

# PROVIDER REIMBURSEMENT REVIEW BOARD DECISION

2003-D63

**PROVIDERS –**  
Subacute Center of Bristol  
Forestville Health & Rehabilitation Center  
CT Subacute

Provider Nos. 07-5198, 07-5210

**vs.**

**INTERMEDIARY –**  
Blue Cross Blue Shield Association/  
Empire Blue Cross

**DATE OF HEARING -**  
December 13, 2002

Cost Reporting Periods Ended  
Various

**CASE NOS.** 99-2054, 99-2307  
01-0337

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ISSUES:**Case No. 99-2054, FYE- December 31, 1996 (Subacute Center of Bristol)  
T/A Forestville Health and Rehabilitation Center**

1. Was the Intermediary's adjustment disallowing capital related expenditures proper?
2. Was the Intermediary's adjustment disallowing interest expense proper?

**Case No. 99-2307G, FYE- December 31, 1996 ( Subacute Center of Bristol, Cedar Lane Rehab Center, and Brook Hollow Health Care Center).**

1. Was the Intermediary's adjustment disallowing rental expense proper?

**Case No. 01-0337, FYE- December 31, 1997 ( Subacute Center of Bristol)**

1. Was the Intermediary's adjustment disallowing rent expense proper?
2. Was the Intermediary's adjustment disallowing capital related expenditures proper?
3. Was the Intermediary's adjustment disallowing interest expense proper?

BACKGROUND:Governing Statutes and Regulations:

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 reports 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 Medicare regulations, 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 services or supplies that could be purchased elsewhere. The regulation at 42 C.F.R. § 413.17. However, there is an exception to this rule. 42 C.F.R. § 413.17(d)(1) provides 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 is transacted with others than the provider and organizations related to the supplier and there is an open competitive market for the type of services furnished by the organization;
- (iii) The services are those that commonly are obtained by institutions such as the provider from other organizations and are not a basic element of direct patient care;
- (iv) The charge to the provider is in line with the charge of services in the open market by the supplier to the provider.

The CMS Manual at CMS Pub. 15-1 § 1010 sets out the same criteria.

Key Parties Involved:

1. **Health and Retirement Properties Trust ("HRPT")** (a real estate investment trust ("REIT") established for the purpose of investing in, purchasing and leasing health care facilities.
2. **Sponsors of HRPT**  
New MediCo/Continuing Health Corp.  
Greenery Rehabilitation  
HRPT Advisors
3. **HRPT Advisors, Inc.** - a partnership established and solely directed by Gerard M. Martin and Barry M. Portnoy, Esq., to provide a variety of investment, management and administrative services to HRPT and other companies, including the sponsors who created HRPT.
4. **Continuing Health Properties** - created in 1986, manager and operator of three skilled nursing facilities: Brook Hollow Health Care Center, Cedar Lane Rehabilitation Center and Subacute Center of Bristol.

**5. Connecticut Subacute Corporation (“CSC”) - successor in 1992 to Continuing Health Properties as the manager of the three facilities identified above.**

**6. 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
- \*Legal advisor to companies sponsoring creation of HRPT

**Charles Brennick** - Director and 100% owner of New MediCo/Continuing Health Properties; cousin of Gerard M. Martin

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

CSC is located in Waterbury, Connecticut and was licensed to operate three chronic and convalescent nursing homes in various Connecticut locations. They are the Brook Hollow Health Care Center, Cedar Lane Rehabilitation and Health Care Center and the Subacute Center of Bristol. The land and buildings occupied by the three nursing homes were owned by HRPT.

Anthem Blue Cross and Blue Shield of Connecticut, Inc., the former Intermediary,<sup>1</sup> audited the cost reports for the Provider’s three nursing homes for the year ended December 31, 1996. A determination was made that the Providers and HRPT were related parties and on that basis disallowed the rental expense paid by the three nursing homes to HRPT. (Case No. 99-2307G). The Intermediary also disallowed capital-related expenditures and interest expense for the Subacute Center of Bristol for the same fiscal year. (Case No.99-2054). Later, the Intermediary disallowed rental expense, capital related expenditures and interest expense for the Subacute Center of Bristol for the year ended December 31, 1997. (Case No. 01-0337). The amount of Medicare reimbursement at issue is approximately \$600,000.

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 Louis B. Todisco, Esquire, of Murtha Cullina, LLP. Eileen Bradley, Esquire, of the Blue Cross Blue Shield Association represented the Intermediary.

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<sup>1</sup> The current intermediary is now Empire Blue Cross.

PROVIDERS' CONTENTIONS:

The Providers contend that the FI's decision should be reversed for four separate reasons. First, the Providers contend that HRPT and the Providers are not related organizations. The Providers cite 42 C.F.R. § 413.17 for the applicable definitions. An entity such as HRPT is related to the Provider only if "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." *Id.* Parties can be related either by common ownership or common control. "Common ownership exists if an individual or individuals possess significant ownership or equity in the provider and the institution or organization serving the provider." *Id.* at § (b)(2). Common 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. *Id.* at § (b)(3). The Providers argue that the regulations require that the relationship, whether by ownership or control, be "significant," and the facts of this case do not show significant common ownership or control.

With respect to common ownership, the Providers argue that the ownership of Mr. Portnoy and Mr. Martin in HRPT, through HRPT Advisors, is insufficient to justify a finding that the Providers and HRPT are related by common ownership. The beneficial interest of Mr. Portnoy and Mr. Martin, through the HRPT Advisor, in HRPT was only 4.1%. Direct ownership by HRPT Advisor was only 1.2%.<sup>2</sup> Accordingly, the Providers contend that these ownership percentages are insufficient to create common ownership. The Providers also contend that the manual examples at CMS Pub. 15-1 § 1004.2 provide guidance as to the level of common ownership necessary for organizations to be related. Neither the CMS manual nor the case law support a finding that Mr. Martin or Mr. Portnoy, through HRPT Advisor, had a significant interest in HRPT.

With respect to common control, the Providers argue that it is the Board of Trustees of HRPT that is the entity with the ultimate responsibility for the operation of HRPT.<sup>3</sup> At all relevant times, the Board of Trustees consisted of five members; Mr. Martin and Mr. Portnoy made up only a minority of the Board of Trustees and, therefore, did not control the Board of Trustees. The Providers contend that this indicates that HRPT and the Provider were not under significant common control.

Furthermore, the Providers contend that, according to the terms of HRPT's Declaration of Trust, Messrs. Portnoy and Martin cannot exercise any control over matters involving the Providers. The Providers argue that Section 7.8 of HRPT's Declaration of Trust unequivocally provides that the transactions between the Trust and parties interested in the Trust must be authorized or ratified by an affirmative vote of a majority of the Trustees who are not so interested.<sup>4</sup> The Providers argue that since the decisions

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<sup>2</sup> Provider Exhibit 12.

<sup>3</sup> Provider Exhibit 4, page 11.

<sup>4</sup> Provider Exhibit 4, Section 7.8, page 39.

pertaining to the Providers were made only by persons with no involvement with the Providers, there clearly was no common control.

The Providers' second contention is that, even if it were determined that they and HRPT are related parties, the lease in question was negotiated in 1986 between unrelated parties, specifically HRPT and Continuing Health, a subsidiary of New MediCo. The Providers contend that HRPT was not a related party either to Continuing Health or New MediCo. Neither Mr. Martin nor Mr. Portnoy nor other trustees of HRPT were officers or directors of any of the New MediCo companies, including Continuing Health. No officer or director of New MediCo or Continuing Health held any position with HRPT. Thus, the Providers argue that there was no common control which existed with respect to HRPT and either Continuing Health or New MediCo. Moreover, while Continuing Health owned 9.9% of the stock of HRPT in 1986, this percentage is far below the percentage which would be necessary to establish common ownership, as discussed above. The Providers further argue that when they became the lessee of the premises which were formerly leased to Continuing Health, the premises were leased on virtually the same terms, including financial terms.<sup>5</sup> Accordingly, the Providers became the lessee of leases which were negotiated between unrelated parties and were not related party leases. The position of the Providers is that the relevant transaction for purposes of determining the issue of relatedness should be the negotiation of the original lease between Continuing Health and HRPT. Therefore, because Continuing Health and HRPT were not related parties at the time the lease was originally negotiated, and the Providers in effect assumed the same lease, the lease held by the Providers should not be considered a related party lease.<sup>6</sup>

The Providers' third contention is that even if it and HRPT are deemed to be related parties, the requirements for application of the exception in CMS Pub. 15-1 § 1010 have been met and the rental expense should be allowed. The Providers contend that the first requirement is met as the Providers and HRPT are bona fide separate organizations.

The Providers contend that the second requirement is met because a substantial part of HRPT's business activity at the time of the lease of the premises to Continuing Health in 1986, at the time of the lease of the premises to the Provider in 1992 and at the time of the audit (1996), was carried on with organizations which are not related to HRPT. The Provider also contends that in 1986, Continuing Health, the prior holder of the leases, would have had alternatives for obtaining financing.

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<sup>5</sup> Provider Exhibit 7, page 9.

<sup>6</sup> The Providers assert that the statements in the HRPT Prospectus (Provider Exhibit 6) that Continuing Health and HRPT were related parties are not relevant to the case at hand. The Providers argue that HRPT and Continuing Health were described as related parties because of the requirements of the securities laws which are substantially different from the Medicare related party requirements. Provider's Final Position Paper, page 5.

With respect to the third requirement of the §1010 exceptions, the Providers contend that it is common for providers to lease facilities, rather than to own the facilities utilized for the care of patients. The Providers contend that most of HRPT's business involves leasing facilities, and this supports their contention. Finally, with respect to the fourth requirement of the §1010 exception, the Providers contend that the charges to the Providers are in line with the charges for services, facilities or supplies in the open market.

Lastly, the Providers argue that the FI erred in disallowing all costs. The Medicare system requires, generally, that a party be reimbursed its reasonable costs related to providing patient care, and there clearly was a cost to the facilities in question. The Providers contend, therefore, that the disallowance of the entire rental expense, interest and capital expenditures on the theory that HRPT and the Providers are related parties was excessive.

#### INTERMEDIARY'S CONTENTIONS:

The Intermediary contends that Continuing Health, Greenery and HRPT Advisors embarked on a joint venture to sponsor and create HRPT. The Intermediary contends that Continuing Health and HRPT are related parties, and this is confirmed by statements in the HRPT Prospectus. The Intermediary also cites various obligations of Continuing Health, such as the payment of an annual stand-by management fee, its pledge of its shares in HRPT to HRPT as security for its obligations, the stand-by management agreement, the fact that the law firm of Sullivan & Worcester served as counsel to HRPT and the Sponsors, and unspecified business dealings between Mr. Martin, Mr. Brennick and Mr. Portnoy in support of its position.

The Intermediary also contends that the Providers and HRPT were related organizations based on 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 are managing trustees of HRPT and also collectively own 100% (50% each) of HRPT Advisor which provides the investment, management and administrative services to HRPT. Through their ownership of HRPT Advisor, Messrs. Martin and Portnoy also have a beneficial ownership interest of 4.1% in HRPT. This may be a significant ownership interest under 42 C.F.R. § 413.17(b)(2),<sup>7</sup> depending on whether or not any other party owns more than a 4.1% interest. CMS Pub. 15-1 § 1004.2 indicates that a substantially low percentage of ownership could still constitute significant ownership, but that must be determined on a case by case basis.<sup>8</sup>

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<sup>7</sup> Intermediary's Final Position Paper for Case No. 99-2054, page 5.

<sup>8</sup> Intermediary Exhibit 7.

Control Issue:

Messrs. Martin and Portnoy are managing trustees of HRPT and hold a 40% membership of that Board. Even if the Intermediary were to ignore the existence of direct control, it argues that there remains the issue of indirect control. Messrs. Martin and Portnoy have indirect control of HRPT by virtue of their ownership of HRPT Advisors, Inc. in that they are the individuals responsible for providing advisory services to HRPT. Those decisions include leasing of HRPT properties. Additionally, the possibility exists that Messrs. Martin and Portnoy could have business ventures with the other three Board members. This could create a situation in which Messrs. Martin and Portnoy could exercise indirect control even though they are abstaining from voting on transactions involving the Providers.

With respect to the exception in CMS Pub. 15-1 §1010, the Intermediary contends that the requirements have not been met. The Intermediary agrees that HRPT and CSC are bona fide separate organizations, and that requirement one of CMS Pub. 15-1 § 1010 is met. However, the Intermediary contends that the other three exception criteria were not met.<sup>9</sup>

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

The Board, after consideration of the facts, parties' contentions, testimony at the hearing, post-hearing briefs, and evidence submitted, finds and concludes that the Providers (lessee) and HRPT (lessor) were related parties within the meaning of 42 C.F.R. § 413.17.

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.

(3) Control. Control exists if an individual or an organization has the power, directly or indirectly, significantly to influence

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<sup>9</sup> Intermediary's Exhibit 8 in Case No. 99-2054, Intermediary Exhibit 9 in Case No. 99-2307G and Case No. 01-0337.

or direct the actions or policies of an organization or institution.

With regard to the ownership issue, the Board notes that HRPT is a publicly traded company. The Providers' shareholders beneficial interest in HRPT (through HRPT Advisors, Inc.) was only 4.1%. Neither of the Providers' shareholders own any interest in HRPT individually. Direct ownership of HRPT by HRPT Advisors, Inc. was only 1.2%. While the Providers' shareholders are on HRPT's Board of Trustees, they represent only a 40% vote and are not allowed to exercise their control on matters involving the Providers. Considering these factors, the Board concludes that the Providers and HRPT are not related by significant common ownership.

With regard to the control issue, the Board finds that it can not look at the audited years, December 31, 1996 and 1997, in isolation. Instead, it must view the entire timeframe to arrive at a determination regarding control. In this regard, the Board finds the following factors to be relevant.

- In 1986, when HRPT was created, it initially conducted business with its three sponsors (HRPT Advisors, Inc., Greenery and New MediCo), all of which were owned by the Provider's shareholders and a relative who owned New MediCo. HRPT (through HRPT Advisors) created a stand-by management agreement whereby Greenery would be called on to manage Continuing Health (successor to New MediCo). Although never implemented, this agreement imposing an obligation is indicative of control.
- The prospectus for HRPT indicates that substantially all of the Company's (HRPT) operations will be conducted by HRPT Advisors (owned by the Provider's shareholders). Furthermore, the prospectus at Intermediary Exhibit 1, page 18, states that HRPT will be subject to various conflicts of interest arising out of its relationships with its sponsors and their affiliates.<sup>10</sup>
- The prospectus indicates that "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 arms-length basis."<sup>11</sup>
- The financial statements of HRPT indicate that HRPT Advisors, Inc. is considered to be affiliated with the Providers based on common ownership.

The Board does not agree with the Providers' argument that it merely assumed leases whose terms were set by unrelated parties, thus negating the "related party" disallowance. Based on the factors noted above, the Board finds that the principals of HRPT Advisors, Inc. (who are the Providers' shareholders) were in the position of dealing with themselves as owners of Connecticut Subacute. Specifically, the Providers' shareholders have indirect control of HRPT since they are also the owners of HRPT Advisors, Inc., which provides management and administrative services to HRPT. This makes them responsible for providing advisory services to HRPT that would include decisions on the

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<sup>10</sup> Provider Position Paper for Case No. 01-0337, Provider Exhibit 6, page 18.

<sup>11</sup> Provider Position Paper for Case No. 01-0337, Provider Exhibit 6, page 19.

leasing of HRPT properties. The Board finds that a related party relationship existed between HRPT and its various affiliates at the time the original leases were signed and extended to the years at issue.

The Board also finds that the Providers do not qualify for an exception to the related organization rules. Under 42 C.F.R. § 413.17(d) an exception is provided if a provider demonstrates by convincing evidence that it satisfies all of the established criteria. In the instant case, the Providers assert that a significant portion of their business activities were transacted with unrelated organizations. However, the Board finds that the record contained no evidence to support the Providers' assertions. In addition, the Board noted that an Intermediary survey disclosed that rental charges for the Forestville facility appeared to substantially exceed the average rental costs incurred by all other skilled nursing facilities in Connecticut. While the Board recognizes there may be a higher lease cost associated with a rehabilitation facility, the Providers did not submit any evidence to refute that their lease payments were out of line with other similar providers. In addition, the Providers did not submit any evidence to indicate that they negotiated with any unrelated REITs to secure alternatives for financing or for raising capital.

The Board further finds that the Medicare rules allow the Intermediary to recognize certain cost factors in instances where the entire rental expenses, interest expense, etc. were disallowed. The Intermediary concurred and requested cost information from the Providers.<sup>12</sup> The Providers failed to submit any documentation of ownership costs; therefore, the Board is precluded from allowing any additional costs, since the Providers have not met the record keeping requirements of 42 C.F.R. §§ 413.20(a) and 413.24(a).

DECISION AND ORDER:

The Intermediary's disallowances based on the fact that the Providers and HRPT are related parties were proper. The Intermediary's adjustments are affirmed.

Board Members Participating:

Suzanne Cochran, Esq.  
Dr. Gary B. Blodgett  
Martin W. Hoover, Jr., Esq.  
Elaine Crews Powell, C.P.A.

DATE: September 29, 2003

FOR THE BOARD

Suzanne Cochran, Esq.  
Chairman

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<sup>12</sup> Intermediary's Final Position Paper, Intermediary Exhibit 8, page 2 for Case No. 99-2054.