PROVIDER REIMBURSEMENT REVIEW BOARD DECISION

2006-D49

PROVIDER -
CT Subacute Corp. 93 Capital Lease Group

Provider Nos.:
07-5234 - Brook Hollow Health Care Center
07-5210 - Cedar Lane Rehabilitation Center

vs.

INTERMEDIARY -
BlueCross BlueShield Association/
Empire Medicare Services

DATE OF HEARING -
November 17, 2004

Cost Reporting Period Ended -
July 22, 1993

CASE NO.: 96-2013G

INDEX

ISSUE:

Whether the Intermediary's adjustments to disallow rental expense as a cost incurred with a related organization were proper.

MEDICARE STATUTORY AND REGULATORY BACKGROUND:

The Medicare program was established in 1965 under Title XVIII of the Social Security Act (Act) to provide health insurance to the aged and disabled. 42 U.S.C. §§1395 – 1395cc. The Health Care Financing Administration (HCFA), now Centers for Medicare and Medicaid Services (CMS) is the operating component of the Department of Health and Human Services charged with administering the Medicare program.

In order to participate in the Medicare program, a hospital must file a provider agreement with the Secretary. 42 U.S.C. §1395cc. The Secretary's payment and audit functions under the Medicare program are contracted out to insurance companies known as fiscal intermediaries (FIs). Fiscal intermediaries determine payment amounts due the providers under the Medicare law and under interpretative guidelines published by CMS. Id.

At the close of its fiscal year a provider must submit a cost report to the fiscal intermediary showing the costs it incurred during the fiscal year and what portion of those costs are to be allocated to Medicare. 42 C.F.R. §413.20. The fiscal intermediary reviews the cost report and determines the total amount of Medicare reimbursement due the provider. Through a notice of program reimbursement (NPR), the Intermediary sets forth the individual expenses allowed and disallowed by the intermediary. 42 C.F.R. §405.1803. A provider dissatisfied with the intermediary's final determination of total reimbursement may file an appeal with the Provider Reimbursement Review Board (Board) within 180 days of the NPR. 42 U.S.C. §1395oo(a); 42 C.F.R. §405.1835.

Under 42 C.F.R. §413.17(a) a provider is entitled to claim "costs applicable to services, facilities, and supplies furnished to the provider by organizations related to the provider by common ownership or control" at the cost to the related organization as long as the cost does not exceed the price of comparable services, facilities or supplies that could be purchased elsewhere. However, there is an exception to this rule.

42 C.F.R. §413.17(b) provides the following definitions to the terms which appear in 42 C.F.R. §413.17(a).

> (1) Related to the Provider - Related to the provider means that the provider to a significant extent is associated or affiliated with or has control of or is controlled by the organization furnishing the services, facilities, or supplies.
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> (2) Common ownership - Common ownership exists if an individual or individuals possess significant ownership or equity in the provider and the institution or organization serving the provider.

> (3) Control - Control exists if an individual or an organization has the power, directly or indirectly, significantly to influence or direct the actions or policies of an organization or institution.

42 C.F.R. §413.17(d)(1) provides an exception that the charge made by the related supplier to the provider is allowable as "cost" provided the following criteria are met:

> (i) The supplying organization is a bona fide separate organization;
> (ii) A substantial part of its business activity of the type carried on with the provider is transacted with others than the provider and organizations related to the supplier by common ownership or control and there is an open, competitive market for the type of services, facilities, or supplies furnished by the organization;
> (iii) The services, facilities, or supplies are those that commonly are obtained by institutions such as the provider from other organizations and are not a basic element of patient care ordinarily furnished directly to patients by such institutions; and
> (iv) The charge to the provider is in line with the charge for such services, facilities, or supplies in the open market and no more than the charge made under comparable circumstances to others by the organization for such services, facilities, or supplies.

The Provider Reimbursement Manual (P.R.M) at §1010 sets out the same criteria.

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

Key Parties Involved:[1]

1. **Health and Rehabilitation Properties Trust (HRPT) -** A real estate investment trust (REIT) established in 1986 to invest in income–producing real estate with an initial emphasis on rehabilitation, health care and related facilities. It is the "Supplier" in this case and owner/landlord of the Provider facilities. HRPT is governed by a five member Board of Trustees consisting of Gerard Martin, Barry Portnoy, Esq. and three Independent Trustees.

2. **Sponsors of HRPT**
   New MediCo/Continuing Health Corp.
   Greenery Rehabilitation Group
   HRPT Advisors

3. **HRPT Advisors, Inc.** - A corporation wholly owned by Gerard Martin and Barry Portnoy, established to provide a variety of investment, management, and administrative services to HRPT and other companies, including the sponsors who created HRPT.

[1] See Intermediary Exhibit 10-November 17, 2004 Stipulations.

4. **Continuing Health Care Corporation (CHCC) -** A corporation created in 1986; licensee and operator of skilled nursing facilities (SNFs) including Brook Hollow Health Care Center (Brook Hollow) and Cedar Lane Rehabilitation Center(Cedar Lane), the Providers in this case. CHCC owned 9.9 percent of the HRPT's shares, which it sold back to HRPT as of October 14, 1992. It leased the Providers' facilities from HRPT. As of July 23, 1993, Connecticut Subacute Corporation (CSC) assumed CHCC's Medicare Provider agreement and became the licensee/operator of the Providers. CHCC is a wholly owned subsidiary of New Medico Holding Co., Inc.

5. **Connecticut Subacute Corporation (CSC) –** A corporation organized in 1992; wholly owned by Gerard Martin (50%) and Barry Portnoy (50%) and subject to the control and direction of CHCC.[2] During the time period at issue in this case (October 1, 1992 through July 22, 1993), CSC served as interim manger for CHCC's Connecticut facilities, which included Brook Hollow and Cedar Lane. Beginning on July 23, 1993, CSC served as the tenant and licensee for Brook Hollow and Cedar Lane under terms that were substantially similar to the leases with CHCC.

6. **New Medico Holding Co., Inc. (New Medico) -** A privately held corporation which owned and operated skilled nursing facilities. New Medico is owned by Charles Brennick, a cousin of Gerard Martin.

7. **Greenery Rehabilitation Group, Inc. (Greenery) –** A publicly traded corporation; owner of Greenery Manager, Inc. (Greenery Managers). Gerard Martin was the controlling shareholder, Chairman of the Board of Directors, President and Chief Executive Officer.

8. **Individuals**

Gerard M. Martin

*Director and 50% owner of CSC
*Managing trustee of HRPT
*Director and 50% owner of HRPT Advisors
*Director/owner of Greenery Rehab Center
*Cousin of Charles Brennick

Barry M. Portnoy, Esq.

*Secretary and 50% owner of CSC
*Managing trustee of HRPT
*Director/and 50% owner of HRPT Advisors
*Partner in a Massachusetts Law firm/counsel to HRPT

[2]See Provider's Frequent Exhibit Book (Ex. 24) at Tab 2. The Board notes that the record contains two exhibits (See Transcript.(Tr.) at 20) which are labeled Provider Exhibit 24. Such exhibits are the Frequent Exhibit Book and a chart of surveyed facilities.

*Legal advisor to companies sponsoring creation of HRPT

Charles Brennick –
*Director and 100% owner of New MediCo/CHCC;/
*Cousin of Gerard M. Martin.

HRPT, a REIT, was established in 1986. In late1986, HRPT contracted for the provision of management and administrative services with HPRT Advisors Inc. HRPT's Board of Trustees supervised HRPT Advisors' activities, and, in turn HRPT Advisors managed the operation of the REIT. In 1986, HRPT purchased three facilities (Brook Hollow, Cedar Lane and Forestville Health and Rehabilitation Center n/k/a Subacute Center of Bristol)[3] from CHCC (a subsidiary of New MediCo) and leased them back to CHCC.[4]

In 1992, HRPT's Trustees decided to eliminate its investment in all of New Medico's companies, including CHCC, and to seek a new tenant for the three Connecticut properties due to CHCC's inability to pay rent. However, HRPT claims that it was unable to find a tenant to replace CHCC, because few companies had the expertise and quality of management necessary to operate these specialized facilities, and none was willing to take over the operation.[5] As a result, on September 15, 1992, Gerard Martin and Barry Portnoy formed CSC to manage the CHCC properties and to eventually take over the leases.

On October 8, 1992, HRPT's Trustees voted to exercise an option to terminate HRPT's leases with CHCC for the Providers' facilities and to enter into an agreement to lease these properties to CSC.[6] According to the Providers, neither Mr. Martin nor Mr. Portnoy voted on this transaction.[7] To allow CSC sufficient time to procure licenses to operate the facilities and to take over as a tenant, HRPT entered into an Agreement to Lease[8] with CSC and arranged with CHCC to enter into an Interim Management Agreement[9] with CSC. CHCC remained the tenant and licensee for the three facilities

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[3] See Provider Ex. 7. Also, the Provider noted that Forestville was assigned a different fiscal Intermediary and is not a party to this appeal (Provider Position Paper at n. 11).

[4] Additionally, Greenery was established as a stand-by manager and guarantor of rent payments in the event that CHCC failed (Tr. at 110-115). The standby agreement was not implemented during the period at issue in this case.

[5] Tr. at 130, 190, 306-307.

[6] Provider Ex.10 (Minutes, Meeting of the Board of Trustees, October 8, 1992).

[7] See Provider Ex. 19 (Martin Affidavit) at ¶9, Tr. at 133, 308-309.

[8] Provider Ex. 11.

[9] Provider Ex. 12. Also, the President of CSC was required to report to the Regional Vice President of CHCC and to use certain CHCC's services such as off-site laundry services. (See Tr. at 310). The Agreement required CSC to pay and perform all of CHCC's obligations under the leases with HRPT, including paying rent due to HRPT. CSC was also charged with supervising the financial affairs of the facilities and representing them in dealings with regulatory authorities. Finally, under the Interim Management Agreement, CHCC agreed to relinquish shares of common stock that it

while CSC served as interim licensee for the three facilities while CSC served as interim manager. As acknowledged by the Intermediary, the terms of the lease between HRPT and CSC, including the financial terms, are substantially similar to the original lease entered in 1986 with CHCC.[10]

Under the Interim Management Agreement, CSC agreed to manage, supervise, and operate the three Connecticut facilities subject to the control and direction of CCHC until such time as CSC obtained all approvals necessary to take over as the tenant and licensee.[11] CSC eventually obtained the required licensure approvals for the Providers, and on July 23, 1993, HRPT entered into leases with CSC for each of the three facilities. At that time, CSC also assumed the Providers' Medicare provider agreements.[12]

After CSC took over as tenant of the facilities, it filed Medicare cost reports for each facility for the fiscal period ending July 22, 1993. In the cost reports, CSC claimed the full amount of the lease payment[13] that it made on CHCC's behalf to HRPT.[14] The Intermediary[15] disallowed the lease expenses for the two facilities under appeal and added in interest and depreciation for the properties. The estimated amount of Medicare reimbursement at issue is $65,864 for Cedar Lane and $80,721 for Brook Hollow.

The Providers filed timely appeals with the Board and have met the jurisdictional requirements of 42 C.F.R. §§405.1835-405.1841. The Providers were represented by Maureen Weaver, Esquire, and Amanda Littell of Wiggin and Dana, L.L.P. Bernard Talbert, Esquire, of Blue Cross Blue Shield Association represented the Intermediary.

PROVIDERS' CONTENTIONS:

The Providers note that although CSC served as interim manager during the time period in question (October 1, 1992 through July 22, 1993), because CHCC remained the tenant, licensee, and certified Medicare provider during this period, the related party analysis

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and its affiliates held in HRPT. HRPT redeemed the stock on January 2, 1993 pursuant to an agreement to prepay certain mortgage obligations that CHCC owed to HRPT. See HRPT 1992 Annual Report, Exhibit P-8 at 16, n. 3.

[10] See Intermediary position paper at 7. Provider Post Hearing Brief at 14, Provider Exhibit 8 at 9.

[11] Provider Exhibit 12, Interim Management Agreement.

[12] Provider Post Hearing Brief at 15.

[13] See I-10 - November 17, 2004 Stipulations. The lease documents at issue in this case are contained at Exhibit P-7.

[14] Provider Exhibit 13.

[15] At the time of the Notices of Program Reimbursement (NPR) in question, the Fiscal Intermediary for Brook Hollow and Cedar Lane was Traveler's Insurance Company n/k/a MetraHealth Insurance Company (Travelers). Anthem Blue Cross/Blue Shield (Anthem) served as the Intermediary at the time of the hearing. Subsequently, Empire Medicare Services became the Intermediary. For purposes of this decision, Travelers, Anthem, and Empire will be referred to collectively as the Intermediary.

must focus on the relationship between the Providers (CHCC) and HRPT. The Providers contend that these organizations are unrelated. The Providers emphasize that to be considered related, the regulation at 42 C.F.R.§413.17 requires that the relationship between the parties, whether by ownership or control, be "significant."

With respect to common ownership, the Providers contend that neither HRPT nor any of its principals or trustees held any ownership or equity in CHCC. No principals in CHCC held any ownership or equity interest in HRPT, except that CHCC purchased a minor 9.95 percent interest in HRPT as part of the 1986 sale-leaseback transaction. The Providers contend that such ownership percentage is not "significant" enough to support a finding of common ownership.[16] The P.R.M. at §1004.2 provides guidance as to the level of common ownership necessary for organizations to be related.

With respect to common control, the Providers contend that neither CHCC nor HPRT could control one another, as demonstrated by the negotiations surrounding the sale-leaseback transaction.[17] The Providers note that CHCC's lack of creditworthiness became a very important factor in negotiating the transaction and that prior to its completion an independent appraiser had concluded that acquisition price and the rents were reasonable and within the fair market value. In addition, the trustees considered other factors such as the properties' condition, sources of revenue and management in their determination.[18] Additionally, the Providers maintain that the Intermediary's contention that the "arm's-length" statement in HRPT's prospectus constitutes an admission of relatedness under the Medicare rules is misguided, because disclosures made for purposes of federal securities laws have no relevance to the determination of whether organizations are related for Medicare purposes.[19] Moreover, the prospectus itself lists numerous factors that the HRPT trustees considered when reviewing the transaction.

Similarly, the Providers contend that the Intermediary's broad view that Mr. Martin and Mr. Portnoy have indirect control of HRPT since they own HRPT Advisors is misplaced. The focus of the analysis should be on the relationship between CHCC and HRPT. Moreover, even if CSC's role was relevant, Mr. Martin and Mr. Portnoy only had a beneficial ownership of 4.1% in HRPT (including HRPT Advisors' 1.2% direct

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[16] See Provider Post Hearing Brief at 19-20. As further support that such interest was not significant, the Provider notes that CHCC did not purchase and own the shares until the lease terms were negotiated, CHCC was required to pledge those shares to HRPT as security for the sale-leaseback transaction, CHCC could not vote on those shares and as of October 14, 1992, the beginning of the time period at issue, CHCC had relinquished its shares in HRPT. See Tr. pp. 109-118.

[17] See Tr. at 106-108, 297-300.

[18] See Provider Ex. 6 at 19.

[19] The Intermediary notes that page 19 of the prospectus (Provider Ex.6) states "To the extent that the terms of the mortgage financing, acquisition and lease of the properties have been negotiated among related parties, they have not been determined on an arm's-length basis."

ownership in HRPT) and together, they only constituted a minority of HRPT's Board of Trustees. Also, Mr. Martin and Mr. Portnoy abstained from the HRPT vote on the 1992 transaction between CSC and HRPT.[20] Moreover, HRPT did not contract with HRPT Advisors to enable Mr. Martin or Mr. Portnoy to control HRPT or the Providers; but rather, since REITs are legally prohibited from providing management and administrative services for its rental properties,[21] HRPT Advisors, under HRPT's Trustees' authority, was contracted to fill a position that was commonly utilized by REITs.

The Providers continue that even if the Board determines that a related party relationship exists, the four exception requirements set forth in 42 C.F.R. §413.17(d)(1) have been met.

The parties stipulate that the first requirement was met since CHCC and HRPT are bona fide separate organizations.[22]

The Providers contend that the second exception requirement was met because a substantial part of HRPT's business is transacted with unrelated organizations and there is an open and competitive market for the types of services furnished by HRPT. CHCC had financing options such as the use of other REITs, banks, private lenders, insurance companies, or other financial institutions.[23] Additionally, the Intermediary incorrectly believes[24] that because the lease had a ten-year term, no open, competitive market existed as far as renegotiating the lease. The Providers argue that such a belief is flawed because it suggests that any term contract or arrangement for the provision of goods or services eliminates the existence of an open and competitive market.

With respect to the third exception requirement, the Providers contend that it was common for Connecticut long-term care providers to lease facilities during the period at issue.[25] Additionally, the existence of the Medicare sale and leaseback regulation at 42 C.F.R. §413.130 and numerous PRRB and HHS Departmental Appeal Board decisions with factual circumstances involving leases provide further evidence that CMS recognized the practice of leasing SNF facilities during the time period at issue.

Regarding the fourth exception requirement, due to the appeal's age, the Providers could not obtain quantitative data on lease payments made by comparable nursing facilities during the time period at issue. However, the Providers maintain that the Board can infer that the lease payments were in line with charges in the open market by virtue of the fact

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[20] Supra, note 7.
[21] See Provider Post Hearing Brief at 31; Provider Ex. 20(a); IRC §§856(c), 857(b)(5) and (6).
[22] See I-10 (November 17, 2004 stipulations).
[23] Tr. at 96, 107-08, 236-37.
[24] Tr. at 356.
[25] Tr. at 102, 256-60. Additionally, the Intermediary's witness, on cross examination admitted that he based his opinion that leasing of long-term facilities was uncommon based upon his experience "mainly in New York."(Tr. at 357)

that CHCC and HRPT negotiated the lease terms and rent calculations at arms-length.[26] The lease negotiations took into consideration a variety of factors to reassure the initial shareholders that a plan existed if the operator failed to perform.[27] Also, the facilities' specialized nature caused the rent payments to be higher than rents for more traditional nursing homes.[28] Additionally, an independent appraiser concluded that the acquisition price and the rents that were negotiated were reasonable and HRPT's independent trustees approved the lease term after conducting a full review of the proposed transaction.[29] The Intermediary also attempted to apply a comparison of the Providers' as-settled data from 1999 to that of other SNFs' as-filed and as-settled data from 1993 to suggest that the Providers' lease costs were out of line. However, the Intermediary's Exhibit 9 supports the Providers' contention that its costs were in line.[30]

The Providers also argue that the Intermediary's new line of argument concerning the reasonableness and necessity of the borrowing or the lease expenses, which was initially presented at hearing, is not properly before the Board, since it was not raised in a timely manner nor adequately disclosed to the Provider.[31] However, even if such arguments were not timely raised, the Providers contend that they met the 42 C.F.R. §413.130 criteria addressing the inclusion of rental charges in capital-related expenses for sale and leaseback agreements.[32] Moreover, the Intermediary's argument that the cost of using the physical plant "went up substantially from the day before [the sale-leaseback transaction] to the day after"[33] is speculative and unsupported, as the record contains no evidence regarding the Providers' cost reports before the 1986 transaction. Accordingly, the Intermediary improperly rushed to the conclusion that the Providers' rental expenses were unreasonable based on their prior capital costs.[34] The lease expenses are "necessary and proper" under the general requirements of 42 C.F.R §413.9 and are not substantially out of line with other comparable facilities under the general reasonableness test of that section.[35] Also, although the enforceability of the "prudent buyer principle"[36] has been limited by two federal court decisions,[37] the Providers claim that they presented ample evidence that the sale-leaseback transaction was the product of extensive negotiations

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[26] See Tr. at 96, 107-108, 236-37.
[27] Tr. at 86, 106-07, 109, 117, 164, 244-45, 250-51, 298-99.
[28] Tr. at 104-05, 254-55, 304-05.
[29] Tr. at 108, 118-21, Provider Ex. 6 at 19.
[30] See Intermediary Ex. 9; Tr. at 378-80, 396-402, Appendix 1 to Provider Post Hearing Brief.
[31] Provider Supplemental Post Hearing Brief in Reply to Intermediary Post Hearing Summary (Provider Supp. Brief) at 3-5.
[32] Provider Supp. Brief at 8-11.
[33] Intermediary Post Hearing Brief at 4.
[34] Provider Supp. Post Hearing Brief at 10-11.
[35] Id at 11-13.
[36] See P.R.M. §§2102, 2103
[37] See Maximum Home Health Care, Inc. v. Shalala, 272 F.3d 318 (6th Cir. 2001); Grancare Inc. and Regency Health Services, Inc. v Shalala, 93 F.Supp 2d 24 (D.D.C. 2000).

between competing parties, which demonstrates that CHCC was acting as a prudent buyer in negotiating the terms of the deal.

INTERMEDIARY'S CONTENTIONS:

The Intermediary contends that CHCC, Greenery and HRPT Advisors embarked on a joint venture to sponsor and create HRPT. Accordingly, CHCC and HRPT were related parties pursuant to P.R.M. §1004 as confirmed by statements in the HRPT Prospectus.[38] CSC, which was established for the sole purpose of being a successor corporation to CHCC, is a related party to HRPT, as CSC was formed by Mr. Martin and Mr. Portnoy while they served as managing directors of HRPT. In fact, the related party lease agreement between HRPT and CHCC formed the basis of the new related party lease between HRPT and CSC. The terms of the new lease, including the financial terms, were substantially similar to the original lease.

The Intermediary also contends that a related party relationship existed based upon the following:

Ownership Issue:

Messrs. Martin and Portnoy collectively own 100% (50% each) of CSC, which operates all three Providers. CSC in turn leases the facilities from HRPT. Messrs. Martin and Portnoy were managing trustees of HRPT and also collectively own 100% (50% each) of HRPT Advisors, which provides the investment, management and administrative services to HRPT. Messrs. Martin and Portnoy have a beneficial ownership interest of 4.1% in HRPT (including HRPT Advisors' 1.2% direct ownership in HRPT), and this may be a significant ownership interest under 42 C.F.R. §413.17(b)(2), depending on whether or not any other party owns more than a 4.1% interest. The P.R.M . CMS Pub. 15-1 at §1004.2 indicates that a substantially low percentage of ownership could still constitute significant ownership, but that determination must be made on a case-by-case basis.

Control Issue:

Messrs. Martin and Portnoy are managing trustees of HRPT and together hold a 40% membership of its board. The Intermediary notes that the Providers have agreed that Messrs. Martin and Portnoy were interested parties to the transaction between CSC and HRPT.[39] Additionally, the Corporate Minutes[40] do not reflect that Messrs. Martin and Portnoy abstained, although the Providers have asserted that Mr. Martin did abstain from voting on the transaction between CSC and HRPT. However, it is clear that Mr. Portnoy advised the HRPT Board of Trustees on matters pertaining to this new relationship with CSC.

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[38] See note 19.
[39] Intermediary Position Paper at 10.
[40] Intermediary Ex. 5

The Intermediary asserts that Messrs. Martin and Portnoy have indirect control of HRPT by virtue of their ownership of HRPT Advisors, Inc., which is responsible for providing advisory services to HRPT. The services include assisting with decisions on the leasing of HRPT properties. Even though Martin and Portnoy may have abstained from voting on those transactions, they could still influence the transactions.

Moreover, the Intermediary contends that three of the four exception criteria to the related party rule under 42 C.F.R.§413.17(d)(1) were not met.[41] The Intermediary argues that to qualify for an exception to the related party rule, the Provider must demonstrate, by convincing evidence to the satisfaction of the Intermediary, that all criteria have been met.

The second criterion requires that "a substantial part of its [the supplying organization's] business activity of the type carried on with the provider, . . . [be] transacted with others than the provider and organizations related to the supplier by common ownership or control and that there is an open, competitive market for the type of services furnished by the organization. The Intermediary asserts it is unmet because the 1992 rental agreement was a carryover from the original 1986 lease. In 1986, all of HRPT's business activity was conducted with related parties, as indicated in the prospectus.

Additionally, the Intermediary contends that when the relationship between CSC and HRPT was originally formed in 1992, a significant part of HRPT's business portfolio was owned by Messrs. Martin and Brennick. The Intermediary disputes that an open, competitive market exists when the lease, security agreement, and substantial control of CSC activities were assigned to HRPT.

Regarding the third exception criterion (the services, facilities, or supplies are those that commonly are obtained by institutions such as the provider from other organizations) the Intermediary contends that skilled nursing facilities do not commonly lease the land and buildings which house their facilities.

Regarding the fourth criterion (the charge to the provider is in line with the charge for the services, facilities, or supplies in the open market and no more than the charge made under comparable circumstances to others by the organization) the Intermediary performed a survey of facilities and determined that the Providers' claimed rental costs measured on a cost per patient day and on a cost per square foot far exceeded the state's average.

Reasonableness

The Intermediary argues that excess cost claimed flows from a related party relationship and is not reasonable when evaluated in any context; accordingly, the Board should limit the allowable costs to the historical cost of the assets and the financing costs and ignore

[41] See Intermediary Ex. 10. The parties stipulated as HRPT and CSC are bona fide separate organizations, the first of the four exception criterion was met.

the Trust's participation. The Intermediary claims that the cost of use of the same physical plant in the hands of the same owner operator went up substantially from the day before the transfer to HRPT to the day after; and that the sale of the three facilities to HRPT was a way to cash out the equity built up over the years, yet keep control over the business.[42] The Intermediary notes that if a provider borrows against the equity in a conventional refinancing transaction, the interest is subject to a "necessary as required to satisfy a financial need" test under 42 C.F.R. §413.153. In this case, no financial need was evidenced. Accordingly, the dramatic increase in the claimed costs for the use of same assets would not be allowable under the "necessary and proper" test of 42 C.F.R. §413.9. The Provider contends that the acquisition price and the lease payments represented "fair market value" based upon an independent appraisal. The Intermediary responds, however, that the appraisal's fair market value analysis assumes a complete sale and control over both the operations and the physical plant. Here, the operations ownership did not change. Accordingly, in the context of whether the resulting lease payments were reasonable, the amounts seem overstated.

The Intermediary notes that its economic analysis best fits under the 42 C.F.R. §413.17(d)(iv) "reasonableness" of the charges analysis. Participating and investing in HRPT may have made business sense to investors, sponsors and moving parties; however, the circumstances by which the rent was fixed precludes any comparability to the market, no matter where the rent might fall in the range of rent paid by other nursing homes.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

After consideration of the Medicare law and guidelines, the parties' contentions, and evidence submitted, the Board finds and concludes that the Providers and HRPT were related parties within the meaning of 42 C.F.R. §413.17(b).

That regulation states that the tests of common ownership and control are to be applied separately in determining whether a provider is related to the supplying organization. Specifically, the provision states:

> (b) Definitions. (1) Related to the provider. Related to the provider means that the provider to a significant extent is associated or affiliated with or has control of or is controlled by the organization furnishing the services, facilities, or supplies.
>
> (2) Common ownership. Common ownership exists if an individual or individuals possess significant ownership or equity in the provider and the institution or organization serving the provider.

[42] Tr. at 146-147, 283.

> (3) Control. Control exists if an individual or an organization has the power, directly or indirectly, significantly to influence or direct the actions or policies of an organization or institution.

Regarding the control issue, the Board finds that it can not look at the fiscal period at issue, 1993, in isolation. Specifically, the Board finds that it must examine the relationship of the parties in 1986, when the original lease was executed. Since New Medico/CHCC was an initial sponsor of HRPT[43] and sold its properties to HRPT upon HRPT's inception, CHCC was critical in the formation of HRPT. The Board finds that a related party relationship existed between HRPT and its various affiliates at the time that the original leases were signed and extended to the period at issue. On that basis alone, the parties are related. The Board also notes that other factors exist which indicate relatedness,[44] although each such factor standing alone would not be dispositive in this case.[45]

The Board also finds that the Providers did not qualify for an exception to the related organization rules, as they failed to meet all of the exception criteria. Under 42 C.F.R. §413.17(d), an exception is met if a provider demonstrates by convincing evidence that it satisfies all of the following criteria;

(i) The supplying organization is a bona fide separate organization; and

(ii) A substantial part of its business activity of the type carried on with the provider is transacted with others than the provider and organizations related to the supplier . . . [first prong] and there is an open, competitive market for the type of services, facilities, or supplies furnished by the organization" [second prong]; and

(iii) The services, facilities, or supplies are those that commonly are obtained by institutions such as the provider from other organizations and are not a basic element of patient care. . .; and

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[43] Intermediary Ex. 3 at 5

[44] Such factors include the fact that Charles Brennick, owner of New Medico and CHCC is a cousin of Mr. Martin, managing trustee of HRPT and Director and 50% owner of HRPT Advisors. Likewise , the Board notes the fact that when HRPT was created, CHCC owned 9.9 percent of HRPT's stock.

[45] The Board notes that because a provider's motives are not a consideration under the Medicare related party rules, the application of the rules arguably may not always produce an "equitable" result. Thus, the Board gave no weight to the Provider's arguments (Provider Post Hearing Brief at 26-28) that the disclosures within HRPT's Prospectus which were allegedly made with the intent to meet the requirements of the Securities Act. Likewise, the Board gave no weight to the implication (Provider Post Hearing Brief at 5-6) that HRPT contracted with HRPT Advisors for the provisions of management and administrative services to comply with tax law restrictions.

(iv) The charge to the provider is in line with the charge for such services, facilities, or supplies in the open market and no more than the charge made under comparable circumstances to others by the organization for such services, facilities or supplies.

The Board notes that when the lease was originally executed, HRPT only conducted business with its sponsors, who were all related parties. Accordingly, the Board finds that the Provider has not met the "first prong" of exception criteria (ii) that a substantial part of its business activity is transacted with others than the provider and organizations related to the supplier. Failure to meet any one of the criteria is fatal to application of the exception.[46]

In addition, the Board notes that the Medicare regulations at 42 C.F.R. §413.130(b)(2) and (3) apply to this apply to this issue:

(2) For sale and leaseback agreements for hospitals and SNFs entered into before October 23, 1992 and for sale and leaseback agreements for other providers entered into at any time, a provider may include incurred rental charges in its capital-related costs, as specified in a sale and leaseback agreement with a nonrelated purchaser (including shared service organizations not related within the meaning of §413.17) involving plant facilities or equipment only if the following conditions are met:

(i) The rental charges are reasonable based on the following –

(A) Consideration of rental charges of comparable facilities and market conditions in the area;

(B) The type, expected life, condition, and value of the facilities or equipment rented; and

(C) Other provisions of the rental agreements.

(ii) Adequate alternative facilities or equipment that would serve the purpose are not or were not available at lower cost.

(3) If the conditions of paragraph (b)(2) of this section are not met, the amount a provider may include in its capital-related costs as rental or lease expense under a sale and leaseback agreement

[46] As all of the criteria must be met to qualify for an exception, the Board does not reach the question of whether the Provider met exception criteria (ii), (iii), and (iv). The parties agree that the first requirement was met as CHCC and HRPT are bona fide separate organizations (supra, note 22).

> may not exceed the amount that the provider would have included in its capital-related costs had the provider retained legal title to the facilities or equipment, such as interest on mortgage, taxes, depreciation, and insurance costs.

The Board finds that since the Providers are related to HRPT, §413.130(b)(3) applies. Therefore, the Providers are not entitled to include incurred rental charges on their Medicare cost reports.[47] Instead, they are limited to the capital-related costs they would have incurred had they retained legal title to the facilities. It is unclear from the record whether the Intermediary allowed the estimated ownership costs or historical cost.[48] Accordingly, the Board remands this case to the Intermediary for the computation of the Providers' historical cost of the facilities as of the day before the transaction with HRPT.[49]

DECISION AND ORDER:

The case is remanded to the Intermediary to compute the Providers' historical cost of the facilities as of the day before the transaction with HRPT and to modify the adjustment as needed.

Board Members Participating:

Suzanne Cochran, Esq., Chairperson
Dr. Gary B. Blodgett, D.D.S.
Elaine Crews Powell, C.P.A.
Anjali Mulchandani- West
Yvette C. Hayes

FOR THE BOARD

DATE: September 13, 2006

Suzanne Cochran, Esq.
Chairperson

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[47] Accordingly, since the Board finds that the Provider is not entitled to "rental charges" the Intermediary's argument that the rental charges were "unnecessary," is deemed moot.

[48] See Tr. at 449 and 459.

[49] The Board notes that the Providers objected to Intermediary Exhibit 9 (Tr. at 12) on the grounds that it received the document untimely and on its relevance. While the Board allowed the exhibit to remain part of the record (Tr. at 14), the Board did not rely on the exhibit (and Provider Ex. 24 chart; supra, note 3) for its decision.