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State of Washington

No. 340651
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Consolidated

COURT OF APPEALS, DIVISION III
OF THE STATE OF WASHINGTON

KADLEC REGIONAL MEDICAL CENTER,
a Washington nonprofit corporation,

Appellant,

v.

WASHINGTON STATE DEPARTMENT OF HEALTH,

Respondent.

REPLY BRIEF OF KADLEC REGIONAL MEDICAL CENTER

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I. INTRODUCTION

The Department fails to identify any evidence supporting its determination that the OFM medium population projection was more accurate for Benton and Franklin Counties than the OFM high population projection. It instead argues that the OFM medium projection always must be used, irrespective of geography, which contradicts the Department's own standard that the "most accurate" of OFM's three projections must be used.

The Department similarly fails to identify substantial evidence supporting its determination that Kadlec's expansion is not a "major" project warranting a planning horizon longer than seven years. The only evidence the Department cites is that Kadlec proposes a hospital expansion rather than a new hospital, but this ignores all of the other evidence—in particular the size (114 beds; 100,000 square feet) and cost ($75 million) of Kadlec's project. Indeed, Kadlec's proposed expansion is larger, and just as expensive, as at least two other hospital expansions for which the Department used 10-year planning horizons.

These determinations simply are not supported by substantial evidence. The Court should set aside the Department's denial of Kadlec's

114-bed expansion request and remand to the Department to issue a CN to Kadlec for 59 more beds, in addition to the 55 already approved.[1]

II. ARGUMENT

A. OFM's high population projection was more accurate for Benton and Franklin Counties than OFM's medium population projection.

The Department agrees that it is required to use the "most accurate" population projection to forecast need. *See* Department of Health's Brief in Opposition to Petitions for Judicial Review ("Dept. Br.") at 11. The issue before the Court is whether there is "evidence that is substantial when viewed in light of the whole record before the court" supporting the Department's determination that the OFM medium projection was "more accurate" than the OFM high projection for Benton and Franklin Counties. RCW 34.05.570(3)(e).

The Department argues that the issue is whether its use of the medium projection was arbitrary and capricious, as opposed to whether it was supported by substantial evidence. *See* Dept. Br. at 20, n.11. But the APA provides that an agency order in an adjudicative proceeding may be reversed on *either* ground, *see* RCW 34.05.570(3)(e) & (i), and Kadlec seeks review of the Department's decision on both grounds. *See* Opening

[1] Kadlec will use the same defined terms in this reply brief that it used in its opening brief.

Brief of Kadlec Regional Medical Center ("Kadlec Op. Br.") at 3-4. The Department fails to identify substantial evidence supporting its determination that the OFM medium projection was more accurate than the OFM high projection because the record does not contain such evidence.

1. The issue is which population projection was more accurate as a factual matter, not what OFM should have done in principle.

The Department argues that because RCW 43.62.035 directs OFM to set, as the medium projection, "the most likely population projection," the medium projection is, ipso facto, the most accurate projection and always must be used. *See* Dept. Br. at 11. The Department's argument is flawed, for two reasons.

First, if the medium projection always is the most accurate and thus always must be used, the language in the Department Methodology directing the Department to use the "most accurate" of the OFM projections would be superfluous. If the medium projection *always* must be used, the Department Methodology would simply direct the Department to use the medium population projection, rather than the "most accurate" of the OFM projections.

Second, just because OFM's medium projection is *supposed* to be the most likely does not mean that OFM has performed its work correctly

and that the medium projection for a planning area actually *is* the most accurate. A perfect example of this would be the previous projections prepared for Benton and Franklin Counties by OFM. It is undisputed that OFM's 2002 high projection was more accurate than OFM's 2002 medium projection for this region. Therefore, the Department should have used OFM's high projection for Kadlec's previous CN application just as it should have used it for Kadlec's current CN application.

The issue is which of OFM's three projections is most accurate for Benton and Franklin Counties, not what OFM is supposed to do under RCW Chapter 43.62. If the high projection is the most accurate, the Department erred by using the medium projection.

2. OFM did not correct the flaws in its 2002 projections for Benton and Franklin Counties when preparing its 2007 projections.

The Department argues that OFM corrected the flaws in its 2002 population projections for its 2007 projections. *See* Dept. Br. at 14. However, OFM merely increased the starting point of the projection; it did not correct the population growth rate assumption, which historically has caused OFM to under-project population growth in this region. AR 2757. OFM's 2007 projections are based on the same flawed growth assumptions and failure to take into account local conditions that

historically have resulted in the high forecast being most accurate for this area. AR 2757.

The fundamental problem with OFM's medium projections is that they are based on the state's population growth rate, which is considerably lower than the growth rate in Benton and Franklin Counties. AR 4721 and 4735. From 1990-2009, the planning area has grown at an average annual rate of 2.5 percent. AR 2758. OFM's 2007 medium projection uses a growth rate of 1.3 percent. AR 4350. OFM's 2007 high projection uses a growth rate of 2.3 percent. AR 4735. Therefore, both the medium and high projections assumed growth rates lower than the historical planning-area growth rate of 2.5 percent, but the high projection is much closer—and thereby more accurate.

3. OFM did not take a position on whether the high or medium population projection was most accurate for Benton and Franklin Counties.

As discussed in Kadlec's opening brief, OFM did not take a position on whether the high or medium projection was more accurate for Benton and Franklin Counties. OFM's memorandum addressing this issue is in the record. AR 3864. If OFM believed its medium projection actually was more accurate for Benton and Franklin Counties, it would have said so. It did not. Instead, OFM advised the Department to make up its own mind "based on local needs and any unique information they may

possess." AR 3864. OFM did not defend its medium projection as the "most accurate" for this planning area—nor could it.

* * *

The Department has failed to identify evidence that is substantial when viewed in light of the whole record before the Court that supports the Department's finding that OFM's medium projection is more accurate than OFM's high projection. The evidence to the contrary—i.e., that OFM's *high* projection is most accurate—is overwhelming. *See* Kadlec Op. Br. at 18-27 (summarizing evidence).

In light of the whole record, a fair-minded, rational person could not be persuaded that OFM's medium projection was more accurate than OFM's high projection for Benton and Franklin Counties. Therefore, the Court should determine that the Department's finding was not supported by substantial evidence. The Court also should determine that the Department's use of the medium projection was arbitrary and capricious because it disregarded (1) the circumstances of the Benton-Franklin planning area that make it different from the rest of the state and have caused OFM to underestimate population growth in this region in the past, (2) the fact that the last time the Department used the medium projection, only five years previously, it left the region with a shortage of hospital

beds, and (3) the consequences of depriving the planning area's principal hospital of enough beds to meet community need.

B. The medium population projection age cohort splits should not be used in the Department Methodology.

The Department Methodology requires the population to be divided between the 0-64 and 65+ age cohorts, which is important because the older age cohort utilizes hospital services at a substantially higher rate than the younger age cohort. OFM's medium projection contains this breakdown. Inexplicably, OFM does not provide county-level age cohort breakdowns within its high (or low) projections.

The Department argues that OFM's failure to provide county-level age cohort breakdowns within its high projection is a reason why the medium projection should be used instead. Dept. Br. at 12. It is not. These are two distinct issues. The first issue is which population forecast to use. The Department Methodology clearly instructs the Department to use the "most accurate" population forecast. AR 4262. Here, that is the high forecast. The Department must then, as part of its need projection, break that population forecast down into age cohorts.

If the high projection is used, there are two available options to break the population forecast down into age cohorts: (1) use the age cohort breakdown from the OFM high projection for the state as a whole, or (2)

use the age cohort breakdown from the medium projection for the planning area.

In 2010, the actual percentage of the Benton-Franklin population falling within the 65+ age cohort was 10.4 percent. AR 4782. OFM's statewide high projection showed 12.1 percent. AR 4782. OFM's Benton-Franklin medium projection showed 9.9 percent. AR 4782. Therefore, the former overstated the 65+ population and the latter understated it. However, the key question is which projection will be more accurate in *future* years.

The percentage of Benton-Franklin residents in the 65+ age cohort is increasing. From 1990 to 2000, this group grew at an average annual rate of 2.3 percent. AR 2758. From 2000 to 2008, this group grew at an average annual rate of 3.1 percent. AR 2758. Therefore the growth rate is rapidly accelerating. This is driven in part by significant in-migration of retirees. AR 4721.

The age cohort split from the medium population projection not only assumes an existing 65+ age cohort smaller than what actually exists (9.9 percent assumed vs. 10.4 percent actual), it also assumes that it will grow at only 3.2 percent per year—effectively holding the growth rate flat and ignoring the historical trend showing that the growth rate is increasing. AR 4350.

The age cohort split from the statewide high population projection assumes that the 65+ age cohort will grow by 4.8 percent per year. AR 2763. This is the statewide projection, and given the demonstrable trend in the planning area, it is reasonable to assume that the percentage of residents of Benton and Franklin Counties in the 65+ age cohort will grow at the statewide rate in the future. It certainly is more reasonable to assume this than to ignore the historical data and hold the growth rate constant as the Department advocates.

The key point, however, is that OFM's failure to provide county-level age cohort breakdowns within its high forecast is not a reason to not use the high forecast if it is the most accurate—which it is here. And even if the age cohort breakdown from the *medium* population projection is used, as the Department advocates, there is a projected need for at least 94 additional beds within ten years, allowing for approval of 39 beds at Kadlec in addition to the 55 already approved. The Department provided such a need forecast. AR 2606 (Department's need forecast using high projection but age cohort assumptions from medium projection) (showing need for 72 beds in 2019); AR 2672 (explaining that Department's projection overstates existing capacity by 22 beds; therefore, projected need actually is 94); AR 2712 (denial of motion to strike new projection). And based on the Department's own precedents, if the forecasted need is

less than the total number of beds requested in a hospital-expansion application, the Department may approve fewer beds than requested, up to the projected need. AR 1095-1150 & 1202-21 (Department approval of 51-bed expansion at Auburn Regional Medical Center, based on forecasted bed need, rather than the 70-bed expansion requested by the applicant); *see also* AR 2688-89 (Kadlec making this request below).

C. Kadlec's proposed expansion is a major project.

The Department agrees that the applicable standard is that "for most purposes" the planning horizon be limited to seven years, but that "[f]or major policy questions, such as whether a community should have a hospital or additional hospitals, long-range forecasts should be prepared." AR 4262 ("target date" standard); *see also* Dept. Br. at 18.

Kadlec's initial need projection, prepared at the outset of this application process, showed need for all 114 beds within seven years. Indeed, it showed need for all 114 beds requested by Kadlec and all 25 beds requested by Trios within seven years. AR 2933. Therefore, whether or not a planning horizon longer than seven years should be used was a moot issue at that time. However, Kadlec's final need projection, which took into account additional data, showed need for only 92 of the 114 beds within seven years. AR 4338. Therefore, whether a 7-year planning horizon or a long-range planning horizon should be used became an issue

that had to be decided at the adjudicative hearing. Kadlec explained why long-range planning horizons are necessary for major projects and why Kadlec's proposal qualifies as a major project. AR 2128-30 & 2307-10.

The evidence is that Kadlec proposed a $75 million, 114-bed, 100,000-square foot hospital expansion project that will take seven years to complete. AR 2728, 2740, 2752 & 2779. The only evidence cited by the Department is that Kadlec proposed a hospital expansion rather than a new hospital. *See* Dept. Br. at 18. But this is not the standard. The standard clearly states that "[f]or major policy questions, *such as* whether a community should have a hospital or additional hospitals, long-range forecasts should be prepared." AR 4262 (emphasis added). New hospitals are not identified as the *only* projects for which long-range forecasts should be prepared; rather, they are given as an *example* ("such as") of when long-range forecasts should be prepared.

As discussed by Kadlec in its opening brief, the Department used a 10-year planning horizon to approve a 106-bed, $73 million hospital expansion project in Snohomish County in 2006. It also used a 10-year planning horizon to approve a 50-bed, $79 million hospital expansion project in Spokane County in 2010. AR 2162-95 & 2197-2230. The Department fails to explain why Kadlec's project is not a "major" project given that Kadlec's expansion is larger than, and just as expensive as, the

Everett and Spokane hospital expansions that were deemed major projects warranting 10-year planning horizons.

No fair-minded, rational person could be persuaded, in light of the whole record before the Court, that Kadlec's $75 million, 114-bed, 100,000-square foot expansion is not a "major" project. Accordingly, the Department's finding that Kadlec has not proposed a major project is not supported by evidence that is substantial when viewed in light of the whole record before the Court. It also was arbitrary and capricious for the Department to use 10-year planning horizons for hospital expansions in Everett and Spokane but to use only a 7-year planning horizon for a larger hospital expansion in the Tri-Cities.

D. The Court should affirm the Department's denial of Trios's application.

Kadlec agrees with the Department that its denial of Trios's application should be affirmed by the Court. *See* Dept. Br. at 22.

1. The Department denied Trios's application for additional beds because Trios's application did not satisfy the Certificate of Need criteria.

After Kadlec applied to add beds, Trios applied to add 25 beds to its Auburn hospital campus. AR 3466-3657. The Department denied Trios's application, because it determined that Trios's project failed to satisfy WAC 246-310-220(1), WAC 246-310-240(1), and WAC 246-310-230(4). AR 3432, 3441 & 3444. The Department's denial of Trios's

application was affirmed by the Presiding Officer, the Review Officer, and the Benton County Superior Court. AR 2391 & 2714; CP 130-31.

2. The Department's finding that Trios's expansion project was not financially feasible is supported by substantial evidence.

The Department will approve a CN application only if "[t]he immediate and long-range capital and operating costs of the project can be met." WAC 246-310-220(1). The Department determined that the immediate and long-range capital and operating costs of Trios's expansion project cannot be met because the facility "does not have a strong enough financial base[.]" AR 2370 (Initial Order); *see also* AR 2712-13 (Final Order) (adopting findings of fact from Initial Order). Kadlec agrees with the Department that this finding is supported by substantial evidence. *See* Dept. Br. at 22-24.

A court should reverse an agency order if it "is not supported by evidence that is substantial when viewed in light of the whole record before the court, which includes the agency record for judicial review[.]" RCW 34.05.570(3)(e). The Department's finding that the immediate and long-range capital and operating costs of Trios's expansion project cannot be met is supported by substantial evidence.

Trios's own financial projections for its Auburn campus show that it is expected to operate at a loss indefinitely. If Trios's proposed

expansion were permitted, Trios's Auburn campus is projected to operate at an annual loss of more than $2 million in each of the eight years shown in Trio's financial projection. AR 3684. Typically the Department requires a project to meet its costs within three years. AR 3428. Trios's expanded Auburn facility would not meet its operating costs within three years; indeed, it would not meet its operating costs in *any* future year shown in Trios's financial projection.

The problem is not limited to Trios's Auburn campus. Trios *as a whole* is financially unstable. The Hospital and Patient Data Systems ("HPDS") division of the Department prepared a financial analysis of Trios, for purposes of evaluating Trios's application. AR 4035-40. HPDS determined that it "does not have the financial capacity to proceed with this project and that the project is not financially feasible." AR 4036.

HPDS compared Trios's financial information to the average of hospitals statewide, in order to evaluate Trios's financial health. Comparing the final year of Trios's financial projection to the current statewide average shows that Trios's financial ratios "are out of reasonable range" of the statewide averages. AR 4037. Indeed, Trios's financial ratios are projected to be worse than the statewide averages with respect to *all five* measurements considered by HPDS. AR 4037. Because of this, HPDS concluded that Trios "does not have a strong enough base to insure that

the long-range capital and operating costs of the project can be met." AR 4037.

Additionally, Trios's financial projections are based on unreasonably high future growth assumptions. If more reasonable assumptions are used, Trios's projected financial situation becomes even more dire. AR 4767-68.

The judicial-review standard is not a preponderance of the evidence; it is whether there is *substantial* evidence in light of the whole record before the Court. "Substantial evidence is evidence sufficient to persuade a fair-minded, rational person of the finding's truth." *Miles v. Miles*, 128 Wn. App. 64, 69, 114 P.3d 671 (2005). Trios's own financial projection, showing annual operating losses in every future year, combined with HPDS's analysis, concluding that Trios as a whole is financially unstable, are sufficient to persuade a fair-minded, rational person that Trios cannot meet the immediate and long-range capital and operating costs of the expanded facility proposed in its application. The Department is correct that its determination is supported by substantial evidence and should be affirmed. *See* Dept. Br. at 24.

3. The Department's finding that Trios's proposed expansion was not the superior alternative is supported by substantial evidence.

The Department also will approve a CN application only if "[s]uperior alternatives, in terms of cost, efficiency, or effectiveness, are not available or practicable." WAC 246-310-240(1). The Department determined that there were superior alternatives to Trios's project. AR 2379-80 (Initial Order); AR 2712-13 (Final Order) (adopting findings of fact from Initial Order). Kadlec agrees with the Department that this finding is supported by substantial evidence. *See* Dept. Br. at 24-25.

First, the Department determined that reallocation of the existing licensed capacity at Trios's Auburn campus would be a superior alternative to expansion of that facility. AR 2379 (Initial Order); *see also* AR 2712-13 (Final Order) (adopting findings of fact from Initial Order). Specifically, Trios has allocated 41 of its 101 licensed beds to its Women's and Children's unit, even though the average daily census in that unit is only 12.1 (i.e., 29.5% occupancy), far below the occupancy rate of Trios's other units (54%-73%). AR 3444. The Department observed that it would be more efficient for Trios to simply reallocate licensed beds from the Women and Children's unit to its other units than to add additional licensed beds to the facility. AR 3444. Trios's CEO admitted at the hearing that there is no reason Trios could not reallocate

beds from an under-utilized unit to an over-utilized unit. AR 5050-51. Trios's utilization statistics, by unit, are sufficient to persuade a fair-minded, rational person that reallocation of beds within Trios would be a superior alternative to adding additional capacity.

Second, the Department also determined that Kadlec's proposed expansion would be a superior alternative to Trios's proposed expansion. AR 2379-80 (Initial Order); *see also* AR 2712-13 (Final Order) (adopting findings of fact from Initial Order). The Department's finding was based on Kadlec's superior financial health, cost-effectiveness, and efficiency, and the fact that Kadlec provides complex services that Trios does not provide. *See id.* These findings are supported by the record. *See, e.g.*, AR 3389, 4770-71 (efficiency and cost-effectiveness); 2745 (complex services).

In addition, Kadlec simply needs beds far more than does Trios. Kadlec is operating above the State's utilization standard. AR 3396, 4467-68. Trios is not. AR 3667. Moreover, planning-area residents generally prefer to obtain care from Kadlec than from Trios, which is reflected in the hospitals' respective growth rates of 4.6% and 0.8%. AR 2737, 3319 (patient days).

The Department addresses Trio's arguments regarding the respective cost of the competing projects. *See* Dept. Br. at 25. Kadlec

further notes that Trios is only able to add beds at its Auburn campus by building, and relocating beds to, its $112 million Southridge campus; the proposed Auburn "expansion" consists of back-filling the beds relocated to Southridge. When the costs of that project are taken into account, Trios's project is actually *higher*-cost, on a per-bed basis, than Kadlec's project. AR 3389. With respect to the relative size of the proposed expansions, the record demonstrates that Kadlec's proposed expansion is necessary to meet the projected need of Benton-Franklin residents for hospital care, particularly taking into account the planning area's population growth. AR 4338 & 4625-26. In any event, the evidence in the record is sufficient to persuade a fair-minded, rational person that Kadlec's project is a superior alternative to Trios's project. The Department is correct that its determination is supported by substantial evidence and should be affirmed. *See* Dept. Br. at 25.

4. The Department's finding that Trios's project would not promote continuity in the provision of health care, and would result in an unwarranted fragmentation of services, is supported by substantial evidence.

Finally, the Department will approve a CN application only if "[t]he proposed project will promote continuity in the provision of health care, not result in an unwarranted fragmentation of services, and have an appropriate relationship to the service area's existing health care system."

WAC 246-310-230(4). Although the Department references Section 230 in its brief, it does not discuss it in any detail. *See* Dept. Br. at 4. However, in the decision under review, the Department specifically determined that Trios's project did not satisfy this requirement, and failed Trios's application on this criterion as well as the two criteria discussed above, "[b]ecause of the overextension of [Trios's] financial standing"; specifically that "the project could lead to a reduction of services if the future revenues are insufficient to cover expenses." AR 2375 (Initial Order); *see also* AR 2712-13 (Final Order) (adopting findings of fact from Initial Order). This additional finding of the Department is supported by substantial evidence. The evidence of Trios's poor financial health is sufficient to persuade a fair-minded, rational person to make the same determination that the Department made, namely that if Trios is permitted to over-extend itself even further, this could result in Trios reducing the scope of services it provides. The Department was correct to deny Trios's application on this additional ground.

* * *

The Department's finding that Kadlec's proposed expansion is a superior alternative to Trios's proposed expansion was supported by substantial evidence, as were the Department's findings that Trios is in poor financial health and the hospital campus it proposes to expand is

projected to operate at a loss indefinitely, that Trios's proposed expansion project would overextend Trios even further, and accordingly could result in a reduction in services, and that Trios could better meet its own needs simply by reallocating beds internally. Kadlec agrees with the Department that the Court should affirm the Department's denial of Trios's application. *See* Dept. Br. at 22.

III. CONCLUSION

There is no evidence that the OFM medium population projection was more accurate for Benton and Franklin Counties than the OFM high population projection; there is overwhelming evidence that the OFM high population projection was the most accurate. The only evidence cited that Kadlec's project is not "major" is that it is the expansion of an existing hospital, not a new hospital; this does not constitute substantial evidence in light of the other evidence in the record, including the size of the expansion and the cost of the project. The Court should set aside the Department's finding that OFM's medium projection is more accurate than OFM's high projection in Benton-Franklin as well as the Department's finding that Kadlec has not proposed a major project, and remand to the Department to issue a CN to Kadlec for 59 more beds, in addition to the 55 already approved.

Respectfully submitted this 5th day of August 2016.

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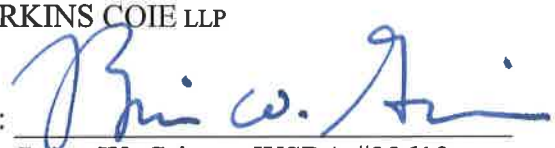
By: 

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CERTIFICATE OF SERVICE

I, the undersigned, certify under penalty of perjury under the laws of the State of Washington that today I caused the foregoing document to be served via e-mail, pursuant to the parties' e-service agreement, on the following persons:

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