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LAWYERS

LAURA C. DULIC • MATTHEW T. FINDLEY • EVA R. GARDNER • REBECCA E. LIPSON
DONALD W. MCCLINTOCK III • JEFFREY W. ROBINSON • ASHLEY K. SUNDQUIST • THOMAS V. WANG
OF COUNSEL JULIAN L. MASON III • A. WILLIAM SAUPE

March 11, 2019

Via Email and Hand Delivery:

Alexandria Hicks
CON Coordinator
Alaska Dept of Health & Social Services
3601 C St, Suite 978
Anchorage, AK 99503

RE: Request for Determination (DIA)

Dear Ms. Hicks:

After my discussion with Justin Nelson and yourself, we decided it was better to submit a revised Request for Determination with the revised lease rather than proceed with a request for reconsideration. Attached is Diagnostic Imaging of Alaska (“DIA”) Request for Determination. This Request for Determination is identical to the November 29, 2018 prior Request for Determination which was addressed by your March 1, 2019 Determination except in two regards:

- (i) The Lease has been amended to remove the option.
- (ii) Given the time that has passed since the November 29, 2018 Request for Determination, construction of the tenant improvements has commenced.

The attached Request for Determination presents the facts of the transaction. I am sending this cover letter to clarify some background that was lost in our earlier submittal and explain why the option was not a significant attribute of the prior transaction as a matter of the business deal.

As stated at page 2 of the March 1, 2019 Determination, the gravamen of the Determination is:

When viewed in its entirety, the CON Program believes that the substance of this matter as it pertains to this RFD is best characterized as a contract for sale. Although the arrangement is referred to as a lease with an option to purchase, the economic reality is that a sale has been contemplated. This compels the conclusion that this project exceeds the limits set forth in AS 18.07.031.

As will be detailed below, the focus of this transaction is not the sale. As reflected by the attached Request for Determination, the lease has been amended to remove the option right.

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The principals of DIA, Drs. Cable and McCormick are 71 and 64 years old respectively. They have practiced in Alaska for many years and at many locations, many of which have been leased space. They are not looking at creating a new long-term practice location. They do want to preserve, however, the relationships and referral and patient base they have created. At the time of this transaction, Drs. Cable and McCormick practice out of the Alaska Spine Institute (“ASI”). They operate under employment agreements. The relationship with ASI has faltered in the past years and Drs. Cable and McCormick wished to find an alternative location to practice. The significance of the need to find another location was that it would be very injurious to their practice to simply stop practicing; referral streams and client relationships could be lost, or at a minimum damaged. When they learned that the current leased space was available for lease, they saw it as an opportunity to set up an alternative practice location they could transition to. The impetus to the current transaction was not the desire to secure ownership of the current leased premises; it was simply to secure a separate location for their practice.

This will not necessarily be their final location. It will allow them to practice without fear of a loss of a place to practice if their employment relationship with ASI came to an abrupt end. In fact, even while engaging in this lease, they have been approached by another practice that contemplates a new practice forming within this two year lease time line.

One of the concerns raised in the Determination is that the amount of the investment contemplates an investment that exceeds what can be expended during a two year lease term.¹ Although the Department does not have to agree with its economic motivations, DIA’s desire was to protect the integrity of its practice,² and DIA was willing to make this investment in this location to protect its investment. However, the use of the size of the Tenant Improvement (“TI”) investment to reflect on intent is at variance with past determinations by the Department, as discussed below.

In fact, the amount of investment is not disproportionate to prior determinations made by the Department. In this case, the largest part of the investment is equipment. The equipment cost totals \$568,661. This investment in the equipment is owned and can be used in other locations or sold. The total rent for the two years was \$429,681. The reconfigurations of the space, the TI costs, total \$382,808.00. TI costs are thus the smallest of the three categories of

¹ March 1, 2019 Determination. (“[T]his assertion of lack of intent to exercise the option unconvincing in light of the magnitude of the interest that will have been acquired in the property in question via the construction expenses.”).

² The practice here is the patient list and referral stream from the other doctors who send patients for diagnostic testing. If the practice ceases, even temporarily, there is great injury to the practice as the referral sources find other doctors who can attend to their patient’s needs.

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expenditures.³ However, the Department in its past rulings has not considered the size of TI investment to be criteria to reject a lease NPV analysis based on a two year lease. To do so now would be an unfair departure from its precedent, something that it should not do without engaging in rule making with its regulatory power.

Two prior cases are significant both in terms of the size of the TI investment and its proportionality to the lease term. In the July 30, 2015 Revised Decision for Request for Determination dated June 26, 2015 (ASC North, LLC), the Department approved a lease arrangement using a two-year NPV analysis that showed rent at \$225,840 and Tenant Improvements at **\$994,874**.⁴ Similarly, in the May 30, 2017 Determination (Surgery Center of Kenai 5-10-2017), the petitioner had a two-year lease with a net present value of \$81,740.16, but Tenant Improvements of **\$487,764**.⁵

Both cases involved a tenant improvement investment greater than contemplated here and in the Surgery Center of Kenai Determination, an explicit two-year lease was presented. The actual size of the tenant improvement investment has not been a factor used by the Department in the past to look past the lease term.

In the initial lease an option was agreed upon, but it was not the motivating force of the transaction as discussed above. That intent was to have a location where the practice could be continued over the next few years free from the concern of an abrupt end of their current relationship with ASI that could leave them without a location to tend to their patients.

DIA has asked its landlord to amend the lease to delete the option. A copy of that amendment is attached to the Request for Determination Letter. It should be noted that the landlord is not related to DIA or its members and this has been an arms-length transaction. Since an option is a burden on the landlord, there was no problem securing his agreement to the amendment as it frees him to market the property to other parties now instead of at the end of the two-year term.

Further, DIA acknowledges that any arrangement to purchase the premises in the future would be a departure from the facts presented to the Department in its Request for Determination and such acts are reportable to the Department for action.

Given the extended time that has passed from the November 29, 2018 Request for Determination, DIA can certify that its cost figures remain accurate as of today. The only

³ Nevertheless, for the purpose of this discussion DIA acknowledges that the TI investment is lost after the end of the term. The point is the Department has not made this a guideline in the past to justify varying from the two year NPV approach.

⁴ See Exhibit N to Request for Determination.

⁵ See Exhibit O to Request for Determination.

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departure is that the passage of time did lead to the decision to commence construction, which is now progressing. That decision, of course, is at its own risk.

We remain available to discuss the contents of the attached Request for Determination and provide such other information as requested by the Department. This letter can be considered as part of the Request.

We hope, to the extent possible, that this review, having had its other details clarified already, can be expedited for review. We appreciate your efforts in that regard.

Sincerely,

ASHBURN & MASON, P.C.



Donald W. McClintock

DWM:haw

Enc.

cc: Client
Justin Nelson Assistant Attorney General (via e-mail only) w/o Encl.
Stacie Kraly Chief Assistant Attorney General (via e-mail only) w/o Encl.