



CON Cost Allocation Issue Determined in May 30, 2008 Final Agency Decision, but Remains Subject to Appeal

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A final agency decision issued May 30, 2008 by the new acting director of the North Carolina Department of Health and Human Services, Division of Facility Services ("DFS") held that certain construction costs born by unrelated third parties should not be included in cost thresholds in determining whether a Certificate of Need ("CON") is required for certain projects. *Mission Hospitals, Inc. et al v. N.C. D.H.H.S., et al., 05 DHR 1369* (Final Agency Decision May 30, 2008). This new final agency decision departs from a previously issued final agency decision in the same case. *Mission Hospitals, Inc. et al v. N.C. D.H.H.S., et al., 05 DHR 1369* (Final Agency Decision 7 August 2006).

This case originated from the issuance of a "no-review" determination granted to Asheville Hematology by the CON Section in February 2005, which permitted Asheville Hematology to relocate and expand an existing medical oncology treatment center and acquire a linear accelerator, CT scanner/ simulator, and treatment planning software and equipment without obtaining a CON. Competing health service providers Mission Hospitals, Inc. and 21st Century Oncology appealed the no-review determination, contending that the costs of the proposed project exceeded the thresholds that require Asheville Hematology to obtain a CON. The director of DFS at that time, Robert Fitzgerald, agreed and reversed the CON Section's no-review determination in a final agency decision issued August 7, 2006. Mr. Fitzgerald's decision forbade Asheville Hematology from undertaking the relocation/expansion or the acquisition of the proposed equipment until it first applied for and obtained a CON. Asheville Hematology appealed to the Court of Appeals, which on March 18, 2008 reversed the final agency decision on procedural grounds and sent the case back to the director of DFS for the issuance of a new final agency decision. On May 30, 2008, a new final agency decision was issued by new acting director of DFS Jeff Horton, and the new final agency decision upheld the initial no-review determination made by the CON Section and permitted Asheville Hematology to proceed without obtaining a CON.

Costs for building construction and up-fit.

The May 30, 2008 final agency decision held that the relocation and expansion of the oncology center by Asheville Hematology did not require a CON because total project costs were below the

threshold of \$2 million dollars, and thus the proposed center was not a "new institutional health service" requiring a CON under G.S. 131E-176(16)b. In calculating total project costs, the final agency decision determined that the developer's base costs for constructing the building should not be included as part of the total project costs. If the builder is unrelated to the entity which will be providing the health service and is leasing space to the health service, the CON Section will only look at the actual costs incurred to specifically upfit or transform the office building into a health service facility. However, if a builder is a party related to the provider of the health service, the CON Section considers the builder to be developing the health service facility, and therefore the entire cost of the facility would be considered when determining total project costs.

The final agency decision further held that none of the equipment acquisitions constituted "major medical equipment" pursuant to G.S. 131E-176(14f), since the costs associated with each piece of equipment should be treated separately, and the costs for each piece of equipment were below the applicable \$750,000 cost threshold.

The CON law seeks to control capital expenditures for health services and facilities. Therefore, the final agency decision is more consistent with the purpose of CON law than Mr. Fitzgerald's previous final agency decision. Costs for construction of space leased in existing buildings or in buildings that are not specific to medical uses and which costs are borne by unrelated third parties should not count towards cost thresholds for purposes of obtaining a CON.

It is important to note that the final agency decision has been appealed and ultimately could be reversed by the Court of Appeals. Unless the Court of Appeals rules otherwise, the CON Section is expected to follow the final agency decision and will likely exclude these unrelated construction costs when calculating cost thresholds for determining whether a CON is required. Any decision by the Court of Appeals will likely not be issued in 2008. Entities proposing new health services should therefore carefully analyze and consider all project costs, including construction costs, before going forward.

Related People

- Jennifer A. Morgan – 919.981.4051 – jmorgan@williamsmullen.com

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