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# Commonwealth of Kentucky

## Court of Appeals

NO. 2009-CA-001908-MR

COMMONWEALTH OF KENTUCKY,  
CABINET FOR HEALTH AND FAMILY  
SERVICES

APPELLANT

v.

APPEAL FROM FRANKLIN CIRCUIT COURT  
HONORABLE PHILLIP J. SHEPHERD, JUDGE  
ACTION NO. 07-CI-00853

BLUEGRASS ORTHOPAEDICS  
SURGICAL DIVISION, LLC

APPELLEE

AND

NO. 2009-CA-001912-MR

SAINT JOSEPH HEALTH SYSTEM, INC.  
(F/K/A SAINT JOSEPH HEALTHCARE, INC.)  
D/B/A SAINT JOSEPH HOSPITAL;  
SAINT JOSEPH HEALTH SYSTEM, INC.  
(F/K/A SAINT JOSEPH HEALTHCARE, INC.)  
D/B/A SAINT JOSEPH EAST;

SAINT JOSEPH HEALTH SYSTEM, INC.  
(F/K/A ST JOSEPH HEALTHCARE INC.)  
D/B/A SAINT JOSEPH BEREAS;  
THE KENTUCKY HOSPITAL ASSOCIATION  
AND ITS MEMBER HOSPITALS;  
BAPTIST HEALTHCARE SYSTEM, INC.  
D/B/A CENTRAL BAPTIST HOSPITAL;  
SAINT ELIZABETH MEDICAL CENTER, INC.;  
FRANKFORT HOSPITAL, INC.  
D/B/A FRANKFORT REGIONAL MEDICAL  
CENTER; GREENVIEW HOSPITAL, INC.  
D/B/A GREENVIEW REGIONAL HOSPITAL;  
GEORGETOWN COMMUNITY HOSPITAL,  
LLC, D/B/A GEORGETOWN COMMUNITY  
HOSPITAL; BOURBON COMMUNITY  
HOSPITAL, LLC, D/B/A BOURBON  
COMMUNITY HOSPITAL;  
WOODFORD HOSPITAL, LLC,  
D/B/A BLUEGRASS COMMUNITY HOSPITAL

APPELLANTS

v. APPEAL FROM FRANKLIN CIRCUIT COURT  
HONORABLE PHILLIP J. SHEPHERD, JUDGE  
ACTION NO. 07-CI-00853

BLUEGRASS ORTHOPAEDICS  
SURGICAL DIVISION, LLC

APPELLEE

AND NO. 2009-CA-002344-MR

LOUISVILLE ORTHOPAEDIC SURGERY  
CENTER, PLLC

APPELLANT

v. APPEAL FROM FRANKLIN CIRCUIT COURT  
HONORABLE THOMAS D. WINGATE, JUDGE  
ACTION NO. 08-CI-00819

COMMONWEALTH OF KENTUCKY, CABINET  
FOR HEALTH AND FAMILY SERVICES;  
BAPTIST HEALTHCARE SYSTEM, INC.;  
ST. ELIZABETH MEDICAL CENTER, INC.;  
AND THE KENTUCKY HOSPITAL  
ASSOCIATION

APPELLEES

OPINION

AFFIRMING 2009-CA-001908-MR AND 2009-CA-001912-MR  
REVERSING AND REMANDING 2009-CA-002344-MR

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BEFORE: VANMETER AND WINE, JUDGES; SHAKE,<sup>1</sup> SENIOR JUDGE.

SHAKE, SENIOR JUDGE: Louisville Orthopaedic Surgery Center, PLLC

(Louisville Orthopaedic), appeals from a Franklin Circuit Court Summary

Judgment granted in favor of the Commonwealth of Kentucky, Cabinet for Health

and Family Services (Cabinet). In a separate case, the Cabinet appeals from a

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<sup>1</sup> Senior Judge Ann O'Malley Shake sitting as Special Judge by assignment of the Chief Justice pursuant to Section 110(5)(b) of the Kentucky Constitution and Kentucky Revised Statutes (KRS) 21.580.

Franklin Circuit Court Summary Judgment granted in favor of Bluegrass Orthopaedics Surgical Division, LLC (Bluegrass Orthopaedics). Saint Joseph Health System, Inc.; Kentucky Hospital Association; Baptist Healthcare System, Inc.; St. Elizabeth Medical Center, Inc.; Frankfort Hospital, Inc.; Greenview Hospital, Inc.; Georgetown Community Hospital, LLC; Bourbon Community Hospital, LLC; and Woodford Hospital, LLC as intervening parties, also appeal from the Franklin Circuit Court Summary Judgment granted in favor of Bluegrass Orthopaedics. These appeals raise the issue of whether physician-owned ambulatory surgery centers (ASCs)<sup>2</sup> may qualify for the physician’s exemption from KRS 216B regulation.

#### Regulation and Licensing Requirements of KRS 216B

In 1980, the Kentucky General Assembly enacted legislation granting the Cabinet authority to regulate certain health care services and facilities. KRS 216B.010. The purpose of this legislation, which is codified in KRS 216B, is,

to insure that the citizens of the Commonwealth will have safe, adequate, and efficient medical care; that the proliferation of unnecessary health-care facilities, health services, and major medical equipment results in costly

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<sup>2</sup> The Kentucky Administrative Regulations (KAR) defines an ASC as, “a public or private institution that is:

- (a) Hospital based or freestanding;
- (b) Operated under the supervision of an organized medical staff; and
- (c) Established, equipped, and operated primarily for the purpose of treatment of patients by surgery, whose recovery under normal circumstances will not require inpatient care.”

902 KAR 20:106 (2).

duplication and underuse of such facilities, services, and equipment; and that such proliferation increases the cost of quality health care within the Commonwealth.

KRS 216B.010.

Under this law, the Cabinet has two primary responsibilities: (1) to regulate the formation of health-care facilities and services by issuing certificates of need, or authorizations, “to acquire, to establish, to offer, to substantially change the bed capacity, or to substantially change a health service.” KRS 216B.015(8); and (2) to oversee these facilities and services to assure their compliance with state and federal laws and regulations.

Under KRS 216B, the Cabinet only regulates health-care services and providers that are covered by the State Health Plan. KRS 216B.015(12) specifically identifies an ASC as a type of facility covered by the State Health Plan, thereby requiring issuance of a certificate of need for an ASC’s establishment.

The Cabinet may approve or deny a certificate of need application based upon the following criteria: (1) the application’s consistency with the state health plan; (2) the need and accessibility of the facility, service, or equipment in the proposed geographic area; (3) the interrelationship between the proposal and the existing health-care system in the region and state and the proposal’s ability to promote efficient functioning of the state health-care system; (4) the proposal’s costs, economic feasibility, available resources, and alternatives; (5) the quality of the services proposed; and (6) hospital-based skilled nursing, intermediate care,

and personal care beds shall be considered to determine the need for freestanding long-term care bed proposals. KRS 216B.040(2)(a)(2)(a) – (f).

Not all health-care services and facilities are subject to Cabinet regulation under KRS 216B. For example, “[p]rivate offices and clinics of physicians, dentists, and other practitioners of the healing arts” are exempt from this regulation. KRS 216B.020(2)(a). This exemption does not extend to physicians and clinics seeking to purchase major medical equipment that costs \$1,500,000 or more. KRS 216B.015(4).

This consolidated appeal concerns two orthopedic ASCs that claim their facilities are exempt from the certificate of need requirement based upon the physician’s office exemption.

#### Louisville Orthopaedic Surgery Center

Louisville Orthopaedic is an ASC which is wholly owned by Louisville Orthopaedic Clinic and Sports Rehabilitation Center, PSC, a corporation owned by a group of practicing physicians. In 2005, through its attorney, Louisville Orthopaedic anonymously sought an advisory opinion from the Cabinet regarding whether its establishment of an ASC required a certificate of need. The request provided the following description of Louisville Orthopaedic:

ABC Physician Group is organized as a professional service corporation that provides single specialty surgery services. All shareholders of the professional service corporation are physicians licensed to practice medicine in Kentucky. ABC Physician Group owns the office

building to construct an outpatient surgery center that complies with Medicare's conditions of participation for an ASC. ABC Physician Group Practices will maintain its current offices on the second and third floors of the building. It is anticipated that two operating rooms will be implemented on the first floor of the physician group's office building. These operating rooms will be implemented at a cost less than the major medical equipment capital expenditure minimum threshold. Shareholders or employees of the physician group practice will personally perform surgical procedures there on a regular basis.

It is our legal opinion that a certificate of need is not required for our clients to establish an ASC or an outpatient surgery center as part of their private physician's group practice and office pursuant to KRS 216.020(2)(a).

On June 14, 2005, the Cabinet issued an advisory opinion concluding that a certificate of need would not be required for the addition of operating rooms to the practice if: (1) the only physicians performing surgery were the shareholders and employees of the physician group; and (2) no major medical equipment expenditure exceeded \$1,500,000. The advisory opinion included several disclaimers rendering the opinion void if the information provided in the request was inaccurate. Approximately six months later, Louisville Orthopaedic financed and constructed two operating rooms, which make up the ASC.

Louisville Orthopaedic applied to the Accreditation Association for Ambulatory Health Care (AAAHC) for Medicare accreditation. AAAHC denied the application based upon the Cabinet's refusal to verify that Louisville Orthopaedic was exempt from regulation and the certificate of need requirement.

The Cabinet opined that Louisville Orthopaedic would be subject to regulation and the certificate of need requirement if it sought licensure for a Medicare certification as an ASC.

Similarly, on November 11, 2007, Louisville Orthopaedic submitted its Medicare Health Care Provider/Supplier Enrollment Application (Medicare application) to receive federal reimbursement for the ambulatory service costs and facility fees incurred by Medicare patients. In order to receive Medicare reimbursements, Louisville Orthopaedic had to also provide a Cabinet statement declaring the ASC was exempt from regulation and the certificate of need requirement.

Louisville Orthopaedic moved the Franklin Circuit Court for a declaratory judgment or summary judgment that the Cabinet failed to recognize its exemption and failed to enforce the advisory opinion. On August 25, 2009, the Franklin Circuit Court granted summary judgment in favor of the Cabinet and concluded that Louisville Orthopaedic was not exempt from KRS 216B regulation. The court found that, “Louisville Orthopaedic is not merely a physicians’ office adding operating rooms to its office; it is a separate and distinct entity that conducts only surgery.” This appeal follows.

Louisville Orthopaedic claims that its physician shareholders are entitled to the exemption regardless of the legal form under which they practice and that they detrimentally relied upon the Cabinet’s advisory opinion.

Bluegrass Orthopaedics Surgical Division



In 1992, Burke & Lockstadt, PSC (Burke & Lockstadt) was established by a group of orthopedic physicians. In 2008, its name was changed to Bluegrass Orthopaedics & Hand Care, PSC (Bluegrass Orthopaedics & Hand Care). For years, the physician shareholders have unsuccessfully attempted to obtain a certificate of need to establish an ASC in Lexington. The Cabinet denied these requests based upon the oversaturation of surgical centers in the Lexington market. The Franklin Circuit Court and this Court have upheld those decisions. Since then, the shareholders have continued to attempt to garner this exemption under KRS 216B.

In 2004, the shareholders applied to the Centers for Medicare & Medicaid Services seeking Medicare certification for an ASC. This certification would allow Bluegrass Orthopaedics & Hand Care to collect a facility fee from Medicare in addition to physician fees and surgical fees. In order to receive the Medicare certification, an ASC must be a “distinct entity that operates exclusively for the purpose of providing surgical services to patients not requiring hospitalization.” 42 Code of Federal Regulations, Section 416.2.

In 2005, an ASC, Bluegrass Orthopaedics, was established as a limited liability company. The ASC is located in the same building as Bluegrass Orthopaedics & Hand Care’s physicians’ offices but has a separate waiting room and registration area. While Bluegrass Orthopaedics & Hand Care provides physician evaluations, examinations, and management services, only surgical

services are conducted at the ASC. The ASC has its own budget and maintains separate billing records, financial records, employee records, and board meetings.

On September 14, 2006, the Medicare certification request was denied based upon the lack of “certificate of need approval and state licensure to establish an [ASC] for which [was] not obtained.” Bluegrass Orthopaedics appealed the denial to the Department for Health and Human Services’ Department Appeals Board. The denial was subsequently upheld by the Administrative Law Judge (ALJ) and later by the Department’s Appellate Division. During this process, Bluegrass Orthopaedics claimed that it was not subject to KRS 216B regulation and licensure requirements because it fell under the physician exemption.

On June 4, 2007, Bluegrass Orthopaedics petitioned the Franklin Circuit Court for a declaration of rights that it is entitled to operate as an ASC under the physician’s office exemption and an order compelling the Cabinet to verify this exemption for Medicare certification purposes. Subsequently, the Circuit Court granted the motion of the aforementioned hospitals to intervene in this action.

On July 8, 2009, the Franklin Circuit Court entered an Opinion and Order declaring that physician-owned ASCs are exempt from the certificate of need requirements. This appeal follows.

#### The Physician Exemption, KRS 216B.020(2)(a)

As previously noted, KRS 216B.020(2) provides, “Nothing in this chapter shall be construed to authorize the licensure, supervision, regulation or

control in any manner of: (a) private offices and clinics of physicians. . . and other practitioners of the healing arts.” However, KRS 216B.015 does not define “physicians’ offices” or “clinics.”

If statutory language is clear and unambiguous, judicial interpretation is unnecessary. *Overnite Transp. Co. v. Gaddis*, 793 S.W.2d 129, 131 (Ky. App. 1990). If ambiguity exists patently or latently, however, we must determine the legislature’s statutory intent. KRS 446.130; *Autozone, Inc. v. Brewer*, 127 S.W.3d 653, 655 (Ky. 2004). While deference is given to an agency’s interpretation of the statutes that they are designated to administer, the court has the final responsibility to construe the legislature’s intent. *Delta Air Lines, Inc. v. Commonwealth, Revenue Cabinet*, 689 S.W.2d 14, 20 (Ky. 1985).

In *Gilbert v. Commonwealth, Cabinet for Health and Family Services*, 291 S.W.3d 712, 716 (Ky. App. 2008), this Court found that the physician’s office exemption was ambiguous. The Court determined that “whether a facility owned by a physician is a physician’s office and therefore exempt from regulation by the Cabinet pursuant to KRS Chapter 216B depends on the nature of the activity conducted there.” *Id.* at 719.

In addition to his office in which he treated patients, the physician in *Gilbert* owned three MRI testing facilities. *Id.* at 715. Although some of the patients that used the testing facility were Dr. Gilbert’s patients, other patients were referred to the testing facility by physicians other than Dr. Gilbert. *Id.* at 719. The Court noted that:

The manner of operation of these facilities establishes one obvious fact. The only reason these patients presented themselves at the testing facility was that, unlike a patient whose blood or urine or biopsied tissue is tested, these patients could not separate themselves from the biological subject matter of the test - their bodies.

*Id.* The Court’s decision did not hinge on whether the testing facility constituted a separate legal entity with a distinct purpose. Instead, the Court concluded that the physician exemption did not apply because Dr. Gilbert failed to show “that the majority of activity at these facilities was the provision of medical care to his own patients or those of his physician-employees.” *Id.* at 719. Dr. Gilbert lacked a connection to many of the testing facilities’ patients and their treatment.

Both Louisville Orthopaedic and Bluegrass Orthopaedics are clearly distinguishable from the facilities in *Gilbert*. The physician shareholders of both ASCs perform surgery on their own patients. While the patients were examined and diagnosed in the physicians’ traditional offices, those patients received treatment from the same physicians at the ASCs. Nothing suggests that either facility allows other physicians to perform surgeries.

“[T]he nature of the activity conducted” at Louisville Orthopaedic and Bluegrass Orthopaedics includes a more intimate doctor/patient relationship than that of a diagnostic testing facility or an ASC owned by a third party.

The physician-patient relationship is one that is built on trust and confidence. Just as a person seeks the professional judgment of an attorney in personal legal matters, a person seeks the professional judgment of a physician in matters related to his or her personal health and wellness.

*Bowman ex rel. Bowman v. Perkins*, 135 S.W.3d 399, 402 (Ky. 2004).

Although both ASCs were independent businesses, the doctor/patient relationship uniquely connected the ASC to the medical office. The surgical treatment performed was, in essence, an extension of the examination and treatment provided by the physician shareholders in their traditional offices. Therefore, we conclude that “the nature of the activity conducted” at Louisville Orthopaedic and Bluegrass Orthopaedics was consistent with the type of treatment intended by the legislature to be exempt from regulation under KRS 216B.

The Cabinet cites *Cabinet for Human Resources v. Women’s Health Services, Inc.*, 878 S.W.2d 806 (Ky. App. 1994), to support its claim that a physician-owned ASC is not exempt from KRS 216B regulation. In *Women’s Health Services*, this Court reversed the circuit court’s grant of summary judgment based upon its opinion that a material issue of fact existed whether the facility was a private physician’s office or an ASC. *Id.* at 807. Our decision in this case, however, is not necessarily inconsistent with *Women’s Health Services*.

Nothing in this decision indicates that all physician-owned ASCs are exempt from KRS 216B regulation and licensure requirements. This decision recognizes that certain ASCs may be exempt depending on whether they are an extension of a physician’s office practice and whether their equipment expenditures do not exceed the maximum allowable. The terms “ASC” and “physician’s office” are not necessarily mutually exclusive in determining whether the exemption from regulation applies.

Accordingly, the Franklin Circuit Court Order, entered on July 8, 2009, granting summary judgment in favor of Bluegrass Orthopaedics is affirmed. The Franklin Circuit Court Order, entered on August 25, 2009, granting summary judgment in favor of the Cabinet is reversed and remanded to the Circuit Court to enter an order in conformance with this opinion and directing the Cabinet to verify Louisville Orthopaedic's exemption from KRS 216B regulation and licensure requirements.

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