

**STATE OF NEW YORK  
DEPARTMENT OF HEALTH**

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In the Matter of the Appeal of	:	
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<b>Sprain Brook Manor Rehab, LLC</b>	:	<b>Decision After</b>
	:	<b>Hearing</b>
	:	
from a determination to recover Medicaid Program	:	<b>Audit Number: 17-5242</b>
overpayments.	:	
	:	

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Before: Natalie J. Bordeaux  
Administrative Law Judge

Held via: Cisco WebEx Videoconference

Hearing Date: November 4, 2021  
The record closed March 4, 2022

Parties: New York State Office of the Medicaid Inspector General  
800 North Pearl Street  
Albany, New York 12204  
By: Ferlande Milord, Esq.

Sprain Brook Manor Rehab, LLC  
77 Jackson Avenue  
Scarsdale, New York 10583  
By: David Ross, Esq.  
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54 State Street, 9<sup>th</sup> Floor  
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## **JURISDICTION**

The New York State Department of Health (Department) acts as the single state agency to supervise the administration of the Medical Assistance (Medicaid) Program in New York. PHL § 201(1)(v); SSL § 363-a. The New York State Office of the Medicaid Inspector General (OMIG), an independent office within the Department, is authorized to investigate and pursue civil and administrative enforcement actions to recover improperly expended Medicaid funds. PHL §§ 31-32. The OMIG determined to recover Medicaid Program overpayments from Sprain Brook Manor Rehab, LLC (Appellant) for the rate period January 1, 2013 through December 31, 2016. The Appellant requested a hearing pursuant to Department of Social Services (DSS) regulations at 18 NYCRR § 519.4 to review the OMIG's determination.

## **HEARING RECORD**

OMIG witnesses: Babu Jacob, Chief Medical Facilities Auditor

OMIG exhibits: 1 – 10, 10a, 17-19, 19a, 19b, 24, 25, 25a, 26, 26a, 26b, 27-29, 29a, 30-37

Appellant witnesses: Kathleen Angelone, Health Care Financial Consultant, Bonadio Group  
Akiva Fried, Administrator

Appellant exhibits: A-JJ

A transcript of the hearing was made. (T 1-160.) Each party submitted two post-hearing briefs.

## **FINDINGS OF FACT**

1. At all times relevant hereto, the Appellant was a residential health care facility (RHCF) in Westchester, licensed under Article 28 of the Public Health Law, and enrolled as a Medicaid provider. (Exhibits 1 and 3.)

2. The Appellant receives a daily rate for each Medicaid recipient occupying a bed in its facility. (Exhibits 1 and 3.)

3. Auditors from the OMIG reviewed the capital portion of the Appellant's Report of Residential Health Care Facility (RHCF-4) cost reports submitted annually for the 2011-2014 calendar years. These RHCF-4 cost reports were used to determine the capital portion of the Appellant's daily rate from the Medicaid Program for the period January 1, 2013 through December 31, 2016. (Exhibits 1 and 3.)

4. On June 26, 2019, the OMIG issued a draft audit report which identified seven categories of disallowances for claimed property expenses and proposed to recover an estimated Medicaid overpayment of \$260,741. The draft audit report advised the Appellant, pursuant to 18 NYCRR § 517.5, that it was entitled to submit objections to the proposed action, which objections were required to include any additional material or documentation that the Appellant wished to be considered. (Exhibit 1.)

5. On August 5, 2019, the Appellant submitted its objections to the draft audit report. (Exhibit 2.)

6. On October 2, 2019, the OMIG issued a final audit report, which advised the Appellant that, after review of the Appellant's objections and supporting documentation, the OMIG had adjusted its findings and determined to reduce the overpayments to \$241,174. (Exhibit 3.)

7. On October 29, 2019, the Appellant requested this hearing to review the findings set forth in the final audit report. (Exhibit 4.)

8. The parties having resolved all other findings in the final audit report, the only audit determinations remaining for resolution in this hearing decision are:

Property Expense Disallowance 1a: Insurance premiums for business income insurance  
Property Expense Disallowance 3b: Laundry and linen service expenses  
Property Expense Disallowance 4: State sales tax on utilities in excess of the allowable residential rate. (Exhibit 3; T 7-8.)

## **ISSUES**

Was the OMIG's determination to disallow premiums for business income (interruption) insurance as a property expense correct?

Was the OMIG's determination to disallow laundry and linen services as a property expense correct?

Was the OMIG's determination to disallow state sales tax paid for utilities in excess of the allowable residential tax rate correct?

## **APPLICABLE LAW**

Residential health care facilities (also referred to as nursing homes in other applicable state regulations) are eligible for payment of a Medicaid daily rate billable for resident beds occupied by Medicaid recipients. 10 NYCRR § 86-2.10. The Department's Bureau of Long-Term Care Reimbursement sets rates for each residential health care facility by using the information that the facility submits annually in a cost report (form RHCF-4). 10 NYCRR § 86-2.2. A facility's basic rate is comprised of four separate and distinct cost components: (a) direct; (b) indirect; (c) noncomparable; and (d) capital. 10 NYCRR § 86-2.10(b)(1)(ii). The capital component of the rate is facility-specific, and includes depreciation, leases and rentals, interest on capital debt, and the costs of major moveable equipment. 10 NYCRR §§ 86-2.10(a)(9)&(g), § 86-2.19, § 86-2.20, § 86-2.21 and § 86-2.22.

Except as otherwise provided in 10 NYCRR Subpart 86-2, allowable costs shall be determined by the application of the principles of reimbursement developed for determining payments under title XVIII of the Federal Social Security Act (Medicare) Program. 10 NYCRR § 86-2.17(a). The Provider Reimbursement Manual (PRM-1) prepared by the Centers for Medicare and Medicaid Services (CMS) offers detailed explanations regarding provider costs deemed allowable under the Medicare Program.

A facility's rate of payment is provisional and subject to audit. The Department may adjust a payment rate retroactively if an audit determines that costs were inaccurately or improperly reported or are otherwise not includible in the Medicaid rate. SSL § 368-c; 10 NYCRR § 86-2.7; 18 NYCRR § 517.3. Upon completion of an audit, the Department may require the repayment of any amounts not authorized to be paid by the Medicaid Program. 18 NYCRR § 518.1.

A Medicaid provider is entitled to a hearing to review the OMIG's final determination to require repayment of any overpayment. 18 NYCRR § 519.4. The Appellant has the burden of establishing that the OMIG's determination was incorrect and that all costs claimed were allowable. 18 NYCRR § 519.18(d).

### **DISCUSSION**

At the hearing, the OMIG presented the audit file and summarized the case, as required by 18 NYCRR § 519.17. The Appellant is contesting disallowances of three types of expenditures included in its 2011-2014 cost reports as property expenses.

Property Expense Disallowance 1a: Insurance premiums for business income insurance.

In its cost reports for the 2011-2014 calendar years, the Appellant included the cost of premiums for business income (also referred to as business interruption) insurance in its reported costs for property insurance premiums. Finding that such insurance is unrelated to the loss or damage of physical property, the OMIG determined that these premiums may only be considered in the operating component of the facility rate. (Exhibits 1 and 3; T 42-47.)

The Appellant disagrees with this finding, arguing that business income insurance premiums should be considered a property expense because the coverage provided stems from damage to property. (Exhibit 2; Appellant's 2/3/21 Brief, pp. 25-26.) Its insurance policy

specifically advises that it covers actual loss of business income when business operations are suspended due to direct, physical loss to property. (Exhibit 10a.)

The Appellant contends that PRM-1 § 2806.2(d) establishes that business income insurance is reimbursable as a capitalized expenditure. This contention significantly distorts PRM-1 § 2806.2(d), which provides that general liability insurance and any other form of insurance to provide protection other than for the replacement of depreciable assets or to pay capital-related costs in the case of business interruption are explicitly excluded from capital-related costs.

The Appellant's argument relies on an unwarranted presumption, without any supporting documentation, that pay-outs from its policy would be used to pay capital-related costs in the event of business interruption. As explained in PRM-1 § 2806.1(F), if an insurance policy provides protection to pay capital-related costs in the case of business interruption, only that portion of the premium(s) to pay capital related costs in the case of business interruption is includable in capital-related costs. The Appellant's business income insurance makes no provision for reimbursement of capital-related costs. Instead, as previously noted, the Appellant's insurance coverage expressly states that reimbursement is only for actual loss of business income, and not what the Appellant might elect to utilize those insurance proceeds for.

The Appellant correctly points out that PRM-1 § 2161(A)(3) permits reimbursement for business income (interruption) insurance. (Appellant's 2/3/21 Brief, pp. 28-29.) However, that provision does not authorize reimbursement of such expenses as capital-related costs. As explained in PRM-1 § 2806.2(d), business interruption or similar insurance may only be considered for reimbursement in the operating component of the rate.

The Appellant's position is incompatible with the reimbursement principles set forth in the PRM-1. As such, the OMIG's determination to disallow the Appellant's business income insurance premiums as a property cost is sustained.

Property Expense Disallowance 3b: Laundry and linen services.

Residential health care facilities are required to include all expenses associated with picking up, sorting, distributing, mending, washing, and processing in-service linens, as well as linen purchases, purchased laundry services and the cost of disposable linen in the "Laundry and Linen Services" functional reporting cost center 09. 10 NYCRR § 455.9. The Appellant reported laundry and linen expenses in the laundry and services cost center as operating expenses for the calendar years 2011 and 2014, while also reporting linen rentals as property expenses in the same cost reports. (Exhibits 1-3, 29, 29(a); T 56-57.)

During the audit, the Appellant submitted invoices from two laundry and linen services companies utilized during the 2011-2014 calendar years, along with its "Linen Service Agreement" with Clean-Tex Services, Inc., effective April 1, 2014 (Exhibits 19(a), 19(b)). The Linen Service Agreement explicitly stated that payment by the Appellant to the vendor was premised upon the provision of laundry services, including delivery and pickup, with linen remaining the property of Clean-Tex. The amount payable by the Appellant was based upon unit rates for laundry items, with linen bulk justifying pricing changes. (Exhibit 19(a); OMIG's 3/4/22 Reply Brief, pp. 2-3.)

The OMIG determined to disallow the reported costs on the grounds that they were incurred for laundry and linen services and were therefore operating expenses. (Exhibit 3.) The Appellant contends that the reported costs were properly included in the property component of its rate as rented moveable equipment subject to capitalization (expensing the costs associated

with attaining an asset over the asset's life, rather than the period in which the expense is incurred) due to the large volume utilized which, in the aggregate, exceeded a value of \$500. (Appellant's 2/3/22 Post-Hearing Brief, p.18.)

The Appellant argues that the capitalization of laundry and linen expenses is not explicitly prohibited by 10 NYCRR § 455.9, the only regulatory provision offering specific detail regarding laundry and linen services, linen purchases, and the cost of disposable linen. (T 71-72; Appellant's 3/4/22 Reply Brief, pp. 10-11.) That provision, however, also does not authorize the Appellant's election to classify these expenditures as capital costs, and the RHCF-4 manual characterizes linens as supplies for which capitalization is not appropriate. (T 50, 73.)

The reimbursement guidelines set forth in the PRM-1 also fail to support the Appellant's attempt to characterize its laundry and linen services as a capital expense. PRM-1 § 2806.1 describes costs that may be reported as capital-related costs. While lease and rental payments for the use of assets that would be depreciable if owned outright are includable in capital-related costs, a distinction is made between the lease of equipment (a capital-related cost) and the purchase of services (an operating cost). Noting that each agreement must be reviewed on its own merits, the PRM-1 offers factors to consider in categorizing costs. For example, if the underlying agreement is memorialized in one document that is labeled a "Service Agreement," that agreement would suggest a purchase of services. Other factors to consider in determining whether the agreement was an equipment rental rather than a service agreement include whether the basis for determining payment is units of time rather than volume, and whether a provider's access to the equipment is not subject to interruption without notice or on very short notice. Cleaning services are explicitly excluded from capital-related costs. PRM-1 § 2806.2.



While, as the Appellant noted, the invoices from Clean-Tex Services, Inc. and another vendor, Superior Linen Services (for which no agreement was provided), itemized charges by category, such as gowns, sheets, etc. (Appellant's 3/4/22 Brief, p. 13), the Appellant paid processing charges by the number of pieces of laundry. (Exhibit 19(b).) As evidenced by the word "services" in the names of both vendors, the purpose of their business interactions with the Appellant were primarily service-oriented. These costs were incurred for processing or laundering soiled linens and replacing them with fresh linens.

The Appellant contends that its decision to capitalize linens received from the laundry and linen services vendors is supported by generally accepted accounting principles (GAAP). (Appellant's 3/4/22 Reply Brief, pp. 14-16.) However, as PRM-1 § 2806.1(C) explains, the distinction between an operating lease and a capital lease, as those terms are defined for purposes of GAAP, is not relevant to the inclusion of lease costs in capital-related costs.

The Appellant cites PRM-1 § 2806.3(B), entitled "Supplying Organization Not Related to the Provider", which provides, in pertinent part:

...where a provider leases or rents facilities or equipment that would be depreciable if the provider owned them outright, in conjunction with obtaining a service...from an unrelated supplier, the capital-related portion of the supplier's charge may be included in the provider's capital-related costs only if: (1) the capital-related facilities or equipment are leased or rented by the provider (that is, the provider has the possession, use and enjoyment of the facilities or equipment), (2) the capital-related equipment is located on the provider's premises, and (3) the capital-related portion of the charge is separately specified in the charge to the provider. All three of the foregoing criteria must be met for a provider to include the capital-related portion of the supplier's charge in the provider's capital-related costs. [Exhibit 32.)

The Appellant argues that the reported expenses meet the requirements in PRM-1 § 2806.3(B) because it "maintained the possession, use, and enjoyment of the linens while they resided" at the facility, and the CleanTex Services, Inc. Linen Service Agreement assigns

specific charges by category, thus establishing, according to the Appellant, that payment was driven by the rental of linens rather than laundry services. (Appellant's 2/3/22 Post-Hearing Brief, pp. 19-21; Appellant's 3/4/22 Reply Brief, pp. 11-13.) This argument requires the acceptance of the premise that the agreements and reported expenses were based mainly upon the rental of linens rather than the laundering of those items and that those linens are capital-related costs, neither of which is supported by the record.

Even if the Appellant had established that its use of linens incidental to a laundry services agreement could be properly capitalized, the Linen Services Agreement did not allocate charges between the Appellant's use of linen and the laundry services that the vendor provided, as required in PRM-1 § 2806.3(B) quoted above. The Appellant's classification of these expenditures was therefore improper regardless of whether its premise regarding the capitalization of costs for rented linens is accepted.

The objective of the laundry and linen services agreement and corresponding business arrangements was to ensure that the vendors removed soiled linens from the Appellant's premises and replenished clean linens. The vendors did not allocate charges between the cleaning and provision of fresh linens and a rental of linens because the vendors held themselves out as, and contracted to provide, laundering services. Payments made for those services were not related to property or capital. The laundry services vendors removed soiled linens, charged the Appellant for the cost of laundering those items, and provided cleaned linens. (T 146-48.) The cleaned linens were fungible. The Appellant did not rent specific linens and had no way of knowing whether items were used only by its facility (T 147), information which, for its needs, was irrelevant.

No applicable regulation, the RHCF-4 form, or any portion of the PRM-1, justifies the Appellant's capitalizing of rented linens it obtained and used incidental to a laundry services agreement. The OMIG's determination to disallow the reported costs for laundry and linen services as a capital expense is upheld.

Property Expense Disallowance 4: State sales tax on utilities in excess of the allowable residential rate.

In its 2013 and 2014 cost reports, the Appellant's reported sales tax expense included state sales tax on utilities. The OMIG disallowed the portion of reported sales tax expenses for utilities in the amount that exceeded the local sales tax. This resulted in a decrease in allowable sales tax on utilities from 6.35% to 3%. (Exhibit 3; T 60.)

Generally, taxes assessed against a residential health care facility for which the provider is liable for payment are allowable costs to the extent that they are actually incurred and related to the care of beneficiaries. PRM-1 § 2122.1. However, taxes for which exemptions are available to the provider are not allowable costs. PRM-1 § 2122.2(D).

Residential health care facilities are exempt from payment of state sales tax on utilities. NY Tax Law § 1105-A; New York State Department of Taxation and Finance Taxpayer Services Division, Technical Services Bureau, Advisory Opinion TSB-A-90(60)S.

The Appellant acknowledges that an exemption to the reported state sales tax on utilities existed in these cost years. However, it contends that, since it paid the state utility sales tax, the costs should be allowed on the basis of equity. (Exhibit 2; T 120.) The Appellant asserts that it paid the tax when it was unaware of the exemption and should not be penalized by having to pay the same tax twice. (Appellant's 2/3/21 Brief, pp. 29-30.) The Appellant's witness, Kathleen Angelone, attempted to blame the utility company by claiming that it should have known that the

Appellant was exempt from state sales tax. (T 118.) It is the Appellant's responsibility to avail itself of any available exemptions. By failing to do so, it incurred and reported costs for which an exemption was available. These costs are not allowable because they were not properly chargeable to necessary patient care. 10 NYCRR § 86-2.17. The disallowance is upheld.

### **DECISION**

The OMIG's determination to disallow premiums for business income (interruption) insurance as a property expense was correct and is affirmed.

The OMIG's determination to disallow laundry and linen services as a property expense was correct and is affirmed.

The OMIG's determination to disallow state sales tax paid for utilities in excess of the allowable residential tax rate was correct and is affirmed.

DATED: April 5, 2022  
Menands, New York

\_\_\_\_\_/s/\_\_\_\_\_  
Natalie J. Bordeaux  
Administrative Law Judge