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SUPERIOR COURT OF THE STATE OF WASHINGTON
FOR KING COUNTY

NORTHWEST KIDNEY CENTERS,

Appellant,

v.

DEPARTMENT OF HEALTH OF THE
STATE OF WASHINGTON and
DAVITA, INC.,

Respondents.

No. 14-2-29824-2 SEA

JUDICIAL REVIEW ORDER

This matter came before the Court on the petition of Northwest Kidney Centers ("NKC") for judicial review of the Findings of Fact, Conclusions of Law, and Final Order of the Washington State Department of Health (the "Department"), dated October 1, 2014, in Washington State Department of Health Case No. M2013-364 (the "Agency Order").

Agency Order

The Agency Order relates to the competing Certificate of Need ("CON") applications of NKC and DaVita HealthCare Partners Inc. ("DaVita") to add eleven kidney dialysis stations in King County Planning Area #9, reviewed concurrently by the Department.

1 NKC previously relocated its existing 28-station dialysis facility without CON
2 review, in accordance with WAC 246-310-289(3). At the time NKC relocated its 28-station
3 facility, NKC incurred construction costs for space to accommodate a total of forty-one
4 dialysis stations (*i.e.*, thirteen more than NKC had CON approval to operate). When it later
5 filed an application to make operational eleven new stations at its facility (for a total of 31
6 operating stations), the application at issue here, NKC did not disclose the construction costs
7 incurred at the time of the relocation to allow for the expansion. The construction costs
8 associated with NKC's expansion space have never been reviewed by the Department. The
9 Department determined that NKC was required to disclose construction costs associated
10 with its proposed 11-station expansion, even though they were incurred prior to the filing of
11 the expansion application. Because NKC failed to do so, NKC's application failed the
12 applicable CON criteria, specifically WAC 246-310-220(2), which requires evaluation of
13 "[t]he costs of the project, including any construction costs" On this basis, the
14 Department denied NKC's application.
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29 DaVita proposed to establish a new, 11-station kidney dialysis facility in the
30 planning area. It proposed to lease space in an existing building. DaVita disclosed in its
31 application capital costs to be incurred by DaVita and/or its landlord to build out the leased
32 space so it could be used as a kidney dialysis facility. The Department determined that
33 DaVita's application satisfied all CON criteria and, consequently, approved DaVita's
34 application.
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41 Judicial Review

42 The Court has reviewed the Petition for Judicial Review, filed October 31, 2014; the
43 Administrative Record ("AR"); all materials submitted by NKC, DaVita, and the
44 Department in support of and opposition to the petition, and heard oral argument on June 1,
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1 2015. Based on the judicial review standards set forth in RCW 34.05.570, the Court finds
2 and rules as follows.
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6 1. NKC has standing to bring the Petition under RCW 34.05.530, and the Petition was
7 timely filed with the Court. RCW 34.05.542.
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10 2. The Court has jurisdiction over the Petition, and venue is proper under RCW
11 34.05.514.
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14 3. NKC asserts several bases for reversing the Department's Agency Order. First,
15 NKC contends that before the application at issue was filed, the Department had
16 never required an applicant to disclose historical "sunk" costs associated with a new,
17 proposed project. By requiring NKC to disclose those costs here, it argues, the
18 Department engaged in improper rulemaking that denied NKC due process.
19 Additionally, because the Department did not require DaVita to disclose historical
20 construction costs to build the retail center in which it would be leasing space for its
21 program, the Department's action was arbitrary and capricious.
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24 4. The evidence shows the Department did not impose a new rule by requiring NKC to
25 provide historical construction costs associated with its present program expansion
26 project. Experienced Department personnel testified at their depositions that this
27 type of information has been required in the past. *See, e.g.,* AR 572 (Sigman Dep.),
28 597 (Nidermayer Dep.).
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31 5. Documentation also shows that NKC's counsel discussed with Department staff how
32 an applicant should "identify capital costs if an application is submitted to add new
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1 stations to the relocated facility”, the situation here. DaVita Response, App. F. In
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stations to the relocated facility”, the situation here. DaVita Response, App. F. In reply, NKC was advised that there is more than one way to describe these historical costs in a CON application, but “[o]ne way that would NOT be considered is identifying ONLY the equipment needed for the additional stations.” *Id.* (emphasis in the original). That, however, is the only information NKC provided in its application.

6. In a March 29, 2007, letter to the Department related to an earlier project, NKC’s representative recited the precise rule enforced here:

[W]e have been informed that the Department customarily requests that the costs of new capacity that have not previously been reviewed in detail by the Department be reported as “allocable” costs at the time the new capacity is licensed.

DaVita Response, App. E. Although the circumstances under which this letter was written are not identical to the circumstances surrounding the instant application, the principle expressed is equally applicable. NKC offers no evidence to the contrary.

7. The requirement to provide historical construction costs is supported not only by the evidence, but by logic. If the cost of increased capacity has not been previously reviewed by the Department and is not reported when a license to operate the increased capacity is sought, these costs never enter into the Department’s calculus of the program’s financial feasibility and cost containment. *See* WAC 246-310-220; 246-310-240. A program operator could relocate its program (for which no CON is required), over-build its capacity at that time, then later seek to implement its

1 expanded capacity without the cost of constructing the new capacity taken into
2 account. This service provider would realize a distinct advantage over a competitor
3 who needed to incur contemporaneous construction costs, and also prevent the
4 Department from performing its mandated financial analysis.
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10 8. The Department did not erroneously interpret or apply its regulations. When a CON
11 applicant incurs capital costs associated with a future expansion during a CON-
12 exempt relocation of an existing dialysis facility, the capital costs associated with the
13 expansion space are costs of the future expansion project. Because these costs are
14 not reviewed by the Department as part of the CON-exempt relocation, they must be
15 disclosed in the expansion application pursuant to WAC 246-310-220(2). These
16 costs must be disclosed in the expansion application even if the capital costs
17 associated with the expansion are incurred prior to submission of the CON expansion
18 application. Accordingly, NKC was required to disclose in its expansion application
19 construction costs that it incurred at the time of relocation that allowed for the
20 proposed expansion.
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35 9. The Department did not adopt a new rule and NKC was not denied due process.
36 Under the Department's existing regulations, NKC was required to disclose in its
37 CON application the previously incurred construction costs associated with NKC's
38 proposed expansion.
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45 10. NKC also argues that if it is required to report its historical construction costs, it is an
46 error of law and arbitrary and capricious for the Department not to require DaVita to
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1 report the same. DaVita's historical construction costs, NKC contends, include
2 construction costs incurred by its landlord when it originally constructed the retail
3 space DaVita eventually would lease.¹ The Court finds no merit to this argument, as
4 it compares apples to oranges. The relevant inquiry – how the costs associated with
5 a program will affect service delivery – involves an assessment of costs borne by the
6 program service provider. In NKC's case, that includes costs it incurred when it
7 built the expanded capacity in its current location. For DaVita, the underlying costs
8 incurred by third party to construct the building it will lease have no bearing on its
9 project proposal.²

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22 11. Where a kidney dialysis facility applicant proposes to lease space in an existing
23 building, it must disclose in its CON application all capital costs incurred by the
24 applicant and the landlord to allow the leased space to be used as a kidney dialysis
25 facility. The applicant is not required to ascertain and report the original costs
26 incurred by a third party to construct a retail center in which space is being leased.

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33 12. Last, NKC contends the Department breached its duty to request information
34 necessary to review NKC's application on the merits. Statute provides that within 15
35 days of receiving an application, the Department "shall request additional
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42 ¹ In its application, DaVita reported build-out costs both it and its landlord would incur to
43 make the leased space useable for its intended purpose, but not the underlying cost of constructing
44 the mall in which the space is located.

45 ² Common area maintenance costs, taxes, and insurance costs DaVita will incur annually do
46 bear on a full financial analysis, and DaVita did not report these costs in its application. Both the
47 Department and the applicants determined these costs to be *de minimus*, and do not challenge the
Department's findings on this basis.

1 information it deems necessary to the application.” RCW 70.38.115(6). The
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3 Department is required to screen an application to determine if it is complete (WAC
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5 246-310-090(2)(a)) and, if not, it must identify specifically the insufficiencies and
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7 request from the applicant supplemental information needed to complete the
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9 information. WAC 246-310-090(1)(c).
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12 13. Additionally, if after the initial screening period has closed the Department identifies
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14 an “unresolved pivotal issue”, it may request additional information so the pivotal
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16 issue can be resolved before a determination is made. WAC 246-310-090(1)(a)(iii).
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18 Although NKC’s failure to provide historical construction costs here was the
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20 determinative reason the Department denied NKC’s CON application, the
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22 Department did not ask NKC for this information before making its decision.
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26 14. Both DaVita and the Department argue it is not the Department’s burden to identify
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28 errors in an application, which may be true, but it mischaracterizes the situation
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30 here.³ In this case, the Department contends it was necessary for NKC to provide
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32 historical construction costs associated with its expanded services, that this is a long-
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34 standing Department requirement, and that NKC’s failure to provide this information
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36 is the one reason to deny its application. If those findings are true as asserted and, as
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38 found by the Court today, established by the record, they fall squarely within the
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40 Department’s duty to request information considered necessary to an application.
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46 ³ This, too, is the extent of the Review Officer’s finding in the Agency Order. DaVita’s
47 Response, App. D, ¶ 1.5. The Department’s representatives, however, acknowledge it was an
oversight not to request this information. See, e.g., AR 578 (Sigman Dep.), 599 (Nidermayer Dep.).

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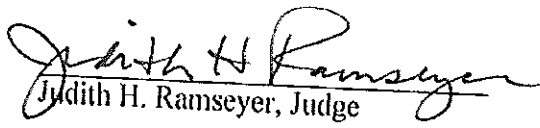
15. The Department seeks to have it both ways, asking the Court to find that the need to submit historical constructions costs is well-established, but that the Department did not err by failing to seek them here. To so hold, however, would render meaningless the Department's duty imposed by both statute and administrative rule to review a complete application. If when the Department screened NKC's application it learned that its proposed construction costs were insufficient and indefinite – indeed, the pivotal issue on which its application was denied – it had a duty under RCW 70.38.115(6), WAC 246-310-090(1)(c), and/or WAC246-310-090(1)(a)(iii) to request the information before determining the merits of the application. The Department's actions constitute a failure to follow a prescribed procedure and an order that is inconsistent with a rule of the agency. *See* RCW 34.05.570(1)(c), (h).

16. NKC was substantially prejudiced by the Department's action failure to request this dispositive information. NKC is entitled to relief on this basis.

Relief

For the reasons stated, the Agency Order is vacated and this matter is remanded to the Department to take action consistent with this order.

Dated: June 16, 2015.


Judith H. Ramseyer, Judge