

**BEFORE THE ALASKA OFFICE OF ADMINISTRATIVE HEARINGS ON REFERRAL
FROM THE COMMISSIONER OF HEALTH AND SOCIAL SERVICES**

In the Matter of)
)
PROVIDENCE HEALTH & SERVICES)
ALASKA) OAH No. 11-0045-DHS
_____)

DECISION

I. Introduction

Providence Health & Services Alaska filed a substantially-affected-person appeal in response to a notice that the Department of Health and Social Services had determined that a certificate of need was not required for Alaska Regional Hospital to make expenditures for a PET/CT scanner project. The question initially presented was whether Alaska Regional could proceed with the project, based on anticipated expenditures and the projected start date, without first obtaining a certificate of need. Because Providence’s appeal was not promptly referred for hearing, the project was nearly complete at the time of the hearing, with most expenditures or commitments to spend already having been made. By the time of the hearing, therefore, the question had evolved into whether Alaska Regional can operate the PET/CT scanner without first obtaining a certificate of need.

With the benefit of hindsight, it was possible to determine whether the project costs remained under the certificate of need threshold, which they did—by \$17,194. Thus, errors in the determination process and in delaying the referral for hearing notwithstanding, the PET/CT scanner project can operate without a certificate of need.

II. Factual Background¹

Alaska Regional decided to add a PET/CT scanner category of service to its hospital, in part to allow inpatients to undergo scans without having to be transported from the hospital by ambulance.² After obtaining some preliminary cost estimates, on March 18, 2010, Alaska Regional wrote to the department, requesting a determination on whether a certificate would be required. The letter stated that

The project consists of renovating no more than 1,500 square feet located on ARH’s campus and the installation of a PET/CT scanner. The renovation cost has been estimated at approximately \$275,000. We negotiated a medical capital expenditure of \$ [REDACTED] [sic] to purchase the

¹ This section provides the procedural backdrop for the specific fact findings interspersed throughout the Discussion below.

² May 18, 2011 Testimony of Paul Morris (P. Morris Test.).

scanner. The net present value of leased space for a 5 year period is \$225,000 at \$2.50 a square foot.^[3]

The letter estimated the total budget to be \$1. [REDACTED] million. It was accompanied by a page out of a preliminary proposal from [REDACTED], citing a system total price of \$ [REDACTED] for the scanner.⁴ The letter predicted that work on the project would start after receipt of the department's determination, with an anticipated service start-up date in fall 2010.

Alaska Regional's request did not purport to include "a certified estimate of the total cost of each proposed component of the activity listed in 7 AAC 07.010(a)," as contemplated by former 7 AAC 07.031.⁵ The certificate of need staff did not require Alaska Regional to certify or supplement its estimates, though the coordinator did obtain some additional information through oral requests.⁶

On April 13, 2010, the certificate of need coordinator issued a letter in which the department "determined that a CON is not required under 7 AAC 07.031" based on Alaska Regional's estimates in the paragraph quoted above.⁷ The determination recited a certificate of need expenditure threshold of \$1.3 million, because that would be the threshold in effect on July 1, 2010, and the project's expected completion date was after that date.⁸

Also on April 13, 2010, the department published a notice of the determination decision in Alaska's On-line Public Notices. The notice included the following appeal rights advisory:

If you are a person substantially affected by this decision, you may request a hearing to appeal the decision by contacting Karen Lawfer as indicated above [address, telephone and email contacts for Lawfer]. A request for a hearing must be received by the department no later than 4:30 PM Friday, May 14, 2010, and must be made in accordance with 7 AAC 07.080.^[9]

By letter dated and emailed May 14, 2010, as directed in the notice, Providence filed an appeal of the determination decision, asserting that Alaska Regional had not included all equipment and

³ ARH Exh. 16 at 1 (March 18, 2010 Letter from Paul Morris to then-Commissioner Hogan).

⁴ ARH Exh. 16 at 2.

⁵ When modifying references to the Alaska Administrative Code (AAC) title 7, chapter 7 regulations, "former" refers to the version in effect prior to the August 11, 2010 amendments, which can be found in the April 2010 publication of the AAC. Though some of the key subsections material to this decision were not changed by the amendments, others were. Thus, the "former" modifier is supplied for clarity, to minimize the risk of readers mistaking the present tense text as speaking of the current version of the regulations.

⁶ May 20, 2011 Testimony of Karen Lawfer (Lawfer Test.) (identifying three conversations between receipt of Alaska Regional's request letter and issuance of the determination letter).

⁷ ARH Exh. 17 (April 13, 2010 Letter from Lawfer to Paul Morris).

⁸ *Id.*; Lawfer Test.

⁹ PH&S Exh. 1 at 2 (April 13, 2010 Notice of Decision on Request for Determination).

construction costs in its estimate.¹⁰ The right to a hearing arose under the version of 7 AAC 07.080 in effect prior to the August 2010 amendments.

Providence's appeal was referred to the Office of Administrative Hearings on February 9, 2011, almost nine months after it was filed. Meanwhile, work had already begun on the project.¹¹ After the initial case planning conference between Providence and the certificate of need staff, Alaska Regional was given notice of the pendency of the appeal and afforded an opportunity to request to intervene.¹²

On March 7, 2011, Alaska Regional filed a Petition to Intervene and gave notice of its intent to seek a remand of this matter to the commissioner for reconsideration under former 7 AAC 07.033—a step skipped because the notice directed substantially affected persons to file appeals. Alaska Regional was permitted to intervene and a briefing schedule was set for the remand request.¹³ The remand request was denied for the reasons set out in the April 13, 2011 Order Denying Motion to Remand.

An evidentiary hearing was held in May and June, 2011. Seventeen witnesses testified. The following exhibits were admitted into evidence with the consent of all three parties:

PH&S Exhs. 1, 2, 4, 6, 7, 10, 12-14, 20 & 22-30;

ARH Exhs. 1, 1A, 1B, 2-8, 10, 14, 16-18 & 25-29.

All other exhibits were withdrawn. Several exhibits were ordered sealed to protect proprietary information, pursuant to a stipulation entered into by the parties.

The evidence established that Alaska Regional's expenditures for the PET/CT scanner project differed from the estimates in the March 18, 2010 letter, which had underestimated the build-out costs and overestimated the lease value. The expenditures proven total \$1,332,806, as explained in detail below.

III. Discussion

A certificate of need from the department is a prerequisite to making expenditures equal to or exceeding a threshold amount for construction of a health care facility or addition of a

¹⁰ PH&S Exh. 1 at 3-4 & 10 (May 14, 2010 Letter from Lamoureux to Lawfer; May 14, 2010 Email from Guess to Lawfer); PH&S Exh. 4.

¹¹ Work to upgrade the space—e.g., abate asbestos, replace the heating and ventilation systems, bring the space up to code, and reconfigure the space, carving out a portion for a separate hospital use—started around September 2010 and the scanner-specific remodeling work followed, starting in February 2011. May 19, 2011 Testimony of Jim Stonebreaker (Stonebreaker Test.)

¹² February 23, 2011 Case Planning Order and Notice to Potential Intervenor at 1.

¹³ March 17, 2011 Order Granting Intervention and on Procedure for Consideration of Motion to Remand.

category of health services.¹⁴ The proponent of a health care project may obtain a determination from the department that a certificate of need is not required by showing that expenditures will not exceed the applicable threshold.¹⁵ Alaska Regional obtained such a determination for the PET/CT scanner project. Providence has challenged the determination on legal and factual grounds, asserting that department staff made a legal error by not requiring Alaska Regional to comply with the regulatory requirements for a obtaining such a determination and, in any event, that the project expenditures will exceed the applicable threshold.

This discussion will address whether strict compliance was required, which threshold applies, and Alaska Regional's expenditures for the project. To resolve those issues, however, it is first necessary to identify the applicable standards of review and proof, and who bears the burden of proof.

A. *Standards and Burdens*

The parties agreed that the version of 7 AAC 07.080 in effect prior to the August 2010 amendments applies to this matter.¹⁶ Former 7 AAC 07.080 provided for hearings on decisions to require, grant, deny or modify a certificate. It did not directly provide for a hearing to challenge a determination that no certificate is required. Instead, former 7 AAC 07.033(f) indirectly extended the section 080 hearing and appeal procedures to such challenges.¹⁷ Former 7 AAC 07.080 did not specifically speak to who has the burden of proof in hearings conducted pursuant to it, but it did provide that hearings would be conducted under the Administrative Procedure Act (APA). The APA provisions create some uncertainty with regard to the burden of proof but not the standard of proof.

Under the APA the standard clearly is proof by a preponderance of the evidence.¹⁸ Who has the burden of proof is not as clear. It depends on who is considered the "petitioner" and "respondent," and on whether the proceeding was commenced through the filing of an accusation or concerns denial of a right, authority, license or privilege, and then on whether it was an initial

¹⁴ AS 18.07.031(a)&(d) (requiring a certificate of need for expenditure of \$1,000,000 or more, with the base \$1,000,000 trigger increasing \$50,000 each year, beginning July 1, 2005, until July 1, 2014). As of July 1, 2011, the threshold became \$1,350,000.

¹⁵ Both the current and former versions of 7 AAC 07.031 make this opportunity available.

¹⁶ See February 23, 2011 Case Planning Order and Notice to Potential Intervenor at 2; also February 22, 2011 Recording of Case Planning Conference.

¹⁷ Former 7 AAC 07.033(f) provided that the reconsideration decision—the step skipped here—would constitute the department's final decision unless the aggrieved person appealed "by requesting a hearing under 7 AAC 07.080."

¹⁸ AS 44.62.460(e).

denial or non-issuance of the authorization, or denial of a renewal of a preexisting authorization.¹⁹ Though Providence could be viewed as a “petitioner” and the department staff as a “respondent,” a hearing request on an agency’s determination that no authorization (certificate of need) is required does not fit squarely into the APA proceeding-type boxes.

Any uncertainty is resolved by a regulation of the Office of Administrative Hearings, 2 AAC 64.290(e), which states that “[u]nless otherwise provided by applicable statute or regulation, the burden of proof and of going forward with evidence is on the party who requested the hearing”²⁰ By regulation, therefore, Providence bears the burden of proof on factual issues. The standard of proof is preponderance of the evidence. The standard of review for legal questions, however, is not found in a regulation or a statute.

This is an executive branch adjudication in which the Commissioner of Health and Social Services (or his delegee) is the final decisionmaker. As such, the standards of review applied by the courts to an administrative appeal from an agency decision do not apply unless specifically made applicable by the rules governing this type of executive branch adjudication. Those judicial standards of review have not been made applicable through the AS 18.07 statutes (and implementing regulations) or the APA adjudication provisions. A prior certificate of need decision adopted by the then-Commissioner of Health and Social Services is instructive.

In the course of making the best decision possible, the final decisionmaker ... may, for a variety of reasons, find it appropriate to defer to judgments made by the agency staff A commissioner or final decisionmaker is never bound to defer to staff, however. As the agency’s policy head, moreover, it is particularly appropriate for a commissioner to make an independent judgment about the best reading of the agency’s regulations; an agency chief is never required to accept strained or problematic interpretations of the regulations advanced by the staff in the litigation process or elsewhere.^[21]

¹⁹ AS 44.62.460(e)(1) (accusation or denial of renewal); AS 44.62.460(e)(2) (initial denial or non issuance).

²⁰ Providence argued that it had an initial burden to raise a substantial question, after which the burden of proving that the costs of the PET/CT scanner project fall below the expenditure threshold shifted to Alaska Regional, but it cited no legal authority to shift the burden. Burden shifting can result from failure to provide required discovery, if that prevents the burdened party from going forward with evidence uniquely in the possession of another party. No such failure has been shown here. Any shortcomings in the prehearing exchange of documents were remedied through a flexible hearing process marked by cooperation in adding witnesses and providing additional documents identified through testimony on very short notice. As is often the situation in an administrative adjudication, some discovery of material facts occurred during the hearing rather than beforehand.

²¹ *Matters of Alaska Medical Development, LLC, Kobuk Ventures, LLC, and Fairbanks Memorial Hospital*, OAH No. 06-0744-DHS at p. 6 of administrative law judge’s the proposed decision (adopted by Commissioner of Health and Social Services Oct. 9, 2007) (citations omitted).

If the interpretation is not strained or problematic, the commissioner may find it prudent not to substitute his judgment for that of subordinate staff or former agency heads, especially if the department expects to receive deference from the courts for longstanding agency interpretations. Accordingly, due regard should be given to the testimony or other evidence showing the department's past interpretation of the regulations at issue here.

B. Compliance with Determination Prerequisites

Providence questions whether Alaska Regional failed to comply with the prerequisites for obtaining a no-certificate-required determination and whether the determination was flawed as a result. A request for determination must include descriptions of each component of the proposed activity and a certified cost estimate.²² The components considered in estimating expenditures encompass building or otherwise obtaining the location for the new facility or category of service to be added, as well as equipment costs, in kind donations or transfers, and related undertakings such as studies, designs, training, consultant costs, and shipping and installation costs.²³ The location components include land; construction, demolition and remodeling; facility development; and leasing costs.²⁴

Alaska Regional's request provided cost estimates for three components: (1) remodeling of existing, hospital-owned space; (2) purchase of equipment (the PET/CT scanner package only); (3) owned-space "lease" value.²⁵ The letter did not purport to "certify" the cost estimates. The certificate of need staff's past practice was to require the requestor to provide a certified estimate developed by a professional architect or engineer.²⁶ Staff did not require this of Alaska Regional prior to issuing the no-certificate-required determination.

Alaska Regional's component descriptions were brief and quite general, providing only a few details, such as the assumed period of the hypothetical lease (five years) and per-square-foot charge (\$2.50), and a not-to-exceed square footage estimate (1,500) for the area to be remodeled. The letter request did not explicitly speak to equipment, other than the PET/CT scanner itself, or

²² Former 7 AAC 07.031(b).

²³ Former 7 AAC 07.010(a).

²⁴ *Id.*

²⁵ AHR Exh. 16 (March 18, 2010 Letter from Paul Morris to then-Commissioner Hogan).

²⁶ PH&S Exh. 10 at 7 (September 19, 2008 Letter from Lawfer to Paul Morris) (requesting certified cost estimates as a prerequisite to making a determination under 7 AAC 07.031 on whether a certificate of need would be required for a different Alaska Regional project); *also* Lawfer Test. (confirming that the usual practice has been to require certified cost estimates if not submitted with the request).

provide sufficient details to tell whether the three component cost estimates covered the undertakings (consultant costs, shipping, etc.), furnishings and fixtures.

The companion needs of the department to have a sound factual basis for the determination and of a challenger to test the soundness dictate that the requestor provide the detail one would expect to underlay certified cost estimates prepared by architects and engineers. Alaska Regional's letter request fell short of this, and it did not transmit certified cost estimates of the type the department requires as a prerequisite for a determination under former or current 7 AAC 07.031. Accordingly, staff erred in issuing the determination.

That error was compounded by the long delay in referring Providence's appeal for hearing. As a result, instead of challenging a prospective determination about estimated expenditures, the commissioner's decision must take a retrospective look at what Alaska Regional spent, or committed to spend, on the PET/CT scanner project and whether a certificate of need is required in light of the applicable expenditure threshold.

C. Threshold

Providence has raised an issue about which expenditure threshold governs whether Alaska Regional's PET/CT scanner project requires a certificate of need. The expenditure threshold was \$1.25 million when Alaska Regional sought and received the determination and increased to \$1.35 million as of July 1, 2011.²⁷ The determination was based on the \$1.3 million threshold that took effect a year earlier because Alaska Regional had predicted that the project would be completed after July 1, 2010, when the threshold reached \$1.3 million.²⁸ Though the work was mostly complete at the time of the hearing, a punch list of final tasks remained to be completed.²⁹ Alaska Regional expected that they would not be completed before July 1 and argued, therefore, that the \$1.35 million threshold should be applied. The certificate of need staff concurred.³⁰

²⁷ AS 18.07.031(a)&(d).

²⁸ ARH Exh. 16 (stating that "[t]he anticipated date of service is the fall of 2010"); ARH Exh. 17 (April 13, 2010 Letter from Lawfer to Paul Morris) (indicating that \$1.3 million was the threshold being applied to the determination).

²⁹ Stonebreaker Test. (describing punch list items such as air balance report and door yet to be installed, and explaining that though the punch list items possibly could be completed by the end of June, the hearing had taken off some of the pressure to get them done).

³⁰ June 6, 2011 Certificate of Need Staff's Post-hearing Brief at 6 (stating that since the testimony showed "that the project will not be open for business until after July 1, 2011, the threshold in this matter should be 1.35 million dollars").

Providence agreed that “the department’s determination that the applicable threshold in effect at the time of the projected completion is a perfectly reasonable one.”³¹ But it questions whether Alaska Regional should get the benefit of subsequent annual increases in the threshold if actual completion occurs in a later year. Providence’s concern seems to be that a project proponent could manipulate the threshold by artificially delaying project completion until the calendar turns over to July 1 and the next \$50,000 increment is added to the threshold by operation of law.

This concern does not undermine the department’s use of the actual completion date when a project is delayed, whatever the cause, beyond the originally projected completion date. The annual increases in the threshold recognize that construction and equipment acquisition costs tend to go up over time. Whether a project’s rising costs are due to cost overruns from delay-causing events or simply to growing labor and commodities prices during a period of delay, the cost through the date of completion is the proper measure of whether the actual expenditures stayed below or exceeded the threshold. As the certificate of need coordinator explained, the department assumes that when the project is completed the construction expenditures will be complete as well.³²

It makes sense to use the projected completion date when determining prospectively whether the threshold is likely to be exceeded such that a certificate of need is required before expenditures are made. When, as here, events have overtaken the prospective determination and instead a mostly retrospective look at actual expenditures (or commitments to spend) drives the decision about whether a certificate of need will be required for the PET/CT scanner operation, it makes sense to use the actual completion date (i.e., after July 1, 2011), no matter what factors cause that date to be pushed back. A project proponent might delay completion past the next July 1 for any number of reasons: to secure additional funding; to await the release of improved technology; to achieve cost control by waiting for a particular contractor or redesigning some aspect of the project; to grapple with events beyond the proponent’s control (e.g., strikes, shipping delays, natural disasters), and even to wait out the decision in a competitor’s appeal.

Alaska Regional forthrightly admitted that it did not push the contractor to finish the punch list work sooner partly because of the pendency of Providence’s appeal. Certainly, the

³¹ June 6, 2011 Providence Health & Services Alaska’s Post Hearing Brief at 5.

³² Lawfer Test.

certificate of need staff's delay in referring the appeal for hearing contributed to the situation in which the parties find themselves—taking a more retrospective than prospective look at expenditures for a project that might have been completed before July 1, 2011 but for that delay and the appeal. None of that changes the fact that the completion date slipped past July 1, 2011, when the threshold increased to \$1.35 million.

The determination Alaska Regional obtained was not a prerequisite to constructing the PET/CT scanner facility, or making expenditures on the project. No one must obtain a no-certificate-required determination from the department. With or without such a determination, a project proponent could plan a project in year one, with anticipated completion in year two, and then postpone completion of the project for good business reasons or for no reason at all until year five, and not run afoul of the certificate of need laws if the project came in under the threshold applicable in year five.

Before July 1, 2011, some of the expenditures for the PET/CT scanner operation had already been made and Alaska Regional was committed to make the rest, including those for the small amount of work yet to be completed.³³ The key statutory language is that “a person may not make an expenditure of [the threshold amount] or more ... unless authorized by a certificate of need”³⁴ This does not prohibit expenditures toward but not equal to or exceeding the applicable threshold amount. Thus, if the evidence showed that Alaska Regional had, in fact, made (not just committed to make) expenditures in excess of \$1.25 million before July 1, 2010, or in excess of \$1.3 million before July 1, 2011, a violation of the statute would be proven. Under the statute, however, it takes actual expenditures, not just a commitment to make expenditures, to lock in the applicable threshold.

For these reasons, the certificate of need staff's practice of applying the threshold in effect on the date of completion is reasonable. The applicable threshold for this decision is \$1.35 million, based on a post-July 1, 2011 completion date.

³³ As shown in the discussion below of specific expenditure, at the time of May 18-20 hearing, Alaska Regional was committed to complete payment on the remodeling work once the punch list tasks were completed, and to make the final payments to ██████ for the scanner package, but it had been billed only \$█████ of the \$█████ remodeling costs and has expended only \$█████—10% of the total—for the scanner. Though the testimony suggested that the next payment (80%) for the scanner purchase might be made before July 1, 2011, the final payment for the scanner and the final billing for the remodeling were not expected until after that date, when the punch list work would be complete and the scanner would be fully installed and operational.

³⁴ AS 18.07.031(a) (emphasis added).

D. Expenditures

By regulation, the department has established which components of a project need to be included in the expenditure calculation, to determine whether a certificate of need is required.³⁵ Most pertinent of these are building construction/demolition/remodeling; equipment purchase or transfer; space acquisition; and undertakings essential to other components (e.g., studies, surveys, and plans).³⁶ Providence's appeal called into question the costs for several components of Alaska Regional's PET/CT scanner project, including the cost of the scanner itself.

1. The PET/CT Scanner

For purposes of determining whether a certificate of need is required, "expenditure" includes the purchase of ... the equipment required for the health care facility ..." but not "costs associated with routine maintenance and replacement of equipment."³⁷ Alaska Regional initially committed to pay ██████ \$█████ for a refurbished PET/CT scanner.³⁸ The items covered included training and an operator's manual.³⁹ When a different scanner had to be substituted because the one originally agreed upon could not use a seismic plate necessary for installation in earthquake-prone Anchorage, ██████ agreed to make another model that is usually more expensive—a new ██████—available to Alaska Regional at the same price.⁴⁰

One condition of substituting the usually more expensive scanner for the refurbished one was that Alaska Regional would purchase a ██████-year service agreement for the scanner's maintenance but not receive the one-year warranty that normally would have come with the substitute scanner if purchased at the regular price.⁴¹ The regular price is about \$█████ more than the \$█████ negotiated price.⁴² An operator's manual and training remained part of the package covered by the \$█████ price for the substitute scanner.⁴³ The ██████-year service

³⁵ See generally 7 AAC 07.010.

³⁶ Former 7 AAC 07.010(a)(2), (4)-(9) & (10).

³⁷ AS 18.07.031(e).

³⁸ May 18, 2011 Testimony of Paul Morris (P. Morris Test.); ARH Exh. 25 at 3 (May 24, 2010 ██████ Proposal, as accepted by Paul Morris of Alaska Regional). Alaska Regional's letter requesting the determination that no certificate of need is required recited an expected \$█████ purchase price. ARH Exh. 16. The March 1, 2010 Preliminary Proposal on which it was based recites a price of \$█████. The proposal ultimately agreed upon rounded the price figure to \$█████. May 19, 2011 Testimony of ██████ (█████ Test.) (explaining that the figure likely was rounded because no one worries about a few hundred dollars in a purchase of this size).

³⁹ ARH Exh. 25 at 2-3.

⁴⁰ ARH Exh. 26 at 3 (December 10, 2010 ██████ Proposal); P. Morris Test.; ██████ Test.

⁴¹ ARH Exh. 26 at 1.

⁴² ██████ Test.

⁴³ AHR Exh. 26 at 2.

agreement Alaska Regional purchased costs \$ [REDACTED] per year.⁴⁴ It provides for labor and parts, system updates, and support services.⁴⁵ Alaska Regional hired a trained operator, elected not to take advantage of the training included in the package, and will receive a \$ [REDACTED] credit in return, reducing the cost to \$ [REDACTED].

Providence argued that the \$ [REDACTED] price has been set artificially low and that the figure used for the scanner should be at least \$ [REDACTED], if the first year of the service contract is added to the “booked price,” and perhaps as much as \$ [REDACTED], if the entire service contract cost is added.⁴⁶ Providence also objected to reducing the expenditure figure for the training Alaska Regional does not need, arguing essentially that the “booked price” should not be changed based on hearing testimony.⁴⁷

Service Agreement. By statute, costs associated with routine maintenance of equipment are not “expenditures” for purposes of determining whether a project exceeds the certificate of need threshold.⁴⁸ The [REDACTED]-year service agreement Alaska Regional promised to purchase provides for maintenance of the scanner. That purchasing it, while forgoing the one-year warranty, was a condition of [REDACTED]’ agreement to keep the new scanner purchase price set at the amount originally negotiated for the refurbished one does not change the inherent nature of the service agreement.

Providence’s regional purchasing manager testified that Providence itself typically obtains service agreements for large pieces of equipment, forgoing use of such agreements in favor of having maintenance performed by in-house biomedical staff only for the smaller equipment.⁴⁹ Two months before the hearing, and many months after Alaska Regional and [REDACTED] reached an agreement for the \$ [REDACTED] scanner price, Providence obtained preliminary proposals from [REDACTED] for a new and a refurbished PET/CT scanner.⁵⁰ The package prices, respectively, were \$ [REDACTED] and \$ [REDACTED].⁵¹ The proposals to Providence do not propose to include in any purchase agreement a condition analogous to the one in the agreement Alaska

⁴⁴ ARH Exh. 27 at 1 (December 13, 2010 [REDACTED] Service Agreement).

⁴⁵ *Id.* at 1-2.

⁴⁶ June 6, 2011 Providence Health & Services Alaska’s Post Hearing Brief at 12-14 & 24.

⁴⁷ *Id.* at 11-14.

⁴⁸ AS 18.07.031(e).

⁴⁹ May 19, 2011 Testimony of Carol Geiger (Geiger Test.).

⁵⁰ PH&S Exhs. 12 & 13 (Preliminary Proposals [REDACTED]—Providence Health System, dated March 15, 2011).

⁵¹ PH&S Exhs. 12 at 2 & 13 at 2.

Regional ultimately signed, waiving the one-year warranty and promising to purchase the [REDACTED]-year service agreement.

Testimony by the [REDACTED] representative, as well as comparison of the corresponding proposal documents, revealed that the packages for the Providence proposals included items not in the Alaska Regional proposals.⁵² For instance, regarding the Providence proposal for the refurbished scanner, the [REDACTED] representative identified more than \$200,000 worth of items in the Providence proposal not purchased by Alaska Regional.⁵³ He also explained that [REDACTED]' usual practice is to allow any customer to negotiate a purchase agreement with a price reduction for [REDACTED], thereby allowing the purchaser to reduce capital costs by separating out the operating costs of servicing the equipment.⁵⁴ [REDACTED]' service agreements typically cost between \$ [REDACTED] and \$ [REDACTED] per year.⁵⁵ Providence's regional purchasing manager testified that Providence had simply requested proposals without engaging in negotiations over the price.⁵⁶

Alaska Regional's parent corporation maintains contractual relationships with [REDACTED] at the national level that enable Alaska Regional to negotiate favorable terms for the purchase of medical equipment.⁵⁷ For the scanner purchase, this resulted in savings of more than \$ [REDACTED] in freight charges that were covered by [REDACTED] and about \$ [REDACTED] due to a larger discount than Providence would have garnered under the proposal it obtained from [REDACTED].⁵⁸

Alaska Regional negotiated a \$ [REDACTED] price for the PET/CT scanner. It was able to get such a good price for a variety of reasons, including by opting out of the warranty and instead purchasing the [REDACTED]-year service agreement. Other [REDACTED] customers could do likewise. Though it is possible to imagine a project proponent using a so-called service agreement to, in effect, finance part of the purchase price for expensive equipment, thereby disguising "expenditures" as maintenance costs, the weight of the evidence in this case is contrary. The

⁵² Compare PH&S Exh. 12 with ARH Exh. 26 (new scanner) and PH&S Exh. 13 with ARH Exh. 25 (refurbished scanner); [REDACTED] Test.

⁵³ [REDACTED] Test. (calling out items totaling \$ [REDACTED] not purchased by Alaska Regional but included in the Providence proposal).

⁵⁴ [REDACTED] Test.

⁵⁵ [REDACTED] Test.

⁵⁶ Geiger Test.

⁵⁷ [REDACTED] Test. (explaining that under a master agreement between [REDACTED] and Alaska Regional's parent corporation, [REDACTED] covers the freight for shipment of equipment and identifying the better discount Alaska Regional obtained because of the parent contract with [REDACTED]).

⁵⁸ [REDACTED] Test.

service agreement here is not a sham. The department’s certificate of need staff considers purchase of a service agreement to fall under routine maintenance costs and not “expenditures.”⁵⁹ There is no reason to reach a contrary conclusion on this record as to the five-year service agreement Alaska Regional promised to purchase. The pre-credit-reduction price for the PET/CT scanner is \$[REDACTED].

Training Credit. The agreed price of \$[REDACTED] for the scanner includes \$[REDACTED] for three types of training [REDACTED] makes available—two priced at \$[REDACTED] each and one at \$[REDACTED].⁶⁰ Alaska Regional will receive a credit back in the corresponding amount for any of the three training sessions it does not use.⁶¹ The nuclear medicine technologist Alaska Regional selected to be the PET/CT scanner operator is already trained and experienced in operating the [REDACTED] [REDACTED] model scanner.⁶² Alaska Regional does not intend to use any of the three training opportunities and expects to receive a reduction of the full \$[REDACTED] amount on the \$[REDACTED] purchase price, yielding a final total price of \$[REDACTED].⁶³

Providence objects to reducing the “expenditure” for the scanner by \$[REDACTED] based on testimony at the hearing when Alaska Regional’s documentation shows a “booked price” (Providence’s term) of \$[REDACTED]. If this matter were at the initial determination stage, the certificate of need staff could reasonably decline to accept the project proponent’s assertion that the documentation overstates the likely expenditure amount. At the hearing stage, however, the commissioner is not constrained to accept as true and final a price recited in documentation when credible testimony, taken under oath, shows that more likely than not the price actually paid will be different from the recited price.

At the time of the hearing, Alaska Regional had paid only ten percent of the scanner purchase price and was due to pay another 80 percent soon, with the remaining ten percent not

⁵⁹ Lawfer Test.

⁶⁰ [REDACTED] Test.; ARH Exh. 3 (April 26, 2011 Email from [REDACTED] of [REDACTED] to P. Morris and others at Alaska Regional, showing the breakdown of training costs and of the cost for the operator’s manual, illustrating that the total cost for the training portion was \$[REDACTED]).

⁶¹ [REDACTED] Test.

⁶² May 19, 2011 Testimony of Meaghan Cerri (describing her training and work experience, and confirming that she has been hired by Alaska Regional to operate the PET/CT scanner).

⁶³ P. Morris Test. Some of the briefing and documents suggest that the “training credit” figure in question is \$[REDACTED]. The combined testimony of Mr. [REDACTED] and Paul Morris revealed that \$[REDACTED] of that figure is for the operator’s manual and that Alaska Regional does not intend to return the manual but only to forgo sending Ms. Cerri through training she has already had. Thus, the “training credit” is \$[REDACTED].

due until installation was complete and the scanner was operational.⁶⁴ The opportunity existed for Alaska Regional’s final payment to be reduced to account for the training that would not be used. This, coupled with the fact that the nuclear medicine technologist already has necessary training and experience to operate the scanner and Paul Morris’ testimony that Alaska Regional did not intend to use any of the training and instead would accept the \$[REDACTED] credit, makes it more likely than not that the full actual expenditure for the scanner is \$[REDACTED].

2. The “Lease” Value (Owned-Space) Calculation

“[T]he net present value of a lease for space occupied by ... the health care facility” counts as “expenditure,” for purposes of determining whether a certificate of need is required.⁶⁵ Under subsection (a)(7) of the version of the expenditure regulation applicable here, when the facility operator will use existing space it owns, the expenditure for the space component is determined

based on the value of the square footage of the space if it were leased, using the average current market rate for similar space leased in the proposed service area or comparable space in a comparable service area[. ⁶⁶]

The regulation then goes on in subsection (a)(8) to address leasing of space occupied by the facility, calling for the expenditure calculation to include “the net present value of the lease” where “net present value” is defined as “the total lease payments over the useful life of the asset as set out in the 2004 version of *Estimated Useful Lives of Depreciable Hospital Assets*[.]”⁶⁷

Alaska Regional has, in effect, combined these two provisions and calculated a net present value (NPV) of \$144,627 for a five-year period, for space it has dedicated to the PET/CT scanner operation in an existing building it owns—Medical Office Building A.⁶⁸ The NPV calculation began with a \$[REDACTED] per square foot market rate, increased that rate over the five-year period using a 2.5% annual escalator, and discounted the cost using a [REDACTED]% internal rate of return.⁶⁹

⁶⁴ May 19, 2011 Testimony of Brian Griggs (Griggs Test.).

⁶⁵ AS 18.07.031(e).

⁶⁶ Former 7 AAC 07.010(a)(7).

⁶⁷ Former 7 AAC 07.010(a)(8).

⁶⁸ ARH Exh. 1A (using \$144,627 as the “NPV Lease” figure in the expenditure calculation table); ARH Ex. 1 at 2 (showing the NPV calculation methodology); P. Morris Test. (describing how the NPV calculation, including the per-square-foot rate and the internal rate of return, was prepared).

⁶⁹ ARH Exh. 1 at 2; P. Morris Test.

Subsection (a)(7), which undisputedly applies to Alaska Regional’s scanner project, stops short of establishing a methodology for converting the “square footage” and “average current market rate” into a lump sum figure useful for determining whether the project will exceed the expenditure threshold. It does not explicitly state that the figure derived from square footage times market rate (price per square foot) is to be projected out over a specified period of time—e.g., the lease term, the expected life of the building, the expected period of operation, or something else. Use of “current” in the phrase “average current market rate” creates an ambiguity. The phrase is equally susceptible to meaning that the owned-space calculation is to be a snapshot taken when the expenditure determination is made, using the then-current rate, or to be constantly updated to keep current with the changing market rate over the unspecified period of time. The latter is consistent with applying an escalator but the former is not.

In contrast, subsection (a)(8), which on its face does not appear to apply to Alaska Regional’s scanner project because no “lease” exists, requires that the cost be reduced to an NPV using the lease price over the useful life the asset—here, the building. The lease itself, if one existed, would set the price (in price per square foot or some other measure) and the lease term. The period for projecting out the cost before reducing it to an NPV is firmly established by reference to an industry publication. The only thing lacking is the answer to what, if any, discount rate should be applied to account for the cost of capital.

The certificate of need coordinator testified that it is acceptable to use either the subsection (a)(7) or the subsection (a)(8) approach under these circumstances, adding that the regulations do not set a discount rate (rate of return) to be used in the NPV calculation and Alaska Regional could have used a shorter, three-year remaining useful life period in the calculation.⁷⁰ Briefing and argument revealed that all three parties agree that, even in the owned-space (no actual lease) situation here, the figure derived from the square footage and market rate needs to be projected out over a period of time, with an escalator applied, and reduced back to an NPV. Providence and the certificate of need staff agree that the five-year period and 2.5% escalator Alaska Regional used are reasonable. Providence, however, questions whether the NPV

⁷⁰ Lawfer Test. Witness testimony confirmed that Alaska Regional’s Medical Office Building A is about 37 years old and that its shell type falls into a 40-year useful life category, though the useful life of the interior areas can be shorter—something in the 23-25 years range, unless renovated. May 19, 2011 Testimony of Randy Morris (R. Morris Test.); May 20, 2011 Testimony of John Hale (Hale Test.).

calculation is reasonable in light of the █% discount rate, the \$█ starting market rate and the number of square feet used in Alaska Regional's calculation.

Discount Rate. The █% discount rate is the internal rate of return Alaska Regional and its parent corporation apply when determining the NPV for capital projects.⁷¹ Providence argued that a █% rate is too high relative to prevailing interest rates. Since the regulation does not set out a specific discount rate or a methodology for determining an appropriate applicant- or project-specific discount rate, it was not unreasonable for the certificate of need staff to accept Alaska Regional's internal rate of return assumption in the absence of proof that the rate is indeed excessive. Providence did not offer evidence of an alternative rate it believes would be reasonable, or even evidence of the prevailing interest rates generally available. Providence, therefore, failed to meet its burdens of production and of proof. The NPV calculation is not flawed due to use of a █% discount rate under these circumstances.

Starting Market Rate. The starting market rate of \$█ per square foot in the calculation prepared for the hearing was taken from a market analysis prepared for Alaska Regional, specifically for Medical Office Building A, by a property management consultant.⁷² As part of a regular routine of preparing market analyses for each of Alaska Regional's medical office buildings, for use in setting the standard business lease terms, the consultant performed a market survey, evaluating Building A (home for the PET/CT scanner) in comparison to six other properties.⁷³ The consultant recommended a base rent in the fair market value range of \$█- \$█ per square foot, per year.⁷⁴ This converts to a monthly per-square-foot rate range of approximately \$█ to \$█.⁷⁵ Alaska Regional's calculation started in year one with a rate close to the high end of the range—\$█—and escalated that rate at 2.5% each year, ending with a rate of \$█ per square foot in year five.

Providence challenged the starting rate of \$█ as too low, arguing that the \$2.50 rate used in Alaska Regional's initial request for determination is more consistent with Providence's

⁷¹ P. Morris Test.; May 19, 2011 Testimony of Richard Davis (Davis Test.).

⁷² P. Morris Test.; R. Morris Test.; ARH Exh. 5 (January 18, 2011 Lincoln Harris Report for Medical Office Building COID 30203A, confirmed through R. Morris Test. to be Building A).

⁷³ R. Morris Test.; ARH Exh. 5.

⁷⁴ ARH Exh. 5 at 3; also R. Morris Test. (explaining that the base rent figures in the report were per square foot per year, not per month).

⁷⁵ R. Morris Test.

own market rate estimate prepared for purposes of the hearing.⁷⁶ The market rate estimate exhibit was withdrawn by Providence and thus cannot be the basis for attempting to undermine other evidence. Providence presented an alternative calculation, using a starting rate of \$ [REDACTED] per square foot, building to \$ [REDACTED] in year five and yielding a pre-discounted gross total of \$ [REDACTED].⁷⁷

Selection of the \$ [REDACTED] rate for Providence’s alternative calculation was based on the testimony of a commercial real estate sales and leasing agent who had been asked by Providence to research the market for medical space. He “cold called” Alaska Regional’s property management consultant and was told that the rate for any space likely to be coming open would be in the \$ [REDACTED] to \$ [REDACTED] range.⁷⁸ He did not ask whether the rates would be different as between the various Alaska Regional buildings.⁷⁹ He testified that he did not believe that the rate for Building A would be any different from Building C (a newer building on the Alaska Regional campus), even though he was aware that Providence itself charges at least \$ [REDACTED] per square foot less for its older buildings than for its newer ones.⁸⁰

The testimony and documentary evidence from Alaska Regional’s property management consultant was to the contrary and more reliable. A “cold call” inquiry that does not distinguish between different buildings, when the caller has reason to know that building age makes a difference, yields dubious results standing alone. In any event, it supplies only an asking price, not a final effective lease rate after negotiation and concessions. In the face of evidence establishing a building-specific market rate, using a market survey of six comparables, prepared not for litigation but as part of the hospital’s routine practice in setting commercial lease terms for its properties, the “cold call” derived rate is wholly unreliable.

Paul Morris explained a misunderstanding that led him to use the \$2.50 rate in the request for determination.⁸¹ Even if he had not, at this point in the process, the decision whether Alaska

⁷⁶ June 6, 2011 Providence Health & Services Alaska’s Post Hearing Brief at 17 (quoting from withdrawn PH&S Exh. 19); ARH Exh. 16 at 1 (explaining that Alaska Regional’s initial space cost estimate of \$225,000 for square footage not to exceed 1,500 total was calculated using \$2.50 per square foot).

⁷⁷ June 6, 2011 Providence Health & Services Alaska’s Post Hearing Brief at 18.

⁷⁸ May 19, 2011 Testimony of Jeffrey Thon (Thon Test.).

⁷⁹ *Id.*

⁸⁰ *Id.*

⁸¹ P. Morris Test. (explaining that when he (Paul Morris) asked Rick Davis for the standard lease rate for the medical office buildings, he (Morris) heard Mr. Davis to have said \$2.50, but that later—after the request for determination at ARH Exh. 16 was submitted—Mr. Davis pointed out that Mr. Morris had gotten it wrong in the letter request and that he (Davis) had said \$ [REDACTED]).

Regional must obtain a certificate of need rests on facts established through the hearing, not on assertions—erroneous or not—made in the request for determination.

The weight of the evidence supports using a \$ [REDACTED] per-square-foot-per-month starting rate in the NPV calculation, as was done in ARH Exhibit 1. Providence has failed to prove that a higher starting rate should be used.

Square Footage. The NPV calculation found at page 2 of ARH Exhibit 1 is based on a square footage figure of 1,381. Alaska Regional began with a footprint square footage figure of 1,528, and then backed out 98 square feet for the Health Information Management (HIM) room and 49 square feet for the portion of a shared equipment room it estimated will not be used for scanner-related equipment.⁸² The HIM room will be used by another department of the hospital, not for the PET/CT scanner.⁸³ Thus, the 98 square feet that room occupies is not part of the scanner project and should not be included in the NPV of the owned-space “lease” value.

The shared equipment room raises a slightly different question. Unlike the HIM room, the shared equipment room is not wholly devoted to a purpose separate from the PET/CT scanner. Alaska Regional estimated that about half the room would be needed to house scanner-related equipment, but the scanner-related equipment will not be confined to a specific half of the room.⁸⁴ Though the scanner-related equipment does not require the entire room, and non-scanner-related equipment will be in the room as well, the question is whether proration of square footage should be allowed.

The regulation provides little guidance on this issue, except insofar as it contemplates that for owned-space the value will be calculated as if the space were leased.⁸⁵ In an actual lease situation, the parties to the lease could address whether the lessee’s payments are offset in some fashion to account for the fact that it will be using only a portion of the space in a shared equipment room. Some lessees might agree to pay the full cost for the shared room in order to control access or to have some control over where the lessee’s equipment will be placed, but most likely the parties would negotiate an offset. When, as here, there is no lease document from which to discern whether the lessee equivalent (the PET/CT scanner project) must pay for all or only a portion of the shared space, it is not unreasonable to prorate the cost-per-square-foot for

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ Former 7 AAC 07.010(a)(7).

that shared room according to the relative portions to be occupied by scanner-related equipment and other hospital equipment.

Even if the department instead chose to treat all space within the PET/CT scanner suite as part of the “leased” area for purposes of the NPV calculation, the NPV for the owned-space lease value would not have to be increased. Though the parties are not disputing Alaska Regional’s use of a five-year lease period, the testimony indicated that it could have used a three-year period, based on a 40-year useful life for the roughly 37-year-old building. This would bring the gross (pre-discounted) cost down by almost \$ [REDACTED], which more than makes up for the \$ [REDACTED] to \$ [REDACTED] cost reduction over, respectively, a three-year or a five-year period resulting when 49 square feet are backed out of the NPV calculation.⁸⁶

In sum, reduction of the square footage from 1,528 to 1,381 for the NPV calculation was reasonable. The weight of the evidence supports the starting rate of \$ [REDACTED] per square foot. Providence failed to prove that the [REDACTED]% discount rate is too high. In any event, the gross (pre-discounted) cost could have been reduced by nearly \$ [REDACTED] by using a three- rather than five-year “lease” period, consistent with the age of Building A. More likely than not, therefore, the NPV lease value for the owned space is no greater than the \$144,627 figure in ARH Exhibit 1.

3. The Build Out

For purposes of determining whether a certificate of need is required, the expenditures include “construction, demolition, or remodeling of a building.”⁸⁷ “Construction” and “demolition” have unique definitions suggestive of work different from that performed to accommodate the PET/CT scanner.⁸⁸ “Remodeling” is more apt here; it means “altering the structure or furnishings of a building” but “does not include routine maintenance or replacement of equipment[.]”⁸⁹ Ordinary upkeep of property or equipment to keep it in safe working condition or good repair is considered “routine maintenance.”⁹⁰ “Equipment” includes utilities,

⁸⁶ The dollar figures used to calculate the gross cost savings are taken from ARH Exh. 1, which shows that the pre-discounted gross costs for years 1-3 would equal just \$ [REDACTED] of the \$ [REDACTED] five-year gross total, for an almost \$ [REDACTED] reduction over the five-year calculation Alaska Regional offered. At the monthly amounts of \$ [REDACTED], \$ [REDACTED] and \$ [REDACTED] per square foot for years 1-3, offsetting the 49 square feet would result in a reduction of \$ [REDACTED]. Adding years 4-5 (\$ [REDACTED] and \$ [REDACTED]) brings the maximum reduction for the offset to just \$ [REDACTED].

⁸⁷ Former 7 AAC 07.010(a)(2).

⁸⁸ See former 7 AAC 07.900(5) & (7) (defining “construction” by reference to AS 18.07.111—e.g., erection, building, alteration, etc., of a health care facility—and “demolition” as “tearing down, razing, destroying, or taking apart of an existing structure”).

⁸⁹ Former 7 AAC 07.010(d)(4).

⁹⁰ Former 7 AAC 07.900(b)(1)(A)(i).

heating, air conditioning, and ventilation.⁹¹ Maintenance necessary to meet the 13 AAC chapter 50 life and safety code standards also is considered “routine maintenance.”⁹²

In a lease situation, the cost of leasehold improvements, as well as furnishings and fixtures, must be included.⁹³ The regulation is silent as to whether a similar principle applies to an owned-space situation so as to allow the owner to allocate costs between a proposed health care facility project and the ordinary activities of a building owner making space market ready (make-ready work). The certificate of need staff historically has interpreted the regulation as allowing the project proponent in an owned-space situation to draw a lease-like line between tenant-specific improvements and landlord make-ready work when identifying expenditures.⁹⁴ The market lease rate already encompasses the cost of making premises ready to lease.⁹⁵ Thus, in a situation where the NPV of a hypothetical leasehold has been incorporated in the cost, the exclusion of these make-ready costs avoids what would be, in effect, double counting.

Alaska Regional entered into two contracts concerning the PET/CT scanner space in Building A. One contract (the remodeling contract) provided for work indisputably attributable to the scanner project and had a budgeted cost of \$[REDACTED].⁹⁶ The parties do not dispute that the costs under this contract are “expenditures” for certificate of need purposes. Alaska Regional, though, has argued that \$[REDACTED] should be backed out of that cost, leaving \$[REDACTED] attributable to the scanner project, to account for work on the HIM room that is not part of the scanner suite.⁹⁷ The other contract (make-ready contract) provided for make-ready work on the space, such as performing asbestos abatement, replacing the old heating and ventilation systems, and work to bring the space up to code.⁹⁸ According to the lead architect, no aspect of the work

⁹¹ *Id.*

⁹² Former 7 AAC 07.900(b)(1)(A)(ii).

⁹³ Former 7 AAC 07.010(a)(8)(B) & (C).

⁹⁴ Lawfer Test. (explaining that the department would not consider make-ready costs to be “expenditures” because those costs are attributed to the landlord).

⁹⁵ R. Morris Test.

⁹⁶ P. Morris Test.; May 18-19, 2011 Testimony of Jeff Koonce (Koonce Test.); May 19, 2011 Testimony of Tara Gallagher (Gallagher Test.); ARH Exh. 7 (Neuser Construction’s project budget); *also* PH&S Exh. 30 (contract document). At the time of the hearing in May 2011, \$[REDACTED] had been billed to Alaska Regional under the remodeling contract and the contractor was obliged to complete the work at the guaranteed price of \$[REDACTED], unless the contractor and Alaska Regional agreed to a change order; the contractor did not anticipate needing a change order because the work was about 99% complete. Stonebreaker Test.

⁹⁷ P. Morris Test.; ARH Exh. 1 at 1 & 3 (illustrating Alaska Regional’s methodology for carving out a construction cost for the HIM space based on the 98 square feet of the overall project it represents).

⁹⁸ Koonce Test.

under the make-ready contract was specific to a PET/CT scanner.⁹⁹ The make-ready contract had a guaranteed maximum price of \$[REDACTED].¹⁰⁰

Providence asserts that the make-ready contract costs should be included as “expenditures,” arguing that Alaska Regional allocated to that contract work necessarily part of the PET/CT scanner project. Abating asbestos, replacing the heating and ventilation systems and bringing the space into code compliance are activities a landlord would do to make a space market ready.¹⁰¹ They also fall into the “routine maintenance” category of work excluded from “expenditures” for certificate of need purposes. On the record developed through the hearing process, it is impossible to separate the cost for that work from other work done under the make-ready contract. Thus, when Providence argues that the cost of moving walls and installing doors, or trenching the concrete to hold cables, in anticipation of the specific configuration needed for the scanner operation should be part of the remodeling expenditure, it stops short of proving how much, if any, of the \$[REDACTED] make-ready cost is attributable to work a tenant rather than the landlord ordinarily would do. Moreover, the argument assumes, without proving, that a landlord’s make-ready work would not include reconfiguring done in anticipation of the specific needs of a prospective or planned next tenant, along with the reconfiguring to meet the landlord’s own needs (e.g., carving out space for the HIM room).

Providence also argued that Alaska Regional has improperly phased the scanner project, in violation of former 7 AAC 07.015, by dividing the work between the two contracts and counting only the remodeling contract cost as an expenditure. That regulation (like its successor, 7 AAC 07.025(d)) prohibits phasing or dividing an “activity” to avoid the requirement to obtain a certificate of need. Contrary to Providence’s argument, remodeling of the Building A space is not the “activity.” It is one expenditure component of the activity under former 7 AAC 07.010, but the “activity” is adding the PET/CT scanner category of service.¹⁰² If Alaska Regional were attempting to divide two or more of the components—e.g., the remodeling from the scanner purchase—the department could consider that prohibited phasing of the activity.¹⁰³

⁹⁹ *Id.*

¹⁰⁰ ARH Exh. 18 at 8.

¹⁰¹ R. Morris Test.

¹⁰² The “activity” can be “construction of a health care facility” or “addition of a category of health services provided by a health care facility[.]” Former 7 AAC 07.900(a)(1)(A)&(C). Alaska Regional’s PET/CT scanner adds a category of service to an existing “health care facility” as defined in AS 18.07.111(8).

¹⁰³ *See* former 7 AAC 07.015(a)(1).

Here, Alaska Regional simply contracted separately for the make-ready work a landlord likely would do and the specific remodeling for the scanner operation. Providence's argument treats the make-ready work as if it is an expenditure component unto itself that cannot be separated from the remodeling work. It is not a component. Treating it as such would create an unlevel playing field as between health care facility operators that own space and those that lease space. Lessee operators would benefit by not having to count as "expenditures" the costs borne by the landlord to make the space market ready. Owner operators would be at a disadvantage if they could not carve out the make-ready work through a separate contract or otherwise.

Nothing in Providence's argument compels the department to change its practice of allowing make-ready costs to be excluded in owned-space situations, just as landlord improvements are excluded from the leasehold expenditures in leased-space situations. The department can scrutinize whether an owner-operator improperly apportions remodeling work to a make-ready work contract, just as it can scrutinize a lease arrangement to uncover improperly shifted costs. Here, that scrutiny was given to Alaska Regional's contracts through the hearing process. Providence raised questions about the allocation between the two contracts but did not prove that the make-ready work, more likely than not, included tasks that a landlord ordinarily would require the lessee to pay for.

Providence disagrees with Alaska Regional's argument that \$ [REDACTED] should be backed out of the remodeling "expenditure" component. The HIM room serves a non-PET/CT scanner function for another department of the hospital. As such, remodeling costs for that room should not be included in the "expenditures." In concept, the methodology Alaska Regional used to calculate an amount to back out of the remodeling costs makes sense: total cost (\$ [REDACTED]) divided by total square footage (1,528) yields a per square foot cost (\$ [REDACTED]), which is then multiplied by the 98 square feet occupied by the HIM room. The difficulty is not with the methodology but with its assumption that significant build-out work acquired through the \$ [REDACTED] contract was done to the HIM room. The testimony was to the contrary.

The vast majority of the work to make the HIM room usable for its intended purpose was performed under the make-ready contract.¹⁰⁴ Only a small amount of painting and finish work remained after the make-ready work had been completed.¹⁰⁵ No evidence presented quantified a

¹⁰⁴ Stonebreaker Test.

¹⁰⁵ *Id.*

specific cost for the small amount of work, but the testimony confirmed that such a small amount probably would not have cost anything close to \$ [REDACTED].¹⁰⁶ More likely than not, therefore, most of the \$ [REDACTED] contract price is attributable to the scanner project, and the remodeling component expenditure is equal to or slightly less than \$ [REDACTED].

4. The Optional Design Elements

Alaska Regional asserts that \$39,000 should be backed out of the remodeling costs for aesthetic improvements that were “not necessary for the safe, functional, and medically appropriate operation of the facility.”¹⁰⁷ This figure reflects the cost of special decorative wall-mounted panels and a fiber-optic-lights twinkling stars and circular cloud motif on the scanner-room ceiling installed at Paul Morris’ direction, based on ideas he got touring other facilities.¹⁰⁸

Under the now-current regulations, such optional design features would not be counted in the expenditures.¹⁰⁹ This was a change from the previous regulations. The change took effect in August 2010, after Alaska Regional had obtained the determination from staff but before the work was performed. During the hearing, the certificate of need coordinator testified that it has been the department’s practice to utilize the old regulations for a project commenced under those regulations, rather than switch to new regulations that take effect after commencement.¹¹⁰ A project is considered commenced when the determination letter has been received or the certificate of need application has been deemed complete.¹¹¹ She explained that for other projects, she has recommended to the proponents that they continue following the old regulations and would have done likewise here if Alaska Regional had raised the aesthetic improvements issue with her. It was raised for the first time at the hearing.

Alaska Regional’s project was “commenced” with receipt of the determination letter in April 2010, months before the August effective date of the optional design features exclusion. In post-hearing briefing, the certificate of need staff took the position that the \$39,000 cost of the

¹⁰⁶ *Id.*

¹⁰⁷ June 6, 2011 Intervenor Alaska Regional Hospital’s Post-hearing Brief at 18-20; *also* ARH Exh. 1A (listing a \$39,000 offset against “Construction Costs” for “Optional Design Features”).

¹⁰⁸ Stonebreaker Test.; P. Morris Test.; ARH Exh. 1B.

¹⁰⁹ 7 AAC 07.900(17), as amended August 11, 2010 (defining “expenditure” with reference to AS 18.07.031, which includes “equipment”); 7 AAC 07.900(16)(B), as amended August 11, 2010 (excepting from the definition of “equipment” “optional design features, furnishings, or décor choices that do not add to the minimum necessary for the safe, functional, and medically appropriate operation of the facility”).

¹¹⁰ Lawfer Test.

¹¹¹ *Id.*

aesthetic improvements “can be properly excluded[,]” if the current regulation applies.¹¹² But the staff did not advocate that the commissioner change the department’s practice of continuing to apply the regulations in effect upon project commencement. Alaska Regional has shown that the \$39,000 properly could be excluded from the expenditure calculation under the current regulation, but it has not offered a compelling argument to support the department changing its practice in this particular appeal. The remodeling expenditure, therefore, will not be reduced by the cost of the aesthetic improvements.

5. Undertakings, Software and Transferred Property

The parties do not dispute Alaska Regional’s expenditure figures for architect fees (\$6,177) and consulting fees (\$15,925). A total of \$22,102, therefore, is included in the expenditure calculation for the “undertakings” component.¹¹³

The parties do dispute whether additional software and equipment costs should be included in the expenditure calculation. Specifically, Providence maintains that about \$[REDACTED] should be added for remote image viewing software and about \$[REDACTED] should be added to the Gravenguard/Biodex hot lab equipment figure for returned equipment needed to safely operate the scanner.¹¹⁴ Alaska Regional disagrees.

Alaska Regional initially ordered remote image viewing software, so that the radiologists could use it to access and view PET/CT scanner images in their offices, but later decided that the radiologists would not have this software after all.¹¹⁵ The order was canceled.¹¹⁶ Providence has not proven that \$[REDACTED] should be added to the expenditures for software.

Alaska Regional ordered hot lab equipment necessary to deal with the radioisotopes used for the scanner operation. The order included an Atomlab 500 Dose Calibrator and a Ludlum 14C Survey and Count (survey meter) instrument, and shows the price of these instruments as \$[REDACTED] and \$[REDACTED], respectively.¹¹⁷ Both instruments are needed for the scanner operation.¹¹⁸

¹¹² June 6, 2011 Certificate of Need Staff’s Post-hearing Brief at 16-17.

¹¹³ ARH Exh. 1; former 7 AAC 07.010(a)(9)(A).

¹¹⁴ Compare June 6, 2011 Providence Health & Services Alaska’s Post-hearing Brief at 7 (listing in the table \$[REDACTED] for “Gravenguard Equipment Purchase” and “~\$[REDACTED]” for “Remote Image Viewing Software”) with ARH Exh. 1 (showing just \$[REDACTED] for “Gravenguard/Biodex” and no figure for software).

¹¹⁵ P. Morris Test.

¹¹⁶ Griggs Test.

¹¹⁷ ARH Exh. 4 at 2.

¹¹⁸ Cerri Test. (explaining that the survey meter detects radiation on materials such as the packages from the radiopharmacy); May 19, 2011 Testimony of Kate Hiemstra (Hiemstra Test.) (explaining that the dose calibrator measures the degradation of the radioactive material to determine when it is ready to be administered to the patient).

Alaska Regional decided to return them to the vendor because the hospital already had these instruments in its nuclear medicine lab.¹¹⁹ An extra survey meter was to be provided to the PET/CT scanner operation from the nuclear medicine lab and, at the time of the hearing, a dose calibrator was already in the suite, though it was not established whether this is the instrument awaiting return to the vendor or a spare that has been transferred.¹²⁰

The invoice for these instruments and other hot lab equipment did not include a well counter—a very sensitive instrument required by the Nuclear Regulatory Commission to be present for use in detecting radiation at low levels.¹²¹ One witness testified that she understands a well counter to cost several thousand dollars, perhaps on par with the cost of a dose calibrator.¹²² When asked about whether the well counter and the dose calibrator need to be on hand near the PET/CT scanner, rather than available elsewhere in the hospital, the witness explained why the dose calibrator needs to be on hand but did not address whether the well counter also needs to be, and she was not asked about necessary proximity of the survey meter to the scanner.¹²³

Transferred equipment, valued at the fair market value at the time of transfer, is part of the equipment component expenditure.¹²⁴ The testimony indicates that, more likely than not, a survey meter and a dose calibrator had been or soon would be transferred to the PET/CT scanner suite. Thus, the fair market value of the transferred items should be included. In the absence of specific information about the two transferred instruments and their fair market values, the invoiced prices for the returned instruments will be used. Accordingly, \$ [REDACTED] will be added to the hot lab equipment expenditure.

Providence, however, did not prove that a well counter has been or necessarily will have to be transferred to the PET/CT scanner operation or purchased for it, rather than borrowed from time to time from the nuclear medicine department, and did not offer sufficient proof of the cost of a well counter.

¹¹⁹ P. Morris Test. (explaining the reason for the return); Cerri Test. (confirming that the she has seen such devices in the hospital and that a dose calibrator was already in the scanner suite, but she did not know whether it was an extra or the one to be returned).

¹²⁰ Cerri Test.

¹²¹ ARH Exh. 4; Cerri Test.; Hiemstra Test.

¹²² Hiemstra Test.

¹²³ *Id.* (explaining that the dose calibrator needs to be used not just at the start of the scan but repeatedly, every 30 minutes, as additional doses are administered to the patient throughout the scanning process).

¹²⁴ *See* former 7 AAC 07.010(a)(10).

Alaska Regional's expenditure calculation lists \$ [REDACTED] for the hot lab (Gravenguard) equipment cost.¹²⁵ Paul Morris testified that he mistakenly deducted \$1,105 in shipping costs when he calculated that figure. Adding \$ [REDACTED] for the transferred property to these two figures yields a total for hot lab equipment of \$ [REDACTED].

Lastly, Providence made the rhetorical point that Alaska Regional's expenditure calculation does not include an amount for furniture. The point is rhetorical because Providence presented no proof of the probable cost—i.e., fair market value to transfer or the purchase price to acquire furniture needed for the scanner suite.

IV. Conclusion

Irrespective of whether the certificate of need staff should have issued the no-certificate-required determination to Alaska Regional on the strength of the minimal information submitted, the evidence adduced through the hearing process confirmed that Alaska Regional's expenditures for the PET/CT scanner project will not exceed the \$1.35 million threshold. The following table summarizes the expenditures proven.

Component	Cost
PET/CT Scanner	\$ [REDACTED]
Lease Value for Owned Space	≤ \$144,627
Build Out	≤ \$ [REDACTED]
Undertakings	\$ 22,102
Software	\$ 0
Hot Lab Equipment	\$ [REDACTED]
TOTAL	≤ \$1,332,806

Alaska Regional, therefore, is not required to obtain a certificate of need for the PET/CT scanner project.

DATED this 12th day of November, 2011.

By: Signed _____
 Terry L. Thurbon
 Chief Administrative Law Judge

¹²⁵ ARH Exhs. 1 & 1A.

Adoption

The undersigned adopts this Decision under the authority of AS 44.64.060(e)(1), as the final administrative determination in this matter.

Judicial review of this decision may be obtained by filing an appeal in the Alaska Superior Court in accordance with Alaska R. App. P. 602(a)(2) within 30 days after the date of this decision.

DATED this 27th day of December, 2011.

By: Signed
William Streur, Commissioner
Department of Health and Social Services

[This document has been modified to conform to the technical standards for publication.]
