.

CONCLUSIONS
In addition to the findings made above, the Director concludes as
follows:
1. The proper percent of total value to be used in the determina-
tion of the Capital Facilities Allowance, Insurance and Prop-
erty Taxes is 100 percent with regard to Waterview and 75.55
percent with regard to Twin Oaks.
2. Petitioners are not entitled to a retroactive reimbursement for
the inflation factor.
3. Mortgage Insurance expenses are to be included within the
Capital Facilities Allowance, therefore, no adjustment to the
reimbursement rate is allowable.
4. Those items categorized as "housekeeping costs" are not enti-
tled to be weighted, therefore, no increased reimbursement is
allowable.
5. Petitioner Waterview Nursing Home should be allowed to re-
cover the amount of the late filing penalty.
Therefore, it is on this 4th day of March, 1981,

ORDERED:
That the agency take all actions necessary to reimburse petitioner
Waterview Nursing Home for the late filing penalty; and
IT IS FURTHER ORDERED:

That the findings, conclusions and recommendations of the administrative law judge contained in the initial decision are reversed and modified to the extent that they conflict with the holding in this decision.

You must check the New Jersey Citation Tracker in the companion looseleaf volume to determine the history of this case in the New Jersey Courts.