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CON Section

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HAND DELIVERED

June 1, 2010

Ms. Jane Rhoe-Jones, Project Analyst
Mr. Craig Smith, Section Chief
Certificate of Need Section
Division of Health Services Regulation
NC Department of Health and Human Services
701 Barbour Drive
Raleigh, North Carolina 27626

Re: Request for Public Hearing and Comments on Orthopaedic Surgery Center of
Raleigh, CON Project ID **J-8496-10**

Dear Ms. Rhoe-Jones and Mr. Smith:

On behalf of Southern Surgical Center, LLC (SSC) and Southern Surgical Building, LLC (SSB), I wish to request a public hearing on the above referenced CON application for change of scope and cost overrun for previously approved CON Project ID J-8170-08. SSC and SSB are affected parties. Both were applicants for the four operating rooms that were awarded to the applicants for this project. SSC and SSB were found conforming to all Statutory Criteria and were denied the operating rooms solely because of the competitive advantages presented in the Orthopaedic Surgery Center of Raleigh (OSCR) application.

As you review the Overrun request, we believe you will agree with us that it not only reveals flaws in the original application, but it is non-conforming with several statutory criteria. Comments in this letter focus on a few critical flaws.

This new OSCR application represents both a request for a scope change and an "overrun" costing \$4 million more than the original request, a capital cost increase of almost 60 percent. (The original combined capital cost for all of the OSCR applicants was \$7.1 million. The Overrun request indicates a true capital cost will be \$11.1 million.) Because of the enormous difference in capital cost, and because the Agency based its approval of the original OSCR application, J-8170-08, only on conformity to Criterion 6, the competitive advantages presented in the OSCR application, when compared to the application from SSC and SSB, J-8182-08, we believe that this overrun should be publicly announced on the Agency website and subjected to a public hearing review.

The following are extracted directly from the Agency Findings on the competing 2008 CON applications for four operating rooms in Wake County.

*The following is a summary of the reasons each of the other applicants is found to be a less effective alternative than **OSCR**.*

OSCR

- *Adequately documents the need the population to be served has for the proposed operating rooms. See Criteria (3) and (6) for discussion.*
- *Adequately demonstrated that the financial feasibility of the proposal is based upon reasonable projections of costs and charges. See Criterion (5) for discussion.*
- *Adequately demonstrates that the proposed services will be coordinated with the existing health care system. See Criterion (8) for discussion.*
- *Projects the third highest percentage of total services to be provided to Medicaid recipients of all the applicants.*
- *Projects the second lowest gross revenue per surgical case in the third year of operation.*
- *Projects the lowest net revenue per surgical case in the third year of operation.*
- *Projects the lowest operating expense per surgical case that is based on reasonable and supported projections of surgical cases to be performed in the third year of operation.*
- *Provides adequate documentation of physician support from Wake County physicians and surgeons.*

SSC

- *Projects the lowest percentage of total services to be provided to Medicaid recipients of all the applicants.*
- *Projects the second highest net revenue per surgical case in the third year of operation.*

Few if any of these reasons hold up with information in the new application:

- **OSCR** alters the original need methodology and now inflates projected utilization by double counting procedures from two new physicians who were counted in the first application as “new physicians to be recruited” and including podiatric surgery in the OR and Procedure Rooms. The application also fails to note that the official OSBM population forecasts for Wake County have now declined from the projections made in 2008, by 5 percent in the second and third operating year.

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- Without the extra cases/ procedures, the proformas do not support the additional capital costs. Operating costs are increased more than \$1 million per year in this new application and the application proposes to offset these by adding as many as 962 double-counted cases each year.
- The new capital costs are still understated. They do not include the cost of construction interest, or the cost of loan origination. The Original OSCR application excluded the capital cost of the leased land and included too little land to support required runoff and parking compliance. Working capital projections fail to recognize the costs that occur during construction years and do not allow for any lag between licensure and certification. The application does not provide adequate financing for the proposed project.
- Projections for Medicaid were and are overstated in the original OSCR application and are overstated again in the Overrun. Medicaid estimates were based on Rex Hospital averages which included Obstetrics and Gynecology. OSCR orthopedic surgeons provided no documentation showing that their Medicaid was that high.
- The new application uses the same charges as the original application, but proposes a different mix of cases. The original CON based charges on a selected sample of individual procedures. It was not based on the likely case mix of the service. Projections of revenue per case were and are artificially understated and only work in the Overrun proformas because projections of cases are overstated.

OSCR CON Project ID J-8496-10 asks to recognize the cost of acquiring land, add the cost of additional land and expand the square footage of the ambulatory surgery facility with the addition of two minor procedure rooms and associated ancillary and support space. This change in scope from the previously approved CON (*erroneously referred to as J-7170-08*) results in an increase in the total capital cost of the project that exceeds 15 percent. During your review of the project, we trust that you will consider the comments presented herein, not only for the reasons why the current application is not conforming, but also as a basis for more significant action.

Because the application was competitive and the proposed changes so dramatic, we believe that this is not a simple overrun, but a basis for withdrawal of the original CON. The application is not developing *in a manner consistent with the representations made in the application....* as required by statute.

In fact, the proposed project appears to be an amendment of the original application. On page 7, the application notes that changes in the economic environment now make it more costly to obtain building financing for a project on a land lease, because the bank perceives the loan as higher risk if the land belongs to an entity other than the borrower. This was true in 2008, when the original OSCR application was filed. If OSCR did not take this into account in the original application, it means that they never approached a bank with full information to approve financing, which would have rendered it nonconforming. It appears that this was the case. SSC also called attention to the absence of land cost in its comments on the original OSCR application. Moreover, on page 8, the new application suggests that the original acreage was inadequate to support the parking and water runoff requirements of the original building.

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Conclusion

The proposed OSCR Overrun is non-conforming with at least two statutory criteria, which in turn would make it non-conforming with other criteria. The cost overrun proposal also reveals many facts that, in retrospect, would have rendered the original application nonconforming. Facts presented here are not facts in dispute, but actual facts conceded by the applicants in this new application. The applicants knew the facts in their original application were misleading when they submitted it. Approving the cost overrun would encourage all applicants to understate and misrepresent costs in competitive reviews, knowing that they could remedy the situation with a non-competitive overrun request. This would undermine the spirit and intent of the statute.

We call special attention to Statutory Finding of Fact GS 131E-175 (7).

That the general welfare and protection of lives, health, and property of the people of the State require that new institutional health services to be offered within this State be subject to review and evaluation as to need, cost of service, accessibility to services, quality of care, feasibility, and other criteria as determined by provisions of this Article or by the NC pursuant to the provisions of this Article prior to such services being offered or developed in order that only appropriate and needed institutional health services are made available in the area to be served.

Our comments are intended to highlight problems, not to provide a comprehensive analysis of the OSCR application. In the following pages, the OSCR CON application is discussed within the framework of the State's CON Review Criteria and applicable rules. We have addressed only a few criteria for which the information provided is nonconforming. Thank you for your time and attention. We understand the difficulties presented in these types of reviews and appreciate your attention to details. Should you have any questions, please do not hesitate to call me.

Sincerely,

Paul L. Burroughs, III, M.D. / pp

Paul L. Burroughs, III, M.D., P.A.

Member SSC and SSB

On behalf of the members

Attachment:

Competitive Review of Orthopaedic Surgery Center of Raleigh (ROC), J-8496-10

**COMPETITIVE REVIEW OF –
Orthopaedic Surgery Center of Raleigh (ROC), J-8496-10**

CON REVIEW CRITERIA

- 3** *The applicant shall identify the population to be served by the proposed project, and shall demonstrate the need that this population has for the services proposed, and the extent to which all residents of the area, and, in particular, low income persons, racial and ethnic minorities, women, handicapped persons, the elderly, and other underserved groups are likely to have access to the services proposed.*

The application is non-conforming with Criterion 3.

It claims a service area of Wake County and calculates need based on Wake County, then shows patient origin based on other counties for which it shows no need. (page 25, step 13 “no in-migration”) On page 27, the application fails to include any assumptions for the projected Patient Origin. The response refers to blank pages.

Proposed cases are overstated in each year.

Comparison of OSCR Proposed and Corrected Cases

		2011	2012	2013
17	Projected OSCR Cases page 23	4645	5056	5496
17	Corrected OSCR Surgery Cases	3980	4094	4639
	Overstated OR Cases	665	962	857

The proposed case counts show the application is non-conforming under the most generous interpretation. According to the methodology in the 2010 SMFP and the special rules, four operating rooms at the state standard of 1872 hours per room, would require 4,992 cases in Year 2 (4 times 1872 hours per room divided by 1.5 hours per case or 4,992 cases).¹ The application does not support 4,992 operating room cases in year 02 or year 03.

Beyond Step 12 in the need methodology, the application begins double counting. Step 14 adds 500 to 600 procedures for newly recruited physicians, failing to realize that the increases in population and use rate have generated additional procedures for the new surgeons to perform. Because the cases to be done by new physicians were already included in the case count forecast in Step 12, the application fails the test of the required

¹ On page 15, the application indicates that the CON Analysts Mike McKillip and Tonya Rupp indicated that the application is exempt from the special Rules for ambulatory surgery facilities 10 NCAC 14C .2100.

cases to support four operating rooms. The following is a corrected methodology. The project does not reach 4,992 procedures in any of the first three years. Four operating rooms are not justified.

Corrected Page 23 Methodology

Step		2011	2012	2013
12	Projected OSCR Cases	4495	4886	5310
16	shift 7 % to Procedure Rooms	-315	-342	-371
20 rev	Shift all Podiatry cases to Procedure Rooms	-200	-250	-300
17	OSCR Surgery Cases	3980	4094	4639

In a further exaggeration, the application on page 21 arbitrarily assumes 1.5 hours per case done in the procedure rooms. This is unsubstantiated and contradicts what the application says in Section II about faster turnover of the procedure rooms compared to the operating rooms.

5. ***Financial and operational projections for the project shall demonstrate the availability of funds for capital and operating needs, as well as the immediate and long-term financial feasibility of the proposal, based upon reasonable projections of the costs of and charges for providing health services by the person proposing the service.***

The application is not conforming to this criterion.

In Exhibit 45, the application provides an undated letter from First Citizens Bank providing \$600,000 in working capital. This has a 5-year amortization schedule that begins immediately, according to the second page of that exhibit. The application does not explain the source of revenue to make these loan payments before the project generates its own cash flow.

The application provides no information to determine how the \$600,000 working capital requirement was calculated.

6. ***The applicant shall demonstrate that the proposed project will not result in unnecessary duplication of existing or approved health service capabilities or facilities.***

The application is not conforming to this criterion.

Because the application fails to demonstrate need for four operating rooms, it does represent duplication of existing capacity in the service area, Wake County.

Moreover, the application asserts, but fails to demonstrate that it does not duplicate capacity in existing or the proposed new freestanding operating rooms that were added to the 2010 Plan over and above the calculated need.

12. ***Applications involving construction shall demonstrate that the cost, design, and means of construction proposed represent the most reasonable alternative, and that the construction project will not unduly increase the costs of providing health services by the person proposing the construction project or the costs and charges to the public of providing health services by other persons, and that applicable energy saving features have been incorporated into the construction plans.***

The application is not conforming to this criterion.

The application provides inadequate information about construction. The proposed Procedure Rooms are as large as the Operating Rooms and the drawings provide no information that would distinguish them from Operating Rooms. Equipment lighting costs and the absence of an anesthesia machine are the only distinctions. In fact, the discussion on page 28 indicates that the applicant may intend to convert these to operating rooms.

In the equipment list, the application admits that some equipment was omitted from the original application – arthroscopy equipment and scope cleaners – See Exhibit 9.