PROVIDER REIMBURSEMENT REVIEW BOARD DECISION

2006-D50

PROVIDER -
CT Subacute Corp. 98 Protested Items Group

Provider Nos.: 07-5234; 07-5210; 07-5198

vs.

INTERMEDIARY -
BlueCross BlueShield Association/ Empire Medicare Services

DATE OF HEARING -
May 5, 2005

Cost Reporting Period Ended -
December 31, 1998

CASE NO.: 01-1326G

INDEX

ISSUES:

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 where 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 Holding Co. Inc./Continuing Healthcare Corp.
   Greenery Rehabilitation Group, Inc.
   HRPT Advisors, Inc.

[1] See Provider Ex. 30 (May 5, 2005 Stipulations). We note that the Provider in this case decision refers to Connecticut Subacute Corporation d/b/a/ Brook Hollow Health Care Center, Cedar Lane Rehabilitation Center, and Subacute Center of Bristol (Forestville Health and Rehabilitation Center).

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.[2]

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), Cedar Lane Rehabilitation Center (Cedar Lane) and Forestville Health and Rehabilitation/Subacute Center of Bristol (Forestville), the "Providers" in this case. It leased Providers' facilities from HRPT. CHCC owned 9.9 percent of HRPT's shares, which it sold back to HRPT as of October 14, 1992. 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%). During the time period from 10/1/92 through 7/22/93 CSC served as interim manger for CHCC's Connecticut facilities, which included Brook Hollow and Cedar Lane. On 7/23/93, CSC served as the tenant and licensee for the three Providers 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

[2] See Providers Post-Hearing Brief at 6, Provider Ex. 16 at 15, Transcript of May 5, 2005 hearing (hereinafter "Tr. II") at pp 64-66. As of January 1, 1998, HRPT entered into an agreement with REIT Management and Research Inc. ("RMR") to serve as the REIT's advisor. RMR was and is owned by Gerard Martin and Barry Portnoy. The Providers claim that RMR filled the same role as HRPT Advisors with respect to HRPT. All references to HRPT Advisors in this decision refer to HRPT Advisors from 1986 though 1997 and to RMR after January 1, 1998.

*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
*A Director and 100% owner of New MediCo/CHCC/
*Cousin of Gerard M. Martin.

In late 1986, 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 the HRPT Advisors managed the operation of the REIT. In 1986, HRPT purchased three facilities (Brook Hollow, Cedar Lane and Forestville) from CHCC (a subsidiary of New MediCo) and leased them back to CHCC.[3]

In 1992, HRPT's Trustees decided to eliminate investment in all of New Medico's companies, including CHCC, and to seek a new tenant for the three Connecticut properties as a result of CHCC's inability to pay rent. However, HRPT claims that it could not 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.[4] Accordingly, 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 and to enter into an agreement to lease these properties to CSC.[5] According to the Providers, neither Mr. Martin nor Mr. Portnoy voted on this transaction.[6] 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[7] with CSC and arranged with CHCC to enter into an Interim Management Agreement[8] with

[3] Additionally, Greenery was established as a stand-by manager and guarantor of rent payments in the event that CHCC failed (Provider Ex. 29, Transcript of November 17, 2004, (hereinafter "Tr. I") at pp. 110-115). The standby agreement was not implemented during the period at issue in this case.
[4] Tr. I at pp.130, 190, 306-307.
[5] Provider Ex. 7.
[6] Provider Ex. 23 at ¶9, Tr. I at pp. 133, 308-309.
[7] Provider Ex. 25.
[8] Provider Ex. 26. Also, the President of CSC was required to report to the Regional Vice President of CHCC and to use certain of CHCC's services such as off-site laundry

CSC. CHCC remained the tenant and 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.[9]

Under the Interim Management Agreement, CSC agreed to manage, supervise, and operate the three Connecticut facilities subject to the control and direction of CHCC until such time as CSC obtained all approvals necessary to take over as the tenant and licensee. The Provider's witness also testified that the CSC agreement was intended to be temporary until HRPT could find another tenant for the property or could sell the property.[10] CSC eventually obtained the required licensure approvals for the three Provider facilities, 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.[11]

During this period the Providers claimed that HRPT attempted to find new tenants to replace CSC but was unsuccessful.[12] Therefore, HRPT bought additional nursing homes to make "a more viable entity that could be sold." [13] In 1999, HRPT sold the properties to HCPL Long Term Care.[14]

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services. See Tr. I 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 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 Provider Ex.14 at 16, n. 3.

[9] See Intermediary Position Paper at 7; Provider Post-Hearing Brief at 16.

[10] Tr. II at 69-71, 99.

[11] See Provider Post-Hearing Brief at 16 and 17.; Tr. II at 71-72, 77. According to the Provider, the lease terms were "substantially similar" to the original lease arrangements with CHCC that had been negotiated in 1986 as part of the sale-leaseback transaction. Neither CSC, Martin, or Portnoy received "special treatment' based on Martin's and Portnoy's affiliation with the REIT. In fact, the REIT's independent trustees insisted that CSC pay the amount of the rent mandated by the leases; therefore, Martin and Portnoy had to make up for the facilities' shortfall in expenses. The leases were set to complete the original ten-year term of the leases with CHCC, and they were renewed in 1996. CSC's ownership did not change during the period 1993 to 1998.

[12] Tr. II pp. 87-88, 91.

[13] Tr. II, p. 88.

[14] Tr. II pp. 88-89.

For fiscal years (FYs) 1996 and 1997 the Intermediary[15] disallowed the Forestville's claimed rental expense on the basis that Forestville and HRPT were related.[16] Accordingly, in FY 1998 the three Providers included the cost of ownership in their as-filed cost reports and protested the rental expenses paid to HRPT based upon the Intermediary's stated position that the parties were related.[17]

The estimated amount of Medicare reimbursement at issue is $238,102 for Cedar Lane, $189,349 for Brook Hollow, and $245,009 for Forestville.

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 claim that the Intermediary incorrectly argues that CHCC, CSC, and HRPT are related parties and that it was proper to disallow rental payment from the providers (CSC) to HRPT pursuant to 42 C.F.R. §413.17(a); however, even if they were related, the exception provision of 42 C.F.R. §413.17(d)(1) applies.

With respect to the common control criterion of 42 C.F.R.§413.17(b)(3),[18] the Providers contend that neither CHCC nor HRPT could control one another, as demonstrated by the negotiations surrounding the sale-leaseback transaction.[19] 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 the 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.[20] Additionally, the Providers maintain that the Intermediary's contention that the "arms-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

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[15] At the time of the Notices of Program Reimbursement (NPR) in question, the Fiscal Intermediary was Anthem Blue Cross/Blue Shield (Anthem). Subsequently, Empire Medicare Services (Empire) became the Intermediary. For purposes of this decision, Anthem and Empire will be referred to collectively as "the Intermediary."

[16] See Provider Ex. 33, Intermediary Exs. 6 and 7.

[17] Tr. II pp. 125-126, 128. Provider Ex. 34.

[18] The Providers note that consistent with the Board's decision in Forestville Health and Rehabilitation Center, et. al, 2003-D-63 (September 29, 2003), aff'd, B &G Investment Partners LP Corp. v. Thompson, No. 03-2469 (D.D.C) (September 29, 2005) (mem), the parties stipulated (Provider Ex. 30) that neither CHHC nor CSC is related to HRPT by the common ownership criterion of 42 C.FR. 413.17(a)(2).

[19] Tr. I at pp. 106-108, 297-300.

[20] See Provider Ex. 6 at 19.

determination of whether organizations are related for Medicare purposes.[21] Moreover, the prospectus itself lists numerous factors that the HRPT trustees considered when negotiating the terms of transaction.

The Providers further contend that CSC, Mr. Martin and Mr. Portnoy had no ability to control HRPT, and vice versa. Mr. Martin and Mr. Portnoy did not have the ability to control HRPT, since together, they only comprised a minority of the Board of Trustees. HRPT had safeguards to protect it from unfavorable conflicts of interest due to Trustee interests in proposed transactions.[22] Likewise, CSC had no more ability to control HRPT than any of HRPT's other tenants.

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. Mr. Martin and Mr. Portnoy abstained from the HRPT vote on the 1992 transaction with CSC.[23] Moreover, HRPT did not contract with HRPT Advisors to enable Mr. Martin or Mr. Portnoy to control HRPT or the Providers; the contract was for HRPT Advisors to provide management and administrative services for HRPT's rental properties.

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

The parties stipulated that the first requirement was met, as CHCC and HRPT are bona fide separate organizations.[24]

The Providers contend that the second exception requirement was met because a substantial part of HRPT's business is transacted with unrelated organizations,[25] and there was 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.[26] Additionally, the Intermediary incorrectly believes[27] that a ten-year lease term is evidence that no competitive market existed.

Regarding 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.[28]

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[21] 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."
[22] See Provider Ex. 4 at §7.8; Provider Ex. 23 at ¶9.
[23] See Provider Ex. 8; Tr. I at 133, 308-09.
[24] Provider Post-Hearing Brief at 34, Intermediary Position Paper at 11; Tr. I at 354.
[25] Intermediary Ex. 7; Provider Ex. 16 at 7; Tr. II, pp. 81-83.
[26] Tr. I at 96, 107-08, 236-37.
[27] Tr. I at 356.
[28] Tr.I at 102, 256-60, Tr. II at 85.

Additionally, the existence of both the regulation at 42 C.F.R. §413.130 and numerous PRRB and HHS Departmental Appeal Board decisions with factual circumstances involving leases provides further evidence that CMS recognized such a practice.
With respect to the fourth exception requirement, the Providers assert that the rental payments were in line with charges in the open market. The Providers adduced evidence that the lease payments were the same as those negotiated between unrelated parties in 1986. Additionally, the Intermediary provided no supporting documentation[29] for its rental payments survey of Connecticut Skilled Nursing Facilities, and such survey even if it could be supported, was for FY 1996 as opposed to the cost year at issue.[30] Moreover, the Intermediary's data indicated that the disputed rental expense was in line with charges in the open market. As further evidence that the lease payments were in line with the market, an independent appraiser who analyzed HRPT's initial public offering concluded that the acquisition price and the rents were reasonable and in the norm, or fair market value.[31] Finally, the rental payments were no greater than the rent charged to others under comparable circumstances, as evidenced by the fact that the rents paid by the Providers in 1998 were comparable to the rents paid by HRPT's other tenants.[32]

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 are related parties pursuant to P.R.M. §1004 as confirmed by statements in the HRPT Prospectus.[33] 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 alleges that the transaction was an "artificial" way to cash out equity by selling property to a new owner, leasing it back, and continuing on within the same business as before. The Intermediary asserts that in this case you do not have a business operator negotiating with the landlord in either a typical "buyer-seller" or "lessor-lessee" relationship in which the tenant is attempting to get the lowest price and the landlord is attempting to get the highest price.[34]

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

Ownership Issue:

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[29] Provider Exs. 24, 31
[30] Intermediary Ex. 7.
[31] Tr. I pp.108, 119, 121.
[32] Provider Ex. 37, Tr. II at pp. 85, 101-02, 147-153
[33] Provider Ex. 6, p. 19. See supra note 21.
[34] Tr. II at 46-47.

Messrs. Martin and Portnoy collectively owned 100% (50% each) of CSC, which operates all three Providers. CSC, in turn, leased 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 constitute 40% of the membership of HRPT's Board of Trustees. The Intermediary notes that the Providers have agreed that Messrs. Martin and Portnoy were interested parties to the transaction between CSC and HRPT. Additionally, the Corporate Minutes[35] do not reflect that Messrs. Martin and Portnoy abstained, although the Providers have asserted, through testimony 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.

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 criterion to the related party rule under 42 C.F.R. §413.17(d)(1) were not met. 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 that 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.

[35] Intermediary Ex. 5.

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.[36] The Intermediary disputes that an open competitive market exists when the lease, security agreement, and substantial control of CSC activities were assigned to HRPT. [37]

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 (SNFs) do not commonly lease the land and buildings which house their facilities.[38]

Regarding the fourth criterion (the charge to the provider is in line with the charge for services, facilities, and 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[39] 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.[40]

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

After consideration of the Medicare law and guidelines, parties' contentions, and the evidence submitted, the Board finds and concludes that the Provider 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.

[36] Tr. II at 56.
[37] Tr. II at 55-57.
[38] Tr. II at 57.
[39] Intermediary Ex. 7.
[40] See also Tr. II at 58-59.

> (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.

With regard to the common ownership criterion, the Board notes that HRPT is a publicly traded company. The Providers' (CSC) shareholders' (Messrs. Martin and Portnoy) beneficial interest in HRPT (through HRPT Advisors, Inc.) was only 4.1%. Neither of the shareholders owns any interest in HRPT individually. Direct ownership of HRPT by HRPT Advisors, Inc. was only 1.2%. While the Providers' shareholders serve on HRPT's Board of Trustees, they represent only a 40% vote and are prohibited from exercising 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" criterion, the Board finds that it can not consider the fiscal year at issue, (1998), in isolation. The Board finds that it must view the timeframe beginning in 1986 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 Providers' shareholders and a relative (who owned New MediCo). HRPT, through HRPT Advisors, Inc., created a stand-by management agreement whereby Greenery would be called on to manage CHCC (successor to New MediCo). Although never implemented, this agreement imposes an obligation indicative of control.
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> --The prospectus for HRPT indicates that substantially all of HRPT's operations will be conducted by HRPT Advisors (owned by the Providers' shareholders). Furthermore, HRPT's prospectus states that HRPT "will be subject to various conflicts of interest arising out of its relationships with its sponsors and their affiliates."[41]
>
> --The prospectus states 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 arm's-length basis."[42]
>
> --The financial statements of HRPT indicate that HRPT Advisors, Inc. is considered to be affiliated with the Providers based on common ownership.

[41] Provider Exhibit 6 at p. 18.
[42] Provider Exhibit 6 at p. 19.

The Board does not agree with the Providers' argument that they merely assumed leases whose terms were negotiated and 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 CSC. 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 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 that relationship extended to the years at issue**.** Additionally, the Board notes that when HRPT bought more facilities to make its portfolio more attractive,[43] this benefited Messrs. Portnoy and Martin.

The Board also finds that the Providers did not qualify for an exception to the related organization rules as the transaction fails to meet the fourth exception criterion. 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;
>
> (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 ("first prong") and there is an open, competitive market for the type of services, facilities, or supplies furnished by the organization ("second prong");
>
> (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 parties agree that exception criterion (i) was met, as HRPT is a bona fide separate organization from CHCC and CSC.[44] The Board finds that the Providers have proven that they have met the "first prong" of exception criterion (ii) because 98% of HRPT's business is transacted with other entities.[45] Regarding the "second prong" of exception criteria (ii), the Board notes that the regulation requires an analysis of the specific service furnished. In this case, the specific service supplied through the lease was financing

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[43] Provider Post Hearing Brief at 17; Tr. II at 88-89.
[44] See, supra, note 24.
[45] I-7 at paragraph 5.

services. The Provider presented unrefuted evidence that other financing tools were available (e.g., banks, private lenders, insurance companies, and other REITs and financial institutions).[46]

Also, the Board does not agree with the Intermediary's allegation[47] that because the original lease was set for ten years and the lease was renegotiated prior to the expiration of that term indicates that no open and competitive market exists. Moreover, while the Intermediary argued that leasing such facilities was uncommon, the Board notes that the Intermediary based its conclusions upon New York providers only.[48] The existence of the regulation at 42 C.F.R. §413.130 is evidence that CMS recognized the practice of leasing SNF facilities during the time period at issue.

The Board also concludes that the Providers met exception criteria (iii), as the Medicare reimbursement regulations themselves recognize that facilities will incur debt. This is an indication that financing services are commonly obtained by institutions such as the Providers.

Accordingly, the sole question remaining is whether the charges to the Providers are in line with the charge for such services in the open market. The Board notes that because facilities have a wide range of characteristics, it is difficult to pinpoint by using comparisons with other providers what constitutes a "reasonable"[49] charge. The Board notes that the evidence is inconclusive as to whether the Providers' characteristics are reasonably comparable to the providers whose allowable costs were in the upper tier of the Intermediary's survey (which the Provider also used).[50]

Nevertheless, the Providers' own admission indicates that the rents were unreasonable. The Providers' witness testified that starting in 1993, HRPT was unable to secure a long-term tenant at the rent that it sought. Accordingly, the Providers packaged the facilities (and upgraded others), to justify the rent. Moreover, as the facilities were not sold until 1999, it was evident that the rent exceeded what the market would bear at least through 1998, the cost year at issue.[51]

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[46] See, supra, note 26.
[47] Tr.I at 356.
[48] Tr. I at 357.
[49] See 42 C.F.R. §413.9(c)(2) which states: "The costs of providers' services vary from one provider to another and the variations generally reflect differences in scope of services and intensity of care." The provision in Medicare for payment of reasonable cost of services is intended to meet the actual costs, however widely they may vary from one institution to another. This is subject to a limitation if a particular institution's costs are found to be substantially out of line with other institutions in the same area that are similar in size, scope of services, utilization and other relevant factors.
[50] Provider Ex. 20, 35, 36., Tr. II at 136.
[51] Tr. II at 78-79, 88-89. Provider Post Hearing Brief at 17.

In addition, the Board notes that the Medicaid 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 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 amounts a provider may include in its capital-related costs as rental or lease expense under a sale and leaseback agreement 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 and HRPT are related, §413.130(b)(3) applies. Therefore, the Providers are not entitled to include incurred rental charges on their Medicare cost reports.[52] Instead, they are limited to the capital-related costs they would have incurred had they retained legal title to the facilities. The Providers claimed the depreciation expense associated with the properties on the filed Medicare cost reports for

[52] To the extent that the Intermediary presented the argument that the rental charges were "unnecessary," such argument is moot.

the year at issue.[53] The Intermediary properly allowed the claimed depreciation expense which was based on the acquisition cost of the properties.[54]

DECISION AND ORDER:

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

Board Members Participating:

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

FOR THE BOARD:

DATE: September 13, 2006

Suzanne Cochran, Esq.
Chairperson

[53] Tr. II pp-17-18, 128, 205.
[54] Tr. II pp 204-205.