IN THE MATTER OF
CRANFORD HALL NURSING HOME
MEDICAID REIMBURSEMENT RATE
EFFECTIVE JANUARY 1, 1980, and
CRANFORD HALL NURSING HOME
MEDICAID REIMBURSEMENT RATE
EFFECTIVE JANUARY 1, 1978,
THROUGH JANUARY 1, 1980

Initial Decision: October 15, 1982
Final Decision: November 24, 1982

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

SYNOPSIS

Cranford Hall appealed the calculation of per diem Medicaid rates payable in 1978, 1979 and 1980 for services provided to qualified recipients under Title XIX of the Social Security Act.

The administrative law judge assigned to the case found that Cranford Hall employed a full-time administrator who, in 1978, received a salary of $77,930. The judge noted that pursuant to N.J.A.C 10:633.5(b)2 reasonable administrative salaries were to be determined by a regression analysis formula utilized by the Division of Health Economic Services and that Cranford in a 1979 provider agreement had agreed to comply with all Medicaid regulations. The judge determined that the administrator's salary screen of $30,509 set through the regression analysis was reasonable and that the Division had been correct in denying Cranford's higher figure as being unreasonable.

In addition, the judge affirmed the disallowance of management fees paid to an individual not actively engaged in the day-to-day activities of the home. The judge determined that Cranford had failed to establish that these disbursements were a cost of doing business nor were they an expense related to the conduct of nursing home activities.

Upon review of this initial decision, the Director of the Division of Medical Assistance and Health Services adopted it as his own.

Raymond T. Lyons, Jr., Esq. for petitioner (Sorkow, Eichen & Lyons Esqs, attorneys)
Robert J. Haney, Deputy Attorney General for respondent (Irwin I. Kimmelman, Attorney General of New Jersey, attorney)
SULLIVAN, ALJ:

These consolidated appeals concern the calculation of per diem Medicaid rates payable in 1978, 1979 and 1980 to Cranford Hall for services provided to qualified recipients under the medical assistance program established by Title XIX of the Social Security Act, 42 U.S.C.A. §1396 et seq.

Medicaid is a cooperative federal and state program for the purpose of furnishing medical assistance to the needy. 42 U.S.C.A. §1396. It obtains funding through a cost sharing formula partially from federal revenues and partially from state revenues. An overview of the entire Medicaid system was presented by the New Jersey Supreme Court:

The Medicaid Act represents an exercise in what has been termed “cooperative federalism.” Note, “State Restrictions on Medicaid Coverage of Medically Necessary Services,” 78 Colum. L. Rev. 1491 (1978). The program is primarily administered by the State, subject to federal guidelines and constraints. Each participating State is required to adopt a plan, which must be approved by the Secretary of the Department of Health, Education & Welfare Now Department of Health and Human Services, covering in detail the services to be rendered. 42 U.S.C. §1396. 1296a(a).

The plan must provide for five general categories of medical assistance and may include others. 42 U.S.C. §1396a(a)(13)(B). Reimbursement must be provided for ... “skilled nursing facility and intermediate care facility services on a reasonable cost related basis....” Id. 1396a(a)(13)(E).


Recently, the section of the Medicaid Act dealing with nursing home care was amended effective as of October 1, 1980. P.L. 96-499. As currently written, 42 U.S.C.A. 1396a(a)(13)(E) provides for payment of skilled or intermediate nursing care at rates “reasonable and adequate to meet the costs which must be incurred by efficiently and economically operated facilities in order to provide care and services in conformity with applicable State and Federal laws, regulations, and quality and safety standards.” Additionally, the amendment requires participating states to make satisfactory arrangements for the “filing of uniform cost reports by each ... skilled nursing facility and intermediate care facility” and to conduct “periodic audits ... of such reports.”

Although states must comply with federal requirements, routine administration of the Medicaid program is placed in the hands of the state agency which transmits payments to the providers of services. New Jersey participates in the Medicaid program pursuant to the Medical Assistance and Health Services Act, N.J.S.A. 30:4D-1 et seq.
enacted in 1968. Payments to long-term care facilities are governed by regulations entitled the Cost Accounting and Rate Evaluation (CARE) Guidelines, \textit{N.J.A.C.} 10:63-3.1 \textit{et seq.}, which were developed jointly by the Department of Health and the Department of Human Services. Computations and initial processing of rates are performed by rate analysts at the Department of Health, but final decision-making authority over Medicaid rates rests solely with the Department of Human Services. \textit{N.J.S.A.} 30:4D-7(b); \textit{Att'y Gen. Form. Op.} 1976—No.8. Providers seeking Medicaid reimbursements are required to follow a uniform system of cost reporting established by the CARE Guidelines. \textit{See, N.J.A.C.} 10:63-3.21. All rates are based on actual costs reported by the facilities. Rates are set to reflect the lower of either "historical costs" together with a return on equity or the so-called "screened rates." \textit{N.J.A.C.} 10:63-3.2. To obtain the screened rates, services are broken down into several components defined in the regulations. Equalized costs attributable to each component are compared with a reasonableness limit or "screen" to determine whether the amount charged by the facility for that particular service is excessive. Screening devices vary from component to component, but basically consist of a comparison with the median cost incurred by comparable facilities for similar services. Any excess over the applicable screen is deducted in calculating the screening rate.

\textbf{PROCEDURAL HISTORY}

As provided in the regulations, the petitioner filed and pursued a so-called Level I appeal before the Division of Health Economics Services (HES) respecting its 1980 rates. Relief was granted in part, but additional requirements were added in the course of the Level I appeal. These requirements could not be amicably resolved and, for this reason, on February 18, 1981, the Director of HES referred the Medicaid reimbursement rate effective January 1, 1980 to the Office of Administrative Law for determination. So too, following an equally unsuccessful pursuit of the Level I appeal, on March 24, 1981, the Director of HES referred the Medicaid reimbursement rate, effective January 1, 1978 through January 1, 1980, to the Office of Administrative Law as a contested case, \textit{N.J.S.A.} 52:14F1 \textit{et seq.}

Following this transmittal, a prehearing conference was held in June 1981. Through stipulation at this conference, the docket numbers on the matters were changed from HLT designations to HMA designations reflecting the fact that the final administrative determination is to be made by the Director of the Division of Medical Assistance
and Health Services rather than by the Commissioner of Health. Hearings were held on March 1, 2, April 20 and June 24, 1982. Because of the complexity of the technical issues in this case, particularly those relating to the regression analysis, the parties were given time to review the transcripts before submitting the proposed findings of fact and conclusions of law. The record closed on September 2, 1982.

Based on the facts developed at the hearing and the applicable law, I CONCLUDE that Cranford has not sustained its burden of showing factual unusual circumstances sufficient to justify relaxing the guidelines.

GENERAL BACKGROUND

The facts respecting Cranford Hall itself are, with few exceptions, not in dispute and I adopt and FIND AS FACT the bulk of the petitioner's proposed, but never accepted, stipulation of fact. That is to say, Cranford Hall Nursing Home is a 112-bed facility, licensed as a skilled nursing facility and intermediate care facility by the Department of Health. Cranford Hall Nursing Home is operated by Cranford Hall, Inc., a New Jersey corporation, the stock of which is owned equally by Raymond C. Zeltner, the administrator, and Anna L. Pizzi.

Zeltner is the administrator of Cranford Hall Nursing Home and has held that position continuously since 1964. Zeltner is licensed by the Department of Health to act as nursing home administrator. He is also licensed as a registered pharmacist by the State of New Jersey. Zeltner holds a B.S. in pharmacy from Rutgers University and an M.B.A. in hospital administration from Wagner College.

The buildings occupied by Cranford Hall Nursing Home consist of a three-story converted mansion house and a two-story building constructed in approximately 1956 specifically for use as a nursing home. The two buildings are connected by a corridor. The mansion houses the laundry and maintenance facilities in the basement, administrative offices and an auxiliary kitchen on the first floor, patient rooms on both the first and second floors and storage facilities and living quarters on the third floor. The other building houses the kitchen, cafeteria and pharmacy in the basement and has patient rooms on the first and second floors.

All department heads report to the administrator. Zeltner's sole and full-time employment is and was as administrator of Cranford Hall Nursing Home. He is intimately involved in the day-to-day operations
of the facility and the myriad problems encountered in caring for 112 needy patients and employing 108 workers.

The two appeals, which were consolidated for the hearing, deal with different events which were, in turn, governed by different regulations. Hence the two cases will be separately described.

**HMA 1155-81—Administrator’s Salary**

Prior to January 1, 1980, the administrator’s compensation was just one element of cost within the General Services rate component. No limits were imposed on the elements within the General Services rate component and, so long as the total costs in the General Services rate component came below the screen, no part of any cost component, including administrator’s compensation, would be disallowed. On November 8, 1979, the Department of Human Services published proposed amendments to the *N.J.A.C.* 10:63-3.1, 3.2, 3.4 and 3.5, 11 *N.J.R.* 552(a). In pertinent part a new provision, *N.J.A.C.* 10:63-3.5(c)(2), was proposed to establish a separate screen within the General Services rate component for administrator compensation. On December 13, 1979, the Commissioner of Human Services adopted the proposed amendments. An order adopting these regulations was filed on December 14, 1979, as R.1979, d.482, to become effective January 1, 1980, 12 *N.J.R.* 42(a).

Cranford Hall submitted its cost report for the base period ending December 31, 1978. It subsequently received a notice of the reimbursesent rate effective July 1, 1979. The notice states, “the effective date of your rate has been established in accordance with the CARE Guidelines which read, ‘Prospective per diem rates to be in effect for one full year commencing six months after the end of the base period or 90 days after receipt of the report; whichever is later.’”

On November 8, 1979, the Department of Human Services mailed to Cranford Hall, Inc. the executed provider agreement for the period November 30, 1979 to September 30, 1980 which provides in part that it will observe all Medicaid regulations.

On February 6, 1980, Cranford Hall received a notice of reimbursement rates effective January 1, 1980, which were calculated in accordance with the amendments to *N.J.A.C.* 10:63-3.1 *et seq.* The result of this recalculation was a reduction of $2.92 per day in Cranford Hall’s reimbursement rate.

The reduction, in turn, reflected the screening of Zeltner’s salary of $77,930 down to $30,509. The screen was based on a regression analysis performed by HES. The arithmetic of the regression is not
in dispute, although experts clashed as to whether the regression provided any information about patterns of administrative salaries in the industry.

My view of the regression analysis is based on the thoroughly open-ended direction of N.J.A.C. 10:63-3.5(b)2, which reads: "Reasonable compensation of unrelated administrators is determined by the regression analysis formula utilized by the Division of Health Economics Services."

The analysis performed by HES falls within the broad definition of a regression analysis. It may be disputed as to whether or not this analysis reveals a relationship between the number of beds and the administrator's salary which would be meaningful in making predictions. Nevertheless, it does establish, as the respondent points out in its brief, that there is a positive slope to the correlation, and the regulation seems to require nothing more. Furthermore, as Vincent Yarmilak pointed out, the analysis is prescriptive, that is, it is designed to generate a rule rather than to show cause-and-effect relationships or, for that matter, to reveal patterns. Further, although it is not Zeltner's problem to worry about such things, it is extremely difficult to imagine what sort of regression could be used if not the one between administrator's salary and the number of beds. No other aspect of the reporting nursing homes is as immediately apparent to the Division, and the Division credibly argues that it would be at a total loss to come up with another formula for determining administrator's compensation.

Lastly, while Zeltner argued that he runs an efficient and quality operation, I note now, as I noted from the bench, that the regulations did not prescribe a reward for excellence of care but rather they are applied to all nursing homes which meet a minimum standard. The screens are in place for all administrators and there was no evidence that Cranford Hall is unusually difficult to administer. Indeed, Zeltner testified that he had visited only two or three other nursing homes and in the absence of any other witnesses no foundation was laid for the claim that Cranford Hall poses unique managerial problems.

Based on the foregoing, I make the following:

**FINDINGS OF FACT**

1. Cranford Hall employed Raymond C. Zeltner as a full-time administrator.

2. Mr. Zeltner oversaw all the operations of the nursing home and was actively engaged in running the home.
3. Mr. Zeltner had been so employed for 16 years as of January 1, 1980.
4. Cranford Hall, under the direction of Mr. Zeltner, provided quality care to its patients.
5. Mr. Zeltner's compensation for 1978 was $77,930.
6. Effective January 1, 1980, the State set $30,509 as the maximum administrator's compensation it would consider in calculating the reimbursement rate for Cranford Hall.
7. Cranford Hall submitted its Cost Study Report for December 31, 1978, on March 30, 1979, within the time provided by the regulations.
8. A provider agreement was entered into between Cranford Hall and the Department of Human Services, effective November 30, 1979 through September 30, 1980, under which Cranford Hall agreed to comply with all Medicaid regulations.
9. At the time of such agreement there were reimbursement rates in effect, starting July 1, 1979 and continuing through June 30, 1980.
10. On December 14, 1979, HES implemented a change in the methodology reducing Cranford Hall's rates and made that reduction effective January 1, 1980.
11. The screen for the administrator's salary was set through a regression analysis with a coefficient of determination of less than 0.07.
12. The salary screen of $30,509 is reasonable.

Petitioner argues that N.J.A.C. 10:63-3.5(b)(2) could not be enforced until after it had received federal approval, which it argues was reflected in the letter of Arthur O'Leary, the Regional Medicaid Director of the Department of Health and Human Services to Commissioner Ann Klein, dated March 2, 1981. Although not formally introduced at the hearing, Mr. O'Leary's letter is set forth as part of the appendix in petitioner's brief. The difficulty with this argument lies in the fact that the letter itself explicitly states that approval was given to what ultimately became N.J.A.C. 10:63-3.5(b)2, effective January 1, 1980. This is precisely the date on which the Division made the amendment effective against Cranford Hall. For this reason, it would appear that the Division implicitly agrees with the petitioner's contention on this point and did not attempt to make the regulation effective on any date prior to its effective federal approval date.

Petitioner argues that the reimbursement scheme which sets a limit on unrelated administrator's salary has, in the context of this case,
impaired its contract with the Division of Medical Assistance and Health Services and, by setting retrospective rates, is unconstitutional. However, since the contract committed the petitioner to observe all Medicaid regulations, it can hardly be argued that the State has bargained away its power to regulate.

Two further observations may be made. The first has to do with whether or not the overall rates of the petitioner's reimbursements are reasonable. As to this, attention may focus on the administrator's salary of $30,509. As shown by the regression analysis, this salary is, if nothing else, totally in keeping with the average salaries reflected in the marketplace for unrelated administrators. In short, if the overwhelming majority of participants in the industry can purchase administrative services for this amount, there is no reason to believe that Cranford Hall cannot. There has been no showing that Cranford Hall's physical plan or staffing patterns are in any way unique or pose unusual managerial challenges. For this reason, the bottom line result is that the salary which predominates in the industry is a reasonable one for Cranford Hall to pay. Cranford Hall is at liberty to pay more but may do so only with respect to charges placed on non-Medicaid patients whose charge structure is not regulated under the CARE Guidelines. As to the Medicaid component of Cranford Hall's operation, the statute requires that the cost be reasonably cost-based, and the salary originally paid to Zeltner far exceeds this amount.

Furthermore, as to the constitutionality of the reimbursement scheme, federal courts have, in passing on the adequacy of state plans, consistently stressed that the statute gives wide discretion to states in formulating reimbursement policy. For example:


By way of explication of the legislative background regarding reimbursement schemes, the court in Alabama Nursing Home Association v. Harris, 617 F. 2d 388, 392 (5th Cir. 1980) observed as follows:

Congress intended that state authorities in developing methodologies for reasonable cost related reimbursement have great flexibility in the areas of cost-finding and rate-setting. The legislative history indicates that states are to be free to experiment with methods and standards for payment that would be simpler and less expensive than that complex Medicare reasonable cost formula. See, S. Rep. No. 92-1230, 92d Cong., 2d Sess. 287 (1972) (herein after "Senate Report"). See also, 43 Fed. Reg. 4,861
at 4,862 (1978); 41 Fed. Reg. 27,300 at 27,300-02 (1976). Congress approved the setting of reasonable cost related rates on either a prospective or retrospective basis. See, Senate Report at 288. See also, 43 Fed. Reg. at 4,861-63.

More to the point, the New Jersey Appellate Division in Twin Oaks Nursing Center Inc. v. The New Jersey Department of Human Services, (N.J App. Div., April 27, 1982, A2657-79A and A3703-79) (unreported), has held that the right to change regulations in order to exclude unreasonable cost was specifically reserved by the provision in the foreword of the CARE Guidelines, namely:

[T]hese guidelines are not purported to be an exhaustive list of unreasonable costs. Accordingly, notwithstanding any inference one may derive from these guidelines, the departments reserve the right to question and exclude from [sic] any unreasonable costs, consistent with the provision of N.J.S.A. 30:4D-1 et seq.

In light of this general organizational background of the cost-related reimbursement scheme, and the fact that there is nothing shocking to the conscience in the $30,509 limit on nursing home administrators’ 1980 salaries, I CONCLUDE that the action taken by HES is reasonable and I ORDER the petition, as to HMA 1155-81, to be DISMISSED.

HMA 1609-81—MANAGEMENT FEES

This matter concerns the disallowance of certain fees paid to Anna L. Pizzi, a part-owner of the nursing home for the period beginning January 1, 1978 through January 1, 1980.

The facts of this aspect of the matter are set forth in the post-trial brief of the petitioner which, with modification, makes the following observations.

Cranford Hall submitted its Cost Study Report for the period ending December 31, 1977. Included in the cost was the amount of $32,192 paid to an owner of fifty percent of the stock in Cranford Hall, Inc., Mrs. Anna L. Pizzi; the amount was denominated as a management expense. This was allowed as an expense by HES and included in the rate calculation. After receiving its rates effective July 1, 1978, Cranford Hall filed a Level I appeal.

Among the issues raised by Cranford Hall was the propriety of allocating fringed cost to the management expense, since Mrs. Pizzi was not active in the everyday activities of the home and did not participate in any fringe benefits. HES agreed with this contention and advised Cranford Hall:

Management costs not representing salaries were reclassified as management expenses, not subject to fringing. The fringe factor was revised as a result of this adjustment.
As a result, Cranford Hall's rates effective July 1, 1978 were increased.

Although it was successful in its Level I appeal on several issues, Cranford Hall filed a Level II appeal which involved two issues, neither of which pertained to management expense.

Soon after the Level II appeal was filed and while it was still pending, Cranford Hall submitted its Cost Study Report for the period ending December 31, 1978. Included in the cost was the amount of $41,418 paid to Mrs. Pizzi as management expense. This expense was allowed by HES and included in the rate calculation. Cranford Hall did not file an appeal of its rates effective July 1, 1979.

On May 5, 1980, approximately 17 months after it had filed its Level II appeal, Cranford Hall received a decision from HES in which it retroactively disallowed $32,192 of management expense.

Also on May 5, 1980, Cranford Hall received a letter retroactively disallowing $14,040 of management costs for the rates effective January 1, 1978. Apparently, HES decided to look back to prior years where the subject of management costs had never even been raised by either party. Cranford Hall's Cost Study Report for the period ending December 31, 1976, showed an amount of $14,040 paid to Mrs. Pizzi as management expense. This cost was allowed by HES and originally included in the rate calculation for July 1, 1977.

HES sent another letter dated May 5, 1980 in which it removed $41,418 of management cost for the rate calculations for July 1, 1979 and 1980.

As the Division observed there was no real showing that Mrs. Pizzi performed any genuine function within the nursing home and, indeed, the fees which are denominated as management fees did not relate to managerial activities which she performed.

Testifying on behalf of petitioner, John Mitros, its accountant, testified that he recalled participating in a conference sponsored by HES in which HES allowed payments such as those made to Mrs. Pizzi to be characterized as management expenses. Mitros recollected that the State's position on this was articulated in a seminar, but neither Mitros nor the petitioner was able to reduce the State's position to a written document.

Based on the foregoing, I make the following:

**FINDINGS OF FACT**

1. Cranford Hall had included in its Cost Study Reports expenses for management in the amount of $14,040 for the year ending

2. HES allowed such cost in each year and included it in the rate calculations for Cranford Hall for the periods beginning July 1, 1977, July 1, 1978 and July 1, 1970.

3. Mrs. Pizzi was not actively engaged in the activities of the home.

4. The subject of this specific expense was addressed in a Level I appeal and was allowed as an expense not subject to fringing.

5. Management expense was not an issue in any pending appeal, when, on May 5, 1980, HES sent Cranford Hall notices that it was eliminating the reported management expense from all rate calculations going back to January 1, 1978.

As to the petitioner’s contention that the so-called management fees were allowed by State policy, the only foundation for such a conclusion is the uncorroborated hearsay on the part of Mr. Mitros. Without questioning into the accuracy or inaccuracy of the details of Mr. Mitros’ recollection, suffice to say that N.J.S.A. 52:14-B10 requires that all findings in a proceeding before the Office of Administrative Law be based upon evidence which is, among other characteristics, competent. The petitioner’s proffer fails in this regard.

It is true that the disallowance of these expenditures occurred after January 1, 1980, the point at which N.J.A.C. 10:63-3.5(b)(2)(iii) was adopted. Nevertheless, it is the burden of the petitioner to prove that the expenditures appropriately fit at any time under the rate review system. At a minimum, the federal statute requires that reimbursement be reasonably cost-related and, while it is clear that Cranford Hall Nursing Home, Inc. disbursed monies to Mrs. Pizzi, there is not the slightest indication that these disbursements were a cost of doing business. Furthermore, petitioner has failed to establish any clause under the CARE Guidelines allowing the disbursements to Mrs. Pizzi as a cost or an expense related to the conduct of the nursing home activities. For that reason, I CONCLUDE that the disapproval of the expenditures was proper. Petitioner argues that the State was heavy-handed in requiring a recoupment against current payments in one year. Nevertheless, as I read petitioner’s position in this matter, it does not seek to schedule the recoupment and, as a practical matter, at the close of 1982, it would appear that the recoupment had already taken place. Since no foundation for the allowance of these disbursements as cost was established, I ORDER that the disallowance of the so-called management fees be approved and I ORDER that relief be denied.
FINAL DECISION BY THE DIRECTOR OF THE DIVISION OF MEDICAL ASSISTANCE AND HEALTH SERVICES, THOMAS M. RUSSO:

The Director, Division of Medical Assistance and Health Services has reviewed and considered the entire record in this matter, including the initial decision of the Honorable Walter F. Sullivan, and the exceptions thereto filed on behalf of the petitioner by Raymond T. Lyons, Jr., Esquire.

The Director notes that no exceptions were filed on behalf of the agency.

Based upon its full review of the record, the Director affirms the decision of the administrative law judge and hereby adopts the findings and conclusions of the administrative law judge in their entirety and incorporates the same herein by reference.

The Director further finds that although the petitioner's exceptions were thorough and well written, they do not warrant modifying the judge's recommended decision in order to grant the requested relief.

Furthermore, the Director notes that the judge properly interpreted and applied the CARE Guidelines and Manual.

THEREFORE, it is on this 24th day of November, 1982, ORDERED,

That the petitioner's request for recognition of the administrator's compensation in excess of the allowable screened amount is hereby DENIED; and

IT IS FURTHER ORDERED:

That the petitioner's request for recognition of certain management fees paid to Anna P. Pizzi during the period from January 1, 1978 through January 1, 1980 is hereby DENIED.

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.