PROVIDER REIMBURSEMENT REVIEW BOARD
HEARING DECISION

98-D32

PROVIDER -
Ashland Regional Medical Center

Provider No. 39-0181

vs.

INTERMEDIARY -
Blue Cross and Blue Shield Association/
Blue Cross and Blue Shield of Western
Pennsylvania

DATE OF HEARING-
August 23 and 26, 1996

Cost Reporting Period Ended -
February 14, 1992

CASE NO. 95-0495

INDEX

ISSUE:

Was the Intermediary's adjustment disallowing the Provider's claimed loss on disposal proper?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

Ashland Regional Medical Center, ("Provider" or "Hospital") formerly Ashland State General Hospital, is a 135 bed hospital and skilled nursing facility formerly owned and operated by the Commonwealth of Pennsylvania ("Commonwealth"). Beginning shortly prior to 1981, the Commonwealth began divesting itself of a number of general hospitals which it owned and operated.[1] Over the next decade, some state hospitals were divested by acts of legislature, some by leases and at least one was closed and demolished.[2] In each case, the Commonwealth considered the particular circumstances of the hospital, including the facility's financial and physical condition, the area economy and market conditions, etc., and attempted to make the best business deal possible for the Commonwealth. In several cases, this required that funds be paid to the hospitals to keep them operating in the short term.[3]

In or about 1985, the Commonwealth commissioned a study by Health Tech, Inc. to identify and evaluate divestiture options for the Provider, located in rural Schuylkill County, Pennsylvania.[4] As part of its study, Health Tech mailed out requests for proposals to 59 acute-care hospitals, received thirteen preliminary letters of intent and actual proposals from four groups.[5] One of those groups was Ashland Area Community Hospital, Inc. ("AACH") , a not-for-profit corporation established to acquire the Provider. AACH was a local group without health care management experience and apparently unprepared to finance and operate the Provider on its own.[6] The Commonwealth did not divest the Provider at that time, and the facility continued to suffer large losses.[7]

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1 Transcript at Volume I, Pg. 50. Hereafter, transcript will be abbreviated as "Tr.", Volume I of the transcript, dated August 23, 1996 will be designated as "I", and Volume II of the transcript, dated August 26, 1996, will be designated as "II".

2 Tr. at I.51-52, I.56-57.

3 Id.

4 Provider Exhibit P-5.

5 Provider Exhibit P-5 at 7; Tr. at I.60.

6 Id. at 11; Tr. at I.106-07, I.133.

7 Tr. at I.62, I.92.

A 1989 study of the Hospital by Touche Ross & Co. projected that the losses would continue to increase, regardless of whether the Provider continued under state or private ownership.[8] The losses continued to mount and in its last full year of operation under state ownership, FYE June 30, 1991, the Provider posted a loss of over $7.4 million.[9] The Intermediary has not challenged this figure.[10]

In early 1991, the Commonwealth issued a notice inviting potential buyers to make presentations regarding their ability to continue the operations of the hospital. The Commonwealth's notice stated that unless a worthy buyer was established by March, 1992, the Hospital would close. AACH was one of the proposals entertained by the Commonwealth.[11]

Effective February 15, 1992, while the Commonwealth and AACH were perfecting a conveyance of the Provider from the Commonwealth to AACH, AACH leased the hospital and operated the Provider for the Commonwealth.[12] The lease, which had an initial term of 3 months, provided that AACH would pay the Commonwealth a rental fee of $1.00. Other terms of the lease provided that the Commonwealth would pay AACH for operating costs of the Provider for the months of February and March 1992 in the amounts of $193,512 and $387,023, respectively, or a total of $580,535.[13] The lease, however, was extended April 1, 1992 and provided for additional payments by the Commonwealth to AACH up to $319,465 for the period April 1, 1992 until May 15, 1992.[14] By the terms of the Lease Agreement and the extension of April 1, 1992, the Commonwealth agreed to provide payments to AACH totaling $900,000 to ensure the hospital's operation during the interim period.[15] Those payments were made to AACH and used to operate the Hospital during the Lease period.

By Act 22 of 1992, approved April 13, 1992, the general assembly of the Commonwealth authorized the State's divestiture of the Provider to AACH. That Act imposed certain conditions and included many of the terms and conditions which had been negotiated and

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8 Provider Exhibit P-6 at 69-71; Tr. at I.64-66.

9 Intermediary Exhibit I-6.

10 Tr. at II.167.

11 Provider Position Paper at 3.

12 Intermediary Exhibit I-1

13 Provider Exhibit I-1 at 18.

14 Intermediary Exhibit I-2.

15 Tr. at I.170, II.53-54.

agreed upon by the parties and which were more fully described in the Disposition, Sale and Purchase Agreement ("Sales Agreement") executed by the Commonwealth and AACH on or about May 6, 1992.[16] These included, among other provisions, continuing to operate the Hospital for a minimum of five years, assumption of all leases, agreements, and contracts, the right of the Commonwealth to disapprove any successor owner and operator of the Hospital during that five year period, the granting of all of the Commonwealth's receivables to AACH while at the same releasing AACH from any of the Commonwealth's liabilities, and a commitment to negotiate with the hospital's two labor unions to arrive at mutually acceptable labor agreements. During this five year period the State retained a right of reentry and a reversionary interest in the real and personal property of the Hospital if AACH failed to abide by the terms of the conveyance.[17]

On May 13, 1992, the Commonwealth sold the Provider to AACH for the sum of $100,000, payable in ten annual installments of $10,000 at an interest rate of 9%.[18] The Provider's Board of Trustees, an independent and autonomous administrative board, also approved the sale.[19] This agreement incorporated the terms and conditions set forth in Act 22, and also conveyed, among other things, all gifts, grants, and donations made to the Hospital, whether made before or after the date of the transfer. AACH also received all of the Hospital's patient accounts receivable as of the close of the business, February 14, 1992, for services rendered by the Commonwealth on or before that date, including any amounts due "as a result of cost settlements," except for those involving the Medicaid program.[20] Medicare receivables alone were in excess of $500,000.[21] All accounts receivable due the Commonwealth during the term of the lease agreement between AACH and the state of Pennsylvania were also conveyed to AACH.

For the cost reporting period ended February 14, 1992, AACH claimed an operating loss of $9,949,652.[22] AACH also computed a loss on disposal for the transfer of assets of $4,809,877,[23] with a Medicare impact of $2,597,333. In settling the Provider's FYE February

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16 Intermediary Exhibit I-4; Tr. at I.116-17.

17 Intermediary Exhibit I-3 at 18-19.

18 Intermediary Exhibit I-4.

19 Tr. at I.80.

20 Intermediary Exhibit I-4 at 24-25.

21 Intermediary Exhibit I-5.

22 Intermediary Exhibit I-6.

23 Intermediary Exhibit I-13.

14, 1992 cost report on June 23, 1994, the Intermediary denied the claimed loss on disposal.[24] The basis for the Intermediary's denial of the claimed loss on disposal was that the transaction conveying the Provider to AACH from the Commonwealth was not bona fide, was effectively and constructively a donation of assets, for which a loss may not be included in the determination of allowable cost in accordance with Medicare regulation 42 C.F.R.§ 413.134(f)(4).[25]

On December 14, 1994, the Provider filed a timely appeal, challenging the Intermediary's denial of reimbursement, with the Provider Reimbursement Review Board ("Board") pursuant to 42 C.F.R. §§.1835-.1841 and has met the jurisdictional requirement of those regulations. The Medicare reimbursement effect in dispute is approximately $2,597,000.[26] The Provider was represented by Marjorie M. Obod, Esquire, of Dilworth, Paxson, Kalish & Kauffman. The Intermediary was represented by Michael F. Berkey, of Blue Cross and Blue Shield Association.

PROVIDER'S CONTENTIONS:

The Provider contends that the disposition of the hospital facility ensued from sales transactions that were conducted between unrelated parties at arm's length and in good faith, which resulted in a bona fide sale of assets for their fair market value. The Provider asserts that it has complied with the criteria and methodology set forth in 42 C.F.R. § 413.134(f)(2) for including the loss on disposal as an allowable cost under the Medicare program. In support of its position, the Provider asserts that:

1. The sale of the Hospital met the definitional criteria of being a bona fide sale since there was a "completed transaction" and it was made in good faith;
2. The parties bargained for valuable consideration;
3. Contrary to the Intermediary's contention, the transaction was not a donation;
4. The sale of the Hospital was an arm's length transaction between unrelated parties, and
5. The bona fideness of the sale was not nullified by payments to AACH or its non-assumption of liabilities.

Following is the Provider's arguments to support each of the above assertions.

1. *The sale of the Hospital met the definitional criteria of being a bona fide sale since there was a "completed transaction" and it was made in good faith.* The Provider points out that although the concept of "bona fide sale" is referenced in several relevant provisions of

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[24] Intermediary Exhibit I-7, audit adjustment number 4.

[25] Intermediary Exhibit I-8.

[26] Intermediary Position Paper at 2, Provider Position Paper at 5.

the HCFA Medicare Regulations including 42 C.F.R. §§ 413.134(b)(2) and 413.134(f)(2), the Regulations do not define this key term.

In its Position Paper, the Intermediary suggested looking to Black's Law Dictionary,[27] an authoritative source for legal definitions, to define "bona fide sale". The current, sixth edition of Black's Law Dictionary contains a definition for "bona fide sale" which is:

> A completed transaction in which seller makes sale in good faith, for valuable consideration without notice of any reason against the sale.

Exhibit P-3 (emphasis added).

The Provider points out that this definition has been referred to by the Board when addressing very similar issues. Lac Qui Parle Hospital of Madison, Inc. v. Blue Cross, et al., PRRB Decision No. 95-D37, May 10, 1995,[28] HCFA Adm.declined review, Medicare and Medicaid Guide (CCH) ¶ 43,269. The Provider notes that both HCFA witnesses in the hearing acknowledged the reasonableness of this definition.[29]

The Provider contends that it is uncontroverted in this case that there was a "completed transaction," i.e., an actual sale of the Hospital, evidenced by the Sales Agreement which constituted a legal, binding contract between the parties.[30] The Provider also contends that negotiations between the Commonwealth and AACH were conducted in good faith. The Provider asserts that HCFA's witnesses acknowledged that there were no indications of a lack of good faith or fraudulent intent by either party in this case.[31]

2. *The parties bargained for valuable consideration.* The Provider notes that Black's Law Dictionary defines "valuable consideration" as that class of consideration upon which a promise may be founded, which entitles the promisee to enforce its claims against the promisor. This may consist of a right, benefit, profit or interest accruing to one party, or some forbearance, detriment or responsibility given or undertaken by the other.[32]

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27 Intermediary Position Paper at 11.

28 Provider Exhibits P-1, P-2.

29 Tr. at II.70-71, II.195-96.

30 Tr. at II.89-91.

31 Tr. at II.70, II.197.

32 Provider Post Hearing Brief at 15.

The Provider contends the consideration in this case flowed both ways. While AACH received certain tangible assets, including buildings, movable equipment, receivables, etc., it also assumed numerous obligations, risks, responsibilities and burdens which constituted valuable consideration. Similarly, the Commonwealth received, in addition to $100,000, contractual promises that AACH would continue to operate the facility as a hospital for at least five years, thereby assuming the risk of future operating losses; would recognize and negotiate with existing labor unions, and would assume contracts, leases and agreements, etc. The Provider argues that neither the $100,000 payment nor the onerous burdens of continued operation of the Hospital, the entering into the labor contracts and other leases, nor the agreements and contracts can be considered nominal consideration. The Provider contends that in both cases, the transaction was made enforceable through the Sales Agreement, which included a reverter and reentry clause recorded as a restriction in the deed.[33]

Based on the above argument, the Provider contends that it is indisputable that valuable consideration was given and received by both parties to the sale.

3. *The transaction was not a donation*. The Provider contends the sale of the hospital by the Commonwealth to AACH was not a donation under the definition set forth in 42 C.F.R. § 413.134(b)(8). According to the Regulations, "[a]n asset is considered donated when the provider acquires the asset without making payment in the form of cash, new debt, assumed debt, property or services." Id.

As discussed above, AACH agreed to pay the Commonwealth $100,000, pursuant to the Sales Agreement. The Provider points out that AACH has made at least two payments of interest and principle and missed at least one payment on the $100,000. However, the Commonwealth has not forgiven the debt and is not barred by any statute of limitation from collecting it.[34]

In addition to the payments, the Provider points out that AACH was obligated to continue operating the hospital despite its historic losses of as much as $7.4 million per year. Therefore, the Provider maintains that since a substantial payment was made in the form of $100,000 in new debt to the Commonwealth, and there was no intent to donate the Hospital, the sale of the Hospital cannot be characterized as a donation under 42 C.F.R. § 413.134(b)(8).

4. *The sale of the Hospital was an arm's length transaction between unrelated parties*. The Provider points out that an "arm's length transaction" is "[a] transaction negotiated by unrelated parties, each acting in his or her own self interest; the basis for a fair market value

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[33] Intermediary Exhibit I-4 at 10-11.

[34] Provider Post Hearing Brief at 19, Tr. at I.79, I.113.

determination."[35] The Provider notes that the Intermediary concedes, based on the testimony of all of its witnesses, that the two parties to the sale of the Hospital were not related, as that term is defined in the Regulations.[36] The Provider believes the concepts of unrelatedness, good-faith negotiations, and fair market value are thus inextricably linked in legal as well as regulatory terminology.

In addition to being unrelated, the Provider argues that both parties were well-informed about each other's demands, needs and requirements. Throughout 1991, the parties engaged in prolonged, sometimes heated, give-and-take bargaining and negotiating.[37] The Provider asserts that the results of this bargaining is attested to by a comparison of the July, 1991 proposal and the final Sales Agreement, which indicates that several key requests were refused while other terms and conditions had changed in the process.[38]

Therefore, it is the Provider's position that the sale of the Hospital was a negotiated, arm's-length transaction between unrelated and well-informed parties, which demonstrates that the sale was bona fide for fair market value.

5. *The bona fideness of the sale was not nullified by payments to AACH or its non-assumption of liabilities.* The Provider points out the $900,000 in lease payments AACH received from the Commonwealth were unrelated to the sale. By the terms of the lease and subsequent amendment, the payments were to ensure the hospital's continued operation during the period prior to the sale. The Intermediary acknowledged the $900,000 from the Commonwealth was money that the operators needed to keep going during the immediate period.[39] The Provider argues that before the Sales Agreement was executed, neither party was under a legal obligation to consummate the sales transaction and all risks associated with operating the Hospital remained with the Commonwealth; AACH did not assume these risks until after the sale was completed. Therefore, the payment of $900,000 to AACH to operate the Hospital, made during the Lease period, pursuant to the Lease Agreement and Amendment, was legally and conceptually separate from the Sales Agreement. It it is the Provider's position that this payment could not and did not impact on the bona fideness of the sale.

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35 Provider Exhibit P-3 at 109; Exhibit P-1 at 5 (emphasis added).

36 Tr. at I.274, II.69, II.139, II.236.

37 Tr. at I.69, I.105, I.144-45.

38 Tr. at I.138-40.

39 Tr. at II.55.

The Provider also argues that the inclusion of accounts receivable in the sales agreement did not negate the bona fideness of the sale. The Provider points out that the Intermediary acknowledged that accounts receivable are commonly included among the assets purchased in sales transactions.[40] Therefore, the Provider concludes that since the inclusion of the accounts receivable was a bargained for and negotiated term of the Sales Agreement, designed to facilitate the Hospital's survival so that all of the terms and conditions of the sale could be effectuated, it did not negate the sale's bona fideness.

The Provider also rejects the Intermediary's argument that the sale of the Hospital was not at fair market value. The Regulations contain a definition for fair market value:

> [f]air market value is the price that the asset would bring by bona fide bargaining between well-informed buyers and sellers at the date of acquisition. Usually the fair market price is the price that bona fide sales have been consummated for assets of like type, quality, and quantity in a particular market at the time of the acquisition.

42 C.F.R. § 413.134(b)(2).

This definition mirrors the concept of an "arm's length transaction" whereby a transaction negotiated between unrelated parties, each acting in its own self interest, establishes the basis for a fair market value determination. Here, the concept of "fair market value" is linked to the notion of "bona fide, or "good faith" bargaining between well-informed buyers and sellers. Thus, the regulatory definition, like the legal definition, presumes that "fair market value" is established through the bona fide negotiating and sales process, not through a remote, purportedly "objective" (i.e. appraisal) determination by a third party Intermediary.

The Provider points out that the Intermediary testified that fair market value is "[d]etermined by the willingness of other people to come to purchase that property", and necessitates "[g]oing out to the market to see what the market will bear."[41] Despite this acknowledgment, the Provider contends the Intermediary purposely ignored evidence that a comparable market existed and, even to the extent that it did not exist, ignored the plain language of the Regulation which presumes that the parties' negotiated agreement establishes the fair market value.

The Provider rejects the Intermediary's claim that fair market value must be determined "without regard to restrictions."[42] The Intermediary's witnesses admitted that not one of the

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40 Tr. at II.86-87.

41 Tr. at I.270, I.291.

42 Tr. at I.285; Intermediary Position Paper at 11-12.

particular conditions listed violate any Medicare Regulation, nor could it indicate anything in the Regulations that prohibit a "prudent seller" from including such conditions as part of a sales transaction.[43]

The Provider points out in Lac Oui Parle, supra, the Intermediary also argued that restrictions defeated the bona fide nature of a sales agreement for a hospital, claiming that "[a] restricted sale cannot be used to define market value."[44] In that case, the Board found that although the existence of the conditions "[m]ay have impacted on the ultimate sales price", such conditions are not uncommon in such sales. The Board then stated that, since the conditions had been "[p]roclaimed and discussed by the parties throughout the negotiating process," and were fully disclosed in the sales agreement, they did not nullify the sale's bona fide nature.[45] Therefore, the Provider concludes that there is no support for the Intermediary's contention that the presence of conditions associated with a sales transaction, which do not violate any Medicare Regulation, invalidated the sales price which represented the Hospital's fair market value.[46]

The Provider asserts the Intermediary's attempt to support its determination with a flawed appraisal was arbitrary, capricious and unsupported by the Medicare regulations.[47] The Provider argues the regulations do not support the use of an appraisal to substitute a price negotiated by the parties. The Intermediary's witness acknowledged that, prior to even obtaining the appraisal, HCFA had already decided that the sale of the hospital was not a bona fide sale for fair market value.[48] However, to justify its determination, HCFA decided to order an appraisal to substitute a value for the sales price agreed to by the parties, ostensibly based on 42 C.F.R.
§ 413.134(f)(2)(iv).[49] The Regulation states:

> (iv) [i]f a provider sells more than one asset for a lump sum sales price, the gain or loss on the sale of each depreciable asset must be determined by allocating the lump sum sales price among all the assets sold, in accordance with the fair market value of each asset as it was used by the provider at the time of sale. If

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43 Tr. at 1.295, II.93, II.161-62.

44 Provider Exhibit P-1 at 12.

45 Id. at 15.

46 Intermediary Position Paper at 11.

47 Provider Post Hearing Brief at 29.

48 Tr. at II.154, II.217.

49 Tr. at II.212, II.214.

> the buyer and seller cannot agree on an allocation of the sales price, or if they do agree but there is insufficient documentation of the current fair market value of each asset, the intermediary for the selling provider will require an appraisal by an independent appraisal expert to establish the fair market value of each asset and will make an allocation of the sales price in accordance with the appraisal.

42 C.F.R. § 413.134 (f)(2) (iv).

The Provider contends the plain language indicates, and the Intermediary's witness noted, this Regulation does not authorize an Intermediary to use an appraisal to substitute for a negotiated sales price. Instead, as the first sentence clearly states, it deals only with the allocation of the agreed-upon lump sales price among the assets in the transaction.[50]

Furthermore, the Provider contends that any claim that the appraisal was independent and unbiased is undercut by the appraiser's acknowledgment that its role was "[t]o support the U.S. Department of Health and Human Services decision that the sale of Ashland State General Hospital was actually a donation."[51] The Provider points out that HCFA's witness acknowledged that it had already decided that the sale of Ashland was not for fair market value, prior to even ordering and directing the appraisal.[52]

Finally, the Provider contends the bona fide nature of the sale for fair market value is supported by the Board's decision in Lac Qui Parle. The Provider points out numerous parallels to the present case.[53] The Provider argues that the Board's decision in Lac Qui Parle could equally apply in the present case. While differing in particulars, the two transactions were structurally similar. In both cases, the seller of a small, rural hospital, wishing to facilitate its continued operation, sought the best possible deal in a market where buyers were scarce. In both cases, while the disparity between sales price and purported "value" of the depreciable assets appeared great, the price reflected the fair market value for an operating hospital facility in light of the specific circumstances. In both cases, the Intermediary argued that there was no open market and, therefore, the sale was "virtually" a donation. However, in both cases, the Provider asserts the Intermediary was wrong, since both involved unrelated parties negotiating at arm's length, who willingly agreed to conditions in the course of good faith bargaining; thereby establishing the fair market value of all of the assets in a bona fide sale.

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50 Tr. at II.214-17.

51 Intermediary Exhibit I-14 at 230, Tr. at II.153.

52 Tr. at II.154, II.171, II.217.

53 Provider Post Hearing Brief at 35-37.

In summary, the Provider argues that the Intermediary's attempt to substitute its judgment as to the hospital's fair market value for the sales price actually negotiated and agreed upon by the parties contravenes the Medicare regulations and the Board's decisional law, and is against the substantial weight of the evidence. Therefore, the Intermediary's adjustment to the Provider's claimed Medicare loss on disposal should be reversed.

INTERMEDIARY'S CONTENTIONS:

It is the Intermediary's position that the Commonwealth's conveyance of the Provider to AACH was effectively and constructively a donation. The Intermediary rejects the Provider's claim that a $100,000 payment to the Commonwealth represented fair consideration for the sale; the Intermediary believes it was not a sale but a donation.

In view of the Provider's assertions that the hospital's fair market value at the time of conveyance was only about $100,000, the Intermediary engaged an independent valuation firm, Marshall and Stevens, Inc., to conduct an appraisal of the facility as of February 15, 1992. The appraisal report[54] valued the Hospital's real estate at $1,040,000 and the facility's major movable equipment at $1,360,000. The Intermediary asserts that for the Provider to argue that $100,000 represented fair market value for a facility appraised at $2,400,000 is cynical to the point of absurdity.

The Intermediary points out that just prior to the conveyance of the Provider to AACH, the Commonwealth paid AACH $900,000 as advances for AACH's reasonable costs in operating the Hospital.[55]

The Intermediary points out that the conveyance agreement contained an indenture which specified that the Commonwealth would turn over to AACH all accounts receivable, with $500,000 payable on closing, an additional amount, not to exceed $500,000, payable on or before May 22, 1992, and any remaining balance payable on or before June 5, 1992. That same indenture also provided that the Commonwealth would convey to AACH any net amounts that would otherwise be due the Commonwealth as a result of cost report settlements for a period of five years from February 15, 1992. Liabilities, however, still remained the responsibility of the State.

The Intermediary contends the above reveals that the Commonwealth effectively and constructively donated the Provider to AACH, actually giving AACH substantial consideration to take the facility off its hands. For a paltry $100,000, AACH received Provider assets and future program reimbursement worth millions of dollars. Therefore, the Intermediary maintains the conveyance of the Provider was in substance a donation. The

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[54] Intermediary Exhibit I-14.

[55] Intermediary Position Paper at 8.

Intermediary argues this alleged "sale for fair consideration" was no such thing, but effectively a donation of assets in which the Commonwealth rid itself of a facility which it had been operating at a loss. Given the financial nature of the conveyance, in which AACH reaped the benefit of millions of dollars in exchange for $100,000, the Provider substantively and constructively meets the definition of a donated asset in accordance with 42 C.F.R. § 413.134(b)(8),[56] which states as follows in pertinent part,

(8) [d]onated asset. An asset is considered donated when the provider acquires the asset without making payment in the form of cash, new debt, assumed debt, property or services.

42 C.F.R. § 413.134(b)(8)

The Intermediary points out that both the HCFA regional office (Intermediary Exhibit I-5) and HCFA's central office (Intermediary Exhibit I-16) agreed with its assessment. Accordingly, the Intermediary maintains that no loss on the disposal of the facility should be recognized.

In support of its position that a donation occurred, the Intermediary also contends the Commonwealth's conveyance of the Provider to AACH was not a bona fide sale at fair market value. The Intermediary notes that Medicare regulation 42 C.F.R. § 413.134(b)(2)[57] states:

(2) [F]air market value. Fair market value is the price that the asset would bring by bona fide bargaining between well-informed buyers and sellers at the date of acquisition. Usually the fair market price is the price that bona fide sales have been consummated for assets of like type, quality, and quantity in a particular market at the time of acquisition.

Id.

In addition 42 C.F.R. §413.134(f)(2)(I) states as follows in pertinent part:

(2) [B]ona fide sale or scrapping. (I) Except as specified in paragraph (f)(3) of this section, gains and losses realized from the bona fide sale or scrapping of depreciable assets are included in the determination of allowable cost. . .

Therefore, based on the above, the Intermediary contends that in order for a loss on disposal to be recognized by the Medicare program, the loss must stem from a sale which is considered bona fide at fair market value.

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56 Intermediary Exhibit I-8.

57 Intermediary Exhibit I-8.

The Intermediary maintains that a bona fide sale contemplates a fair and open market without encumbrances. The Intermediary believes a fair market does not involve the imposition of restrictions imposed by either a buyer or a seller which so distort the market so as to preclude obtaining a fair market price.[58] The Intermediary points out that the Provider itself admits that the Commonwealth imposed numerous restrictions in connection with the conveyance of the Hospital to a potential purchaser. These included, among other things, an obligation to continue operating the Hospital for a period of at least five years, a requirement that the purchaser enter into contracts with the Hospital's two labor unions, an assumption of all leases and hospital contracts, etc.

The Intermediary argues that the Commonwealth had an obligation to obtain the best possible price for the Provider. Instead, the Intermediary believes that political considerations apparently overrode its fiduciary responsibilities to the taxpayers of Pennsylvania. It is the Intermediary's position that the Commonwealth's restrictions on the conveyance of the Hospital to potential purchasers effectively removed the facility from a fair and open market in which the best possible price could be obtained, to the detriment of the State's taxpayers and the Medicare program. The Intermediary concludes that the Commonwealth essentially gave the Hospital away and paid AACH handsomely to take the facility off its hands, perhaps, in an effort to cut its operating losses, but with the important political goal of maintaining an inpatient facility in an area with declining utilization.[59]

In University of California Irvine Medical Center v. Blue Cross and Blue Shield Association et al., PRRB Decision No. 85-D8,[60] October 15, 1984, Medicare & Medicaid Guide (CCH) ¶ 34,415, affirmed, HCFA Deputy Admin. Decision, December 12, 1984,[61] Medicare & Medicaid Guide (CCH) ¶ 34,527, ownership of a county-owned hospital was transferred to a state university. The Board found that the sale was not bona fide because the price paid was $13.5 million below the market value of the assets sold. Moreover, while the county was able to sell the assets on the open market, the transfer had the restriction that the university supply medical care to indigent residents under specified conditions. In affirming the correctness of the Intermediary's determination that the transaction was not a bona fide sale, the Deputy Administrator held as follows:

> [u]pon review of the testimony and evidence, the Deputy Administrator finds that substantial evidence in this case indicates that the sale was not bona fide. The testimony and evidence established that the fair market value of the assets transferred

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58 Intermediary Position Paper at 11.

59 Intermediary Position Paper at 12.

60 Intermediary Exhibit I-18.

61 Intermediary Exhibit I-19.

> was over $19 million. The cash given in exchange for the assets transferred, however, was only $5.5 million . . . . The evidence also indicated that the consideration given in addition to the cash was that the university agreed to furnish care to Orange County residents at cost for the first three years after the transfer, and at the comparable county hospital rate thereafter.
>
> Clearly, the cash consideration given was far less than the market value of the assets transferred. Further, there was insufficient evidence to establish that the value of the non-cash consideration was anywhere near the approximately $13.5 million difference between the market value and the cash exchanged. It was indicated that while the county had the option to sell the assets on the open market, it chose rather to sell to the university to facilitate fulfillment of its obligation to furnish medical care to county residents . . . .
>
> All of these factors point out that the assets in this case were transferred at less than what a willing buyer would pay a willing seller in a transaction on the open market . . . . .
>
> The county still had to meet its medical care obligation to its indigent residents, and this apparently influenced its decision not to sell on the open market . . . . .

CCH ¶ 34,527.

The Intermediary contends the above reasoning is equally applicable to the facts and circumstances in the instant appeal. The Commonwealth conveyed the Provider to AACH for $100,000, a consideration far below the fair market value of the hospital's assets. The Commonwealth, in fact, paid AACH to take the facility, and imposed restrictions on the sale which yielded important political benefits. These considerations, not the Commonwealth's fiduciary responsibilities to the taxpayers of Pennsylvania and the United States who maintain the Medicare program, apparently were paramount in perfecting the sale, which was, in fact, a sham. Accordingly, the Intermediary contends the Board should sustain the Intermediary's disallowance of the claimed loss on disposal.

In its above arguments, the Intermediary asserts that the sale of the Provider to AACH was not bona fide. As a result, the Intermediary maintains the sales transaction was a sham, effectively and constructively, a donation. Therefore, the Intermediary believes the Provider should be considered as having been conveyed for a fair market price of $2,400,000, the appraised value of the hospital. Rather than recognizing a contrived loss, the Intermediary asserts the Board should use the Hospital’s appraised value as a fair market price to determine whether a gain on sale is the more accurate financial treatment of the conveyance. Recognition of a potential gain could result in the Medicare program's recapture of depreciation in accordance with the provisions of 42 C.F.R. § 413.134(f) and HCFA Pub. 15-1 §§ 132 and 132.3 respectively. (See Intermediary Exhibits I-8, 20, and 21).

The Intermediary maintains the Commonwealth chose not to dispose of the Provider in a fair and open market and accepted far less in consideration than the value of its assets. As a result, the Commonwealth effectively and constructively donated the Provider to AACH and paid AACH substantial sums to take the hospital off its hands. It also imposed conditions on the conveyance which rendered the transaction not a bona fide sale in a fair market. Accordingly, the Intermediary believes the Board should affirm the Intermediary's disallowance of the Provider's claimed loss on disposal. In addition, the Intermediary believes the Board should consider the appraised value of $2,400,000 as the fair market price for the Provider for a determination of whether a gain should be recognized in connection with the conveyance of the Hospital in this case.

CITATION OF LAW, REGULATIONS AND PROGRAM INSTRUCTIONS:

1. Laws - 42 U.S.C.:

§ 1395x(v)(1)(A)	-	Reasonable Cost

2. Regulations - 42 C.F.R.:

§ 405.1835-.1841	-	Board Jurisdiction
§ 413.134	-	Depreciation: Allowance for Depreciation Based on Asset Costs

3. Program Instructions - Provider Reimbursement Manual, Part I, (HCFA Pub. 15-1):

§ 132	-	Gains and Losses on Disposal of Depreciable Assets (excluding involuntary conversions)

4. Case Law :

Lac Qui Parle Hospital of Madison, Inc. v. Blue Cross, et al., PRRB Decision No. 95-D37, May 10, 1995, HCFA Adm. declined review, Medicare and Medicaid Guide (CCH) ¶ 43,269.

University of California Irvine Medical Center v. Blue Cross and Blue Shield Association et al., PRRB Decision No. 85-D8, October 15, 1984, Medicare & Medicaid Guide (CCH) ¶ 34,415, affirmed, HCFA Deputy Admin. Decision, December 12, 1984, Medicare & Medicaid Guide (CCH) ¶ 34,527.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

The Board, after consideration of the facts, parties' contentions, evidence presented, testimony elicited at the hearing and the post hearing brief, makes the following findings of fact and conclusions of law.

The Board finds that pursuant to the Sales Agreement,[62] there was a bona fide sale of the hospital facility by the Commonwealth to AACH that resulted in a loss on the disposal of depreciable assets which the Provider properly included on its cost report and claimed in accordance with the governing regulations at 42 C.F.R. § 413.134(f)(2). In reviewing the record, the Board looked to Black's Law Dictionary for a definition of bona fide sale. Accordingly, a bona fide sale is one which is

> "[a] completed transaction in which the seller makes a sale in good faith, for valuable consideration without any reason against the sale."

Provider Exhibit P-3 at 177.

Based on the above definition, the Board finds there was substantial evidence in the record to support its finding that the transaction was in fact a bona fide sale and not, as the Intermediary asserts, a donation of assets. The Board finds that the parties negotiated in good faith to establish a fair market value or sales price for the Hospital that was consistent with the terms, obligations, and conditions that were negotiated, understood, and accepted by both parties.

The Board further finds that an actual transfer of assets took place between unrelated parties as evidenced in the Sales Agreement. The Board notes that valuable consideration in the form of cash and future obligations of services was given by both parties in consummating the transaction. In particular, the Board notes that AACH gave considerable consideration in consummating the sale. In addition to agreeing to recognize and negotiate with existing labor unions, and to assume leases, agreements and contracts, AACH assumed the risk and obligation of operating a hospital for at least 5 years where losses where projected to be between $17 and $35 million dollars over this time period.[63] Based on this fact, the Board rejects the Intermediary's contention that the Commonwealth "donated" AACH a valuable asset for only $100,000.

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[62] Intermediary Exhibit I-4.

[63] Provider Exhibit P-6, pg. 69. Based on a study of Ashland State Hospital in 1989 by Touche Ross & Co., it was projected that the hospital would lose between $17 and $35 million between 1993-1998 if the hospital continued to operate under state or private ownership respectively.

The Board also finds that the Commonwealth made a competent and reasonable solicitation effort to find potential purchasers of this Hospital. The record indicates the Commonwealth contracted for various studies to evaluate its options for divestiture or continuing to operate the Hospital. In 1986 and again in 1991, the Commonwealth sent out notices to potential buyers to submit proposals and make presentations regarding their ability to purchase and operate the facility. The Board finds that the above actions by the Commonwealth support its finding that the transaction was, in fact, a bona fide sales transaction.

The Board rejects the Intermediary's contention that the Commonwealth's restrictions on the conveyance of the Hospital to potential purchasers effectively removed the facility from a fair and open market in which the best possible price could be obtained. The Intermediary argues that the value of the property would have been higher without the restrictions. The Board finds that neither the buyer's right to receive the Medicare loss or the other conditions outlined in the Sales Agreement nullifies the bona fideness of the sales transaction. The Board notes that restrictions and conditions are not abnormal in a bona fide sale. The Board finds that the governing regulations in 42 C.F.R. § 413.134(f)(2) do not nullify losses on the disposal of depreciable assets based on the existence of restrictions in a bona fide sales transaction. Additionally, the Board is unable to find anything in the regulations that limits restrictions in a bona fide sales transaction.

Contrary to the Intermediary's main argument, the Board finds there was not a donation of assets as defined in the governing regulations in 42 C.F.R. § 413.134(b)(8): which says, "[a]n asset is considered donated when the provider acquires the asset without making payment in the form of cash, new debt, assumed debt, property or services." The Board finds that pursuant to the Sales Agreement, there was an agreement by AACH to pay the Commonwealth $100,000 as well as the continuing obligation of providing services despite the Hospital's historical record of yearly financial losses. As indicated in the Touche Ross & Co. Study (Provider Exhibit P-6), the Hospital was projected to lose anywhere between $17 and $35 million dollars in the 5 years after the sale. Therefore, the Board finds that since there were payments by AACH in the form of cash and a continuing obligation of providing services and operating the Hospital for at least 5 years, there was no intent to donate the Hospital, and accordingly, the sale of the Hospital cannot be characterized as a donation under 42 C.F.R. § 413.134(b)(8). The Board finds the Intermediary's assertion, that the transaction was a donation of depreciable assets, is inconsistent with the relevant facts of the case.

The Board rejects the Intermediary's contention that the fair market value of the Hospital should be based on the results of an appraisal which was contracted for by the Intermediary. The Board notes that the purpose of the appraisal was to support the Intermediary's contention that the sale of the Hospital was actually a donation. The Board finds that the appraisal contained too many non-marketplace assumptions, was not based on historical financial statements, nor did it consider the business aspect related to the projected losses. In particular, this Hospital lost $7.4 million in its last full year before the sale and was projected

to lose up to $35 million in the 5 year period following the sale. In its income capitalization approach, the appraiser compared the subject Hospital to ongoing hospitals generating net incomes of $5-10 million per year. The Board finds these comparisons unrealistic.

The Board also notes testimony as to the Intermediary's intent when contracting for the appraisal. The Board notes that in a letter from the appraiser to the Intermediary,[64] the appraiser writes

"[w]e have been directed not to value the business enterprise as a whole. ....[w]hile we will not be performing a financial evaluation in the nature of the business enterprise valuation, the business component of the hospital must be considered by our real estate appraisers in determining a real estate value. This component cannot be ignored under USPAP standards. It is our understanding that this appraisal report is to be used as an aid to support the U.S. Department of Health and Human Services decision that the sale of Ashland State General Hospital, was actually a donation: its use for any other purposes or valuation date may invalidate the appraisal."

Intermediary Exhibit I-14.
It is the Board's opinion that having been directed not to value the business enterprise as a whole, the appraiser did not take into consideration projected future losses of the Hospital as a going business concern. Had the appraiser done so, the appraised value of the Hospital could have been significantly lower. In addition, the Board notes testimony of asbestos contamination in one or several of the Hospital's buildings, as well as references to underground storage tanks and contaminated soil.[65] The record is unclear as to whether these conditions were known at the time of the appraisal, however, the Board believes that if each of these factors, (i.e. clean-up & abatement) were taken into consideration, they would significantly diminish the value of the appraisal and market value of the Hospital. Based of the above scope of work, as directed by the Intermediary, the Board finds the appraisal to be flawed as a basis for determining a realistic sales value of the Hospital.

In conclusion, the Board finds that the substantial factual evidence in the case can lead to no other conclusion but that the transaction was a bona fide sale and, accordingly, that the Provider was entitled to claim a loss on the disposition of depreciable assets in accordance with 42 C.F.R.
§ 413.134(f)(2). The Board considers the assumption of projected future losses, and the obligation to provide crucial services to the community to be valuable consideration given by AACH in negotiating the final sales agreement.

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64 Intermediary Exhibit I-14.

65 Tr. at I, 207, Tr. at II 158-161, 169,175.

DECISION AND ORDER:

The Intermediary's adjustment improperly disallowed a claimed loss on the disposal of the Hospital and is reversed.

Board Members Participating:

Irvin W. Kues
James G. Sleep
Henry C. Wessman, Esquire

Date of Decision: February 27, 1998

FOR THE BOARD:

Irvin W. Kues
Chairman