



THE STATE
of **ALASKA**
GOVERNOR BILL WALKER

**Department of
Health and Social Services**

OFFICE OF THE COMMISSIONER

Anchorage

3601 C Street, Suite 902
Anchorage, Alaska 99503-5923
Main: 907.269.7800
Fax: 907.269.0060

Juneau

350 Main Street, Suite 404
Juneau, Alaska 99801-1149
Main: 907.465.3030
Fax: 907.465.3068

September 6,
2016

John C. Rothermick
Garvey Schubert Barer
121 SW Morrison Street
Eleventh Floor
Portland, OR 97204-3141
Email: JRothermich@gsblaw.com

Re: Denial of request for reconsideration dated July 28, 2016

Dear Mr. Rothermick:

The Certificate of Need (CON) office has forwarded the request for reconsideration submitted by Diagnostic Health Center of Anchorage, LLC's (DHA) on July 28, 2016, as well as the documentation sent in support of the request. I have also reviewed the email response you provided to Ms. Kraly on August 22, 2016 related to the ownership of the entities involved. I have reviewed all of the documents submitted with the request for reconsideration, the prior letters, and other documentation in the CON program's files, and other information available to the Department as indicated below.

After this review, I affirm the CON program's determination made on June 28, 2016, finding that DHA must obtain a Certificate of Need before operating a new imaging and radiology clinic at 1751 E. Gardner Way in Wasilla, Alaska. The decision is affirmed for the following reasons.

TIMELINE

- July 27, 2015: DHA submits a Request for Determination (RFD).
- August 6, 2015: CON staff request additional information before making its decision regarding whether a certificate of need is required. The letter asked DHA

to provide additional information regarding the scope of leasehold work, costs for furniture and accessories, and confirmation regarding the space being leased.

- August 17, 2015: DHA submits additional information.
- September 1, 2015: The CON staff informs DHA that based upon their certified cost estimates a CON is not required.
- September 22, 2015: Imaging Associates seeks reconsideration of the decision that a CON is not required by DHA.
- September 29, 2015: CON staff requests additional information from DHA.
- October 23, 2015: DHA responds to the request for additional information.
- April 25, 2016: Diagnostic Health Alaska submits an Amended Request for Determination after determining that DHA did not include some required expenditures in its initial request.
- May 13, 2016: CON staff request additional information from DHA.
- June 8, 2016: DHA provides a written response to questions posed by CON staff and provides additional documentation.
- June 28, 2016: CON staff determine that a CON is required based on the documentation submitted by DHA, and upon learning of many additional expenses that DHA incurred before the time of its initial request but never reported to the CON program.
- July 28, 2016: DHA seeks reconsideration.

ARGUMENTS RAISED BY DHA

In its request for reconsideration, DHA raises three points of contention with the CON staff's determination that a CON is required:

1. the inclusion of costs for the x-ray, c-arm and ultrasound;
2. the inclusion of sign purchase and installation and other leasehold improvements such as interior painting and new cabinet and surface facings;
and
3. the inclusion of the full lease rather than the lease adjusted to deduct the amount of two subleases.

DHA concedes that some equipment was not, but should have been, included in their request for determination. Each of the above three contested points will be discussed individually.

1. The inclusion of the x-ray, c-arm and ultrasound.

DHA admits that when they submitted the RFD on July 27, 2015, they had committed to the following equipment expenses:

- \$188, 803.60 for a XR Gold Seal Definium (x-ray machine),
- \$83,750 for a US Gold Seal Logiq E9 (ultrasound machine), and
- \$181,925 for a C-Arm Gold Seal 9900 Elite.

Additionally, DHA admits that they did purchase these items and installed them at 1751 E. Gardner Way, Wasilla. Thus, there is no dispute that these amounts should have been, but were not included in the original RFD. Including these three costs would have added \$454,478.60 to the original cost estimate of \$1,272,817.73, putting DHA over the statutory threshold of \$1.5 million by \$227,296.30. Thus, had these costs been included at the time of the RFD, the staff would have determined a CON was required.¹

DHA argued in its request for reconsideration that all three pieces of equipment should not be included in the cost estimate because, after determining that the costs should have been included, DHA sold that equipment and purchased much less expensive equipment (“upon learning the x-ray, C-arm and ultrasound equipment had to be included in the CON threshold, DHA sold the expensive state-of-the art equipment it had purchased and replaced it with less expensive equipment”).²

¹ Notwithstanding Ms. Hicks’s letter dated May 3, 2016 which indicated your Amended Request for Determination would be looked as a new request, I cannot abide by that conclusion in light of the factual information that has been provided through this process and through the litigation. Specifically, the information that is outlined in this decision questions the accuracy of the initial request for determination, and the continued veracity of the claims that have been made related to the original request. As such, this decision looks at the totality of the circumstances and concludes that had all of the information been provided at the time of the original submission a CON would have been required. And the attempts to mitigate the costs associated with the facility at the time of the original submission cannot be rewarded.

² None of these three pieces of equipment were reported in DHA’s July 27, 2015 RFD. Months after DHA (and DHSS) were sued by Imaging Associates, DHA submitted an amended RFD which included—without mentioning the initial equipment purchased—the following expenses (continued):

While DHA's quick equipment switch avoided the inclusion of the higher costs in the cost estimate submitted in June 2016, the manner in which this was done does not comport with the letter and intent of the CON statutes and regulations and cannot be accepted. The sale of the expensive equipment at actual cost, and the subsequent purchase of the new equipment at a massive discount is nothing more than a bait and switch to avoid the statutory threshold. If the question is whether the costs should have been included in July of 2015, there is no question that they should have been. Therefore, no discount should be allowed.

But there is a second reason why the discount should not be allowed and that is because the sale of the "state-of-the art equipment" was not completed in an arm's length transaction, and the costs that were reported to purchase the used C-arm and ultrasound machine were not reasonable. The three pieces of expensive equipment were sold by Chugach Imaging JV, LLC *by its Managing Member* Alliance Healthcare Services, Inc., signed by Richard W. Johns to Alliance Healthcare Services, Inc., signed by Richard W. Johns, for the exact same price that the equipment was originally purchased for. Additionally, it is reported that these pieces of equipment have been or will be moved for use at a different DHA facility. The same entities, including signor, then bought and sold a different C-arm and ultrasound machine for a combined total of \$3500. DHA's creative, yet manufactured sale of their brand new, state-of-the-art equipment, to what is essentially for use by itself, cannot be viewed as a valid transaction to avoid the CON threshold.

Under AS 18.07.031, any expenditure for a health care facility that exceeds \$1.5million must have a CON before construction and operation. In this case, DHA failed to include significant expenditures for equipment in its original certified cost estimate

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- Ultrasound Siemens Sequoia 512 (\$1,500),
 - X-Ray Unit Americorps Summit AM2 (\$57,840),
 - OEC C0Arm GE Stenoscope 2 (\$2,000).

When CON staff determined in June 2016 that DHA did need a CON, they relied upon information showing that DHA had spent far more than reported for these pieces of equipment. The CON staff had this information because of the ongoing lawsuit. It was unclear to CON staff that DHA replaced the initially-purchased equipment with older, used equipment, two items that they now say are obsolete in the imaging market and these costs were included with the new equipment purchases. Based on information in DHA's request for reconsideration, I conclude that the cost to purchase these three pieces of older equipment used should be removed from the project costs, but the cost to purchase the new equipment should remain.

thereby avoiding the CON process at that time. After realizing their error, they sold the expensive equipment at full cost to itself then sold to itself discounted equipment. The discounts are simply not credible costs.³ Accordingly, the CON program continues to assert the full cost of these three pieces of equipment on the date of the submission of the RFD must be included in the certified cost estimate;⁴ therefore, threshold has been exceeded, DHA must have a CON to operate.

While it is not clear if you are arguing that Turnagain's 20% ownership in Chugach impacts the analysis here, but assuming such an argument is being made, I find any such argument unavailing. On August 18, 2016, Ms. Kraly requested that you provide a summary of the ownership interest of the entities involved in this matter. You responded on August 22, 2016, and the following is a summary of the information you provided in that response:

- Alliance HealthCare Services, Inc. (Alliance) is a publicly held Delaware corporation that owns and operates imaging facilities around the country.
- Diagnostic Health Center of Anchorage, LLC (DHA) is 100% owned by Alliance. DHA is a Delaware LLC engaged in providing imaging and radiology services at a facility located at 4100 Lake Otis Parkway, Anchorage. Diagnostic Health Alaska is a registered d/b/a name registered by DHA.
- Chugach Imaging, LLC (Chugach) was formed by Alliance in October 2015. Alliance was 100% owner of Chugach until December 2015 when Turnagain Radiology Associates, LLC (Turnagain) purchased a 20% interest. Chugach

³ DHA submitted a letter dated February 12, 2016 from an employee at Integrity Medical Systems, Inc., the same company DHA purchased an X-ray machine from one month earlier, evaluating pricing for a C-Arm and ultrasound machine. Presumably this estimate looks at the same models installed in the Wasilla facility, though DHA has not made this claim nor demonstrated this fact. The estimate is based on recent market pricing, yet there have been few to no sales taking place and the estimates are based on the use of parts. Consistent with prior CON program decisions, this type of nearly zero valuation is not an acceptable estimate because the facility obviously will continue to benefit from it.

⁴ But, consistent with this decision, we will remove the X-Ray Unit Americorps Summit AM2 (\$57,840) from the cost estimate. The \$1500 and \$2000 expenses had already been removed in the CON program's June 28, 2016 decision.

entered into a lease agreement with CST Properties, LLC for 1751 East Gardner Way, Suites A, B, C, F, and Telecom Room on October 5, 2015.

The fact that Turnagain is a minority owner of Chugach does not impact this analysis. The timing of these transitions and the fact that Turnagain only holds a 20% ownership in Chugach does not mitigate the facts in this record that show that bills of sale for the equipment were sold by and purchased by the same individual (Richard W Johns) and the same company (Alliance Health Care Services, Inc. – managing member of Chugach Imaging JV, LLC).⁵ Even with Turnagain's limited interest, there is no way to recognize these purchase/sale agreements as arms-length transactions.

The cost of all three items of equipment must be included in the cost estimate to determine whether DHA has exceeded the statutory threshold of \$1.5 million, when included there is no question that the threshold has been exceeded; therefore, DHA requires a CON before construction and/or operation of this health care facility in Wasilla.

2. The inclusion of the sign and other leasehold improvements.

DHA argues that the decision to include its custom-made sign and other leasehold improvements that they would like to characterize as aesthetic improvement should not be included because they are unnecessary upgrades. The costs of these two items are \$8928 and \$6948 respectively. I disagree. The CON program consistently includes signage as part of the cost estimate, and considers the other repairs to be leasehold improvements. Under 7 AAC 07.010(8), expenses to lease equipment or space occupied by the facility must be included in the cost estimate to determine whether a CON is required. Costs for leasehold improvements, fixtures, and equipment purchased for operation are included under this subsection. Leasehold improvements are not defined, but the commonsense definition includes alterations made to a space in order that the new tenant may use it for their business purpose. The definition of fixture includes anything permanently affixed to a building, and specifically includes cabinets, counters, and signs.⁶ Equipment is defined in 7 AAC 07.900. The exclusion that DHA wishes to use includes "optional design features, furnishings, or décor choices that do not add to the minimum necessary for the safe, functional, and medically appropriate operation of the facility." New cabinet surfacing and painting fall within the regulatory definition of

⁵ See Exhibit 3 of Mr. Joslin's declaration, Bill of Sale effective March 1, 2016.

⁶ 7 AAC 07.010(h)(3).

leasehold improvements, and the purchase of new carpet, and new cabinets are explicitly incorporated into the definition of fixture. Further, all leasehold improvements that are not like those identified above, must be included in the cost estimate and absent further information from DHA, their argument that other improvements be excluded is denied.

Finally, signs are included in the definition of fixtures and must be included in the cost estimate. The sign is integral to the operation of this facility and while some of the cost may be excluded because it is above and beyond the basic sign, the entire cost cannot be excluded. The CON has included these types of expenditures in the past and will continue to do so in the future. The analysis of *ITMO Providence* supports this determination.⁷

3. The inclusion of the full lease rather than the lease adjusted based upon two subleases.

DHA argues that the inclusion of the subleases is inappropriate because the calculation must consider the net present value of the lease for space that is *occupied by the facility*. 7 AAC 07.010(a)(8). The CON staff does not disagree with the legal framework of this question but disagrees with DHA's conclusion that the subleases should not be included in the lease calculation.

DHA argues that the subleased space should not be included as a matter of law, policy and fairness. Relying on the decision of *ITMO Providence Health Systems of Alaska*, OAH 11-0045 DHS, DHA argues that the sublease space can be "backed out" because it is not being used by DHA. In this instance, Chugach is the lessee of the space at issue. It leased approximately 7827 square feet of office space located at 1751 East Gardner Way, Wasilla (not the entire building), and then promptly subleased portions of the space to two subleases; Alliance HealthCare Services and Cottonwood Clinic. In July and October 2015 DHA reported the entire lease costs in its cost estimate. In April 2016 DHA reduced this amount by \$39,264 and in June 2016 reduced the amount by an additional \$10,333.20.

⁷ DHA argued that the sign falls under the exclusion allowed for "optional design features" as discussed in the Providence matter. In that case, the costs associated with "fiber optic twinkling lights and social decorative all-mounted panel and the cloud motif room ceiling" were excluded. This exception covers items over the minimum necessary to function; as stated, if the sign is decorative, then the amount above and beyond a normal sign would be excluded, but I do not have information to support that the sign itself is above and beyond what a normal sign would cost.

Both subleases must be included in the net present value calculation because Chugach Imaging is legally responsible for the cost of the entire lease should either sublessee default on the terms of the sublease. While this may be a revenue generating option for Chugach, it does not limit their ultimate responsibility over the premises and the costs of the lease, nor does it offset the total cost to Chugach under the master lease for these premises. In support of this position, I find that the facts present here are distinguishable from *ITMO Providence* cited by DHA. In that case, Providence owned the entire building and planned to use only part of it for an imaging facility. Providence did not have to rent the entire property as a cost of doing business. Here, all indications are that DHA⁸ had to rent the entire area that it did in order to operate its facility, and therefore, the entire lease is considered in determining whether DHA needs a CON.

Additionally, I disagree with DHA's argument regarding the words "occupied by the facility" in the definition of leased property. DHA leased part of the building at 1751 E. Gardner Way, and they plan to operate an imaging facility in that space that they rented. The fact that not all of the space will be used as an imaging facility does not mean that they can carve out pieces of the premises to reduce the net present value calculation. I find that this interpretation is not consistent with the plain meaning of the regulation.

Accordingly, I find that the entire cost of the lease should be included.

CONCLUSION

The motion for reconsideration is denied in full:

1. The certified cost estimate must include the full cost of the x-ray, c-arm and ultrasound as of the date of the original RFD;
2. The signage and leasehold improvements must be included as they are not considered optional design features as contemplated by the regulations;
3. The subleases may not be backed out of the net present value lease calculations.

Therefore, based upon our review of the material submitted and available to the Department, we have concluded that DHA's revised total project expenditures are calculated as follows:

⁸ When DHA submitted copies of the draft lease agreement in July and August, 2015, Alliance was the named lessor even though DHA submitted the RFD. The month that the lease was signed is the same month Chugach was created.

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MRI GE Gold Seal 1.5T 16 Channel HDXT	\$ 588,600.68
CT GE Gold Seal Brightspeed 16	\$ 266,987.75
US Gold Seal Logiq E9	\$ 83,750.00
C-Arm Gold Seal 9900 Elite	\$ 181,925.00
XR Gold Seal Definium	\$ 188,803.60
Lease Costs	\$ 276,000.00
Leasehold Improvements	\$ 286,763.00
Radiologist Table	\$ 2,460.20
Lobby Furniture	\$ 2,471.30
UltraSound Table	\$ 7,280.20
Other Furniture, Signage and Misc.	\$ 55,970.16
Procedure Table	\$ 5,273.34
X-Ray Install	\$ 6,646.24

For a total cost of **\$1,952,931.47**, since the revised expenditures exceed the \$1.5 million statutory threshold under AS 18.07.031, this determination finds that the proposed project requires a certificate of need.

This constitutes a final agency decision pursuant to 7 AAC 07.033. If you wish to appeal this decision, you must file an appeal with the Superior Court within 30 days of the date of this letter as provided in Alaska Rules of Appellate Procedure 601.

Respectfully,



Valerie Davidson, Commissioner
Alaska Department of Health and
Social Services

cc. Jon Sherwood, Deputy Commissioner, DHSS
Alexandria Hicks, CON Program
Stacie L. Kraly, Chief Assistant Attorney General
Stanley Lewis, Counsel for Imaging Associates