



THE STATE
of **ALASKA**
GOVERNOR MIKE DUNLEAVY

**Department of
Health and Social Services**

Certificate of Need Program

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March 1, 2019

Mr. Donald W. McClintock
Ashburn & Mason, P.C.
1227 West 9th Avenue, Suite 200
Anchorage, AK 99501

RE: Request for Determination dated 11-29-2018

Dear Mr. McClintock,

Enclosed please find the department's response to your November 29, 2018 Request for Determination ("RFD") whether a Certificate of Need ("CON") is necessary for a diagnostic imaging center that your client, Diagnostic Imaging of Alaska ("DIA"), is proposing. The project facility, located at 2110 East Northern Lights Boulevard in Anchorage, Alaska encompasses 7,085 rentable square feet and will include the following radiological modalities: MRI, CT, C-Arm, Ultrasound and X-Ray.

You estimate the cost of the project to be \$1,380,661 and construction to take approximately 90 days post notice from the department that your client may proceed. We have evaluated your request for determination and have concluded that your calculation and valuations are too low for the reasons set forth below.

The CON Program has been asked to make a determination under 7 AAC 07.031(a)(1) as to whether the total cost of the expenditures provided in its request for determination will meet or exceed the statutory threshold set in AS 18.07.031. AS 18.07.031(e) defines expenditure for CON determinations as "purchase of property occupied by or the equipment required for the health care facility and the net present value of the lease for space occupied by or the equipment required for the health care facility." DIA has elected to characterize this transaction as a lease with a purchase of equipment. The CON Program asserts that the purchase price method of calculation is the more appropriate method of valuation in light of the surrounding circumstances of this transaction and most accurately gives effect to the intent of the statute.

Characterization of a transaction in terms of a short-term lease, when the economic reality indicates a sale is contemplated, is contrary to the intent of the statute. The statute contemplates review of projects with a clear cap on the amount of expenditures permitted before a CON is necessary to proceed with the project. To effectuate the intent of the statute these determinations must be conducted in a

manner that looks to the substance of the transaction, and not merely at the form. Efforts to evade review with creative transactional structures cannot be permitted without defeating the essential intent of the statute.

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 18.07.031.¹

If the CON Program accepts the valuation figures provided for this project (remodeling costs of \$382,808) as provided in Exhibit E, it would constitute 27.7% of the value of the purchase price of the building for what is being styled as a 2 year lease with an option that may not be exercised. Claims that DIA would make such a substantial investment without an intent to recoup it via exercise of its option to purchase are not persuasive.

Upon its request for clarification regarding DIA's plans to exercise the options to purchase terms in the master lease, the CON Program was assured by a letter dated January 30, 2019 that there is no intent to exercise the option now, but that it would be evaluated before the option period expires. The CON Program finds this 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. While the intent may not be of a current certainty subject to due diligence completion, the circumstances indicate that this transaction is structured to position the parties for completion of a sale of this property.

DIA will acquire the entirety of the building for operation of its facility. That not all of the space will be used as an imaging facility does not reduce value calculations for purposes of CON applicability review under a purchase interpretation of AS 18.07.031(e) expenditures for this transaction. The value of the entire building must be included in this determination.

Accordingly, the CON Program finds that the proper amount for review should include the purchase price of the building and equipment, as set forth in the Purchase and Sale Agreement, the cost of renovations as set forth in Exhibit E, and the cost of the medical equipment identified in Section C of the November 29, 2018 RFD and that value is more properly set at \$2,435,894.00.

The CON Program accepts the representations regarding the medical equipment costs in the letter of November 29, 2018 for purposes of this determination. However, it is also specifically noted that the Purchase and Sale Agreement includes options to purchase other medical equipment for prices as the parties to the agreement may agree and to the assumption of an MRI lease. It is unnecessary to determine the value of either of these at this time in light of the conclusion that this agreement is primarily for the purchase of the building and specific pieces of medical equipment identified by this

¹In the alternative, it is noted that this project would exceed the CON threshold of AS 18.07.031 (a) even under the calculation method requestor proposes but for exclusion of the value of the purchase option. The presence of an option to purchase in a lease has an effect upon its terms and this effect must be assigned a value. A straight net present value calculation has the effect of artificially devaluing the expenditures involved in this project. Even a nominal value for a project of this magnitude would have caused the request to exceed the threshold expenditure amount and triggered the need for a CON.

request for determination and valued as set forth above which, standing alone, have the effect of triggering CON requirements.

In conclusion, based on the request for determination, as presented, a CON is required for the proposed project because the expenditures at issue exceed the \$1.5 million threshold under AS 18.07.031. The department, upon review, has revised the project cost to reflect the inclusion of the building purchase price and our valuations and calculations are set forth below:

Total Expenditures:	<u>\$2,435,894.00</u>
Building purchase minus option fee credit:	1,484,425.00
Design/Construction:	382,808.00
Equipment:	568,661.00

If you are dissatisfied with this determination, you may request reconsideration under 7 AAC 07.033. A request for reconsideration must be postmarked no later than 30 days after publication of the decision's public notice.

Please do not hesitate to contact me if you have any questions.

Regards,

Alexandria Hicks

Alexandria Hicks, CON Program Coordinator

cc: Stacie Kraly, Chief Assistant Attorney General
Justin Nelson, Assistant Attorney General
Douglas Jones, Acting Director Office of Rate Review