

Commonwealth Of Kentucky

Court of Appeals

NO. 2004-CA-001528-MR

PATHWAYS, INC.

APPELLANT

v. APPEAL FROM FRANKLIN CIRCUIT COURT
HONORABLE ROGER L. CRITTENDEN, JUDGE
ACTION NO. 02-CI-01363

COMMONWEALTH OF KENTUCKY, CABINET
FOR HEALTH AND FAMILY SERVICES

APPELLEE

OPINION
AFFIRMING

** ** * * *

BEFORE: MINTON, SCHRODER, AND TAYLOR, JUDGES.

TAYLOR, JUDGE: Pathways, Inc. (Pathways) brings this appeal from a June 30, 2004, Order and Opinion of the Franklin Circuit Court affirming a decision of the Commonwealth of Kentucky, Cabinet for Health and Family Services (Cabinet) to disallow Medicaid reimbursement of \$134,192.00. We affirm.

The circuit court has succinctly set forth the facts of this case as follows:

Pathways, Inc. is a not for profit Community Mental Health Center ("CMHC") located in Ashland, Kentucky. It was

established pursuant to KRS 210.370 through KRS 210.460 to provide regional, community based mental health care. Medicaid reimbursement services constitute forty to fifty percent of Pathways' income. After providing services to Medicaid beneficiaries, Pathways is reimbursed by the Cabinet based upon actual, reasonable and allowable costs recorded in costs reports.

Between 1997 and 1999, the Cabinet for Health Services began to explore a new Medicaid reimbursement system for mental health and mental retardation services. The Cabinet desired to implement a managed care model of Medicaid reimbursement. The Cabinet applied for and was granted a Section 1915(b) waiver from the federal government. The waiver allowed the Cabinet to offer behavioral health care services to Medicaid beneficiaries through Managed Behavioral Healthcare Organizations ("MBHO"). On November 19, 1997, the Cabinet promulgated 907 KAR 1:710, the Managed Behavioral Health Care Initiative. The regulation states that "[i]n order to maintain the existing community-based programs which provide behavioral health services to citizens of Kentucky, the department shall initiate a contract with an MBHO by a coalition in accordance with the requirements [of this regulation and applicable statutes]." (brackets added).

The MBHO initiative required each region to include [sic] at least one CMHC, and one or more acute care hospitals. While each MBHO had to possess at least one CMHC, the initiative did not require each of Kentucky's fourteen CMHCs to participate. Pathways considered its participation in the MBHO initiative essential for its continued existence since it risked losing forty to fifty percent of its income from the loss of Medicaid reimbursements.

The Cabinet's managed care initiative ultimately failed. Public and private healthcare providers were unable to reach an agreement on critical issues during the preliminary negotiations. Pathways now seeks costs expended by its employees during the time spent negotiating the managed care initiative. These costs include salaries, employee fringe benefits, travel and vehicle expenses documented in a June 30, 1999, FYE cost report. The Cabinet's Department of Medicaid Services denied Medicaid reimbursement because the expenses were unrelated to patient care. Pathways appealed the denial to the Secretary.

During the administrative appeal, the Hearing Officer indicated that were the initiative successful, the contracts would have included a mechanism to recapture Pathways' costs. However, since the managed care initiative failed, no existing mechanism allowed for reimbursement. The Hearing Officer determined, and the Secretary agreed, that Pathways' claim for reimbursement failed because the costs were not direct or indirect costs related to the treatment of Medicaid beneficiaries. CMHC Reimbursement Manual Section 217.

The circuit court ultimately agreed with the Cabinet that Pathways' claimed costs of \$134,192.00 expended in an attempt to bring the Managed Behavioral Healthcare Organizations (MBHO) initiative to fruition was not reimbursable. This appeal follows.

Appellant contends the circuit court committed reversible error by affirming the Cabinet's denial of the \$134,192.00 contained in its June 30, 1999, cost report. When reviewing an administrative agency's decision, we step into the

shoes of the circuit court and review the agency's decision for arbitrariness. American Beauty Homes Corp. v. Louisville and Jefferson Co. Planning and Zoning, 379 S.W.2d 450 (Ky. 1964). Arbitrariness has many facets, but material to this appeal is whether the Cabinet's decision was based upon substantial evidence of a probative value. Pathways believes the Cabinet's decision was not based upon substantial evidence; however, we disagree.

Relevant to this appeal is Section 217 of the Community Mental Health Center (CMHC) Reimbursement Manual, which provides:

217. COST RELATED TO PATIENT SERVICES:

- (A) Principle. All payments to providers of services shall be based on the reasonable allowable cost of covered services under the programs and related to the treatment of beneficiaries. Reasonable allowable cost shall include all necessary and proper costs incurred in rendering the services, subject to principles which relate to specific items of revenue and cost. However, as provided in Section 219 of this manual, payments to providers of services shall be based on the lesser of the reasonable allowable cost of covered services furnished to program beneficiaries or the customary charges to the general public for these services.
- (B) Definitions
 - (1) Reasonable Allowable Cost.
Reasonable allowable cost of any

services shall be determined in accordance with the principles of reimbursement establishing the method or methods to be used and the items to be included. These principles consider both direct and indirect costs of providers of services. The costs with respect to individuals covered by a CHR program shall not be borne by individuals not so covered, and the costs with respect to individuals not so covered shall not be borne by CHR.

(2) Necessary and Proper Costs. Necessary and proper costs shall be costs which are appropriate in developing and maintaining the operation of patient treatment facilities and activities. They shall be costs which are common and accepted occurrences in the field of the provider's activity.

(C) Application. The determination of reasonable allowable cost of services shall be based on cost related to the treatment of beneficiaries under the program. Reasonable allowable costs, both direct and indirect, shall include all necessary and proper expenses incurred in rendering services, such as administrative costs, facility maintenance costs, and premium payments for employee health and pension plans. However, where the provider's operating cost include amounts not related to patient services, specifically not reimbursable under the program, or flowing from the provision of luxury items or services (that is, those items or services substantially in excess of or more expensive than those generally considered necessary for the provision of needed services), the amounts shall not be allowable. The provider may

require clarification of whether a particular cost item may be allowable and may request the advisement of the Cabinet. Upon receipt of all pertinent data regarding the item in question, the Cabinet shall take the matter under consideration and issue a response binding upon the provider and the Cabinet. (Emphasis added.)

Section 209 of the Manual defines direct and indirect costs:

- (1) "Direct Costs" means those costs that can be identified specifically with and charged in whole or in part to a particular project, service, program or activity of an organization.
- (2) "Indirect Costs" means those costs or an organization which are not specifically identified with a particular project, service, program, or activity but nevertheless are necessary to the general operation of the organization and the conduct of the activities it performs.

Pathways argues that its expenditures related to the failed implementation of the MBHO initiative were reimbursable under Section 217 as: (1) necessary for the implementation of 907 KAR 1:710 (the MBHO initiative); (2) related to the development and maintenance of patient treatment activities and facilities; and (3) necessary for the general operation of current patient treatment facilities and continued treatment of Medicaid patients in the region.

Under Section 217, any costs recoverable must be related to the treatment of patients. Both direct and indirect costs are reimbursable expenses only when such are necessarily and properly incurred in rendering services. We believe that costs incurred by Pathways related to the failed MBHO initiative cannot be related to patient care because the initiative was never implemented. It is undisputed that Pathways never provided care to its patients under the provisions of the initiative. As the MBHO initiative was never implemented, Pathways may not recover costs related to the upkeep or development of facilities as no facilities can be maintained or developed under an initiative that was never implemented and never accepted patients.

Pathways also maintains that it was mandated by the legislature to participate in the MBHO initiative; thus, the costs associated with its participation should be reimbursed. As pointed out by the circuit court, Pathways was not mandated to participate in the initiative. Rather, Pathways' participation in the initiative was spawned from a sense of self-preservation.

Pathways also argues that by denying reimbursement for these costs, the Cabinet has impermissibly shifted these costs to non-Medicaid patients. The Cabinet claims that such a cost-shift is not permitted under 42 U.S.C. § 1395x (v)(1)(A). The

Cabinet, however, has not directed that these costs be placed upon non-Medicaid patients. Instead, Pathways has elected to defray the cost ostensibly by raising costs to non-Medicaid patients; that was Pathways' voluntary decision. Upon the record as a whole, we are simply unable to conclude that Pathways' expenses related to implementing the failed MBHO initiative were reimbursable.¹ Thus, the Cabinet correctly disallowed same.

We view Pathways' remaining contentions as moot or without merit.

For the foregoing reasons, the Order and Opinion of the Franklin Circuit Court is affirmed.

ALL CONCUR.

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¹ We observe that this Court ordered supplemental briefs upon the issue of whether an audit or desk review of the cost report was performed by the Commonwealth of Kentucky, Cabinet for Health and Family Services (Cabinet). Upon a review of these supplemental briefs and the record, it is clear that this issue was not brought before the Cabinet. As such, we will not reach the merits of this issue as it was not properly preserved for our review.