PROVIDER REIMBURSEMENT REVIEW BOARD
HEARING DECISION

99-D25

PROVIDER -
Central Georgia Rehabilitation Hospital
Macon, Bibb County, Georgia

DATE OF HEARING-
October 21, 1998

Provider No. 11-3027

Cost Reporting Period Ended -
September 30, 1991

vs.

INTERMEDIARY -
Blue Cross and Blue Shield of Georgia

CASE NO. 94-2452

INDEX

ISSUE:

Were the sale and lease of the Provider transactions between related organizations?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

Central Georgia Rehabilitation Hospital ("Provider") is a 50 bed facility located in Macon, Bibb County, Georgia. Blue Cross and Blue Shield of Georgia ("Intermediary") reviewed the Provider's cost report for its fiscal year ended September 30,1991, and effectuated several adjustments. In a Notice of Program Reimbursement ("NPR") issued on September 20, 1993, the Intermediary reflected adjustments to the lease expense and interest expense paid by the Provider to the Macon-Bibb County Hospital Authority ("Authority") (a/k/a "Medical Center of Central Georgia") based upon Medicare's related party principles. These adjustments reduced the Provider's program reimbursement by approximately $833,000. In addition, the NPR reflected an adjustment to the Provider's home office costs which further reduced program payments by an additional $110,000.[1]

On March 15, 1994, the Provider appealed these three adjustments to the Provider Reimbursement Review Board ("Board") pursuant to 42 C.F.R. §§ 1835-.1841, and met the jurisdictional requirements of those regulations.[2] On October 21, 1998, a hearing was held before the Board. At that time, the Intermediary agreed to reverse its adjustment to the Provider's home office costs, and that issue was effectively withdrawn. Also, the Provider and Intermediary agreed that the two remaining issues pertaining to lease expense and interest expense, respectively, could be resolved as one issue regarding related party transactions, i.e., a decision as to whether or not the sale and lease of the Provider were transactions between related parties pursuant to Medicare rules and regulations.[3]

The Provider was represented by Thomas C. Fox, Esq., and Frances M. Bhambhani, Esq., of Reed Smith Shaw & McClay, LLP. The Intermediary was represented by James Grimes, Esq., Associate Counsel, Blue Cross and Blue Shield Association. .

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1 Provider's Position Paper at 1. Provider's Post-Hearing Brief at 4.

2 Intermediary's Position Paper at 1.

3 Transcript ("Tr.") at 5.

STIPULATION OF FACTS:

Through the discovery process and correspondence, the parties have agreed to the following:[4]

- In 1985, Lakeshore, Inc. ("LI"), a not-for-profit corporation, and the Authority, a public corporation, entered into a partnership (the "Partnership") to own and operate the provider, with LI and the Authority each having a fifty percent (50%) interest. Lakeshore System Services, Inc. ("LSS"), a for-profit, wholly-owned subsidiary of LI, entered into a management agreement with the Partnership to manage the facility's daily operations.[5]

- From 1985 until 1987, the Partnership maintained ownership of the Provider, and LSS continued to manage its daily operations for the Partnership. In 1987, LI sold all of the stock of LSS to ReLife, Inc. ("ReLife"), a publicly held corporation. As part of the transaction, LI agreed to transfer its 50% interest in the Partnership to LSS prior to the sale to ReLife. The Authority, however, refused to consent to the transfer of LI's Partnership interest.[6]

- When the Authority refused to consent to the transfer of LI's Partnership interest, LI and ReLife placed in escrow that portion of the LSS purchase price, which would have constituted the payment for the Partnership interest, and continued with the sale of LSS to ReLife. While the escrow was in place, LI paid all monies it received from the Partnership to ReLife, and LSS (now owned by ReLife) continued to manage the Provider's daily operations. From 1987 until 1990, LI continued to own 50% of the Partnership and the Authority continued to own the other 50%.[7]

- In 1990, LI sold its 50% Partnership interest to the Authority, and the proceeds from the sale were paid to ReLife as compensation for the escrowed portion of the LSS purchase price. Following LI's sale of its Partnership interest to the Authority, the Partnership was terminated, and through a lease agreement, dated August 31, 1990, the Authority, acting as a public corporation organized and existing under the laws of Georgia, directly leased the Provider to ReLife, a publicly-held corporation, doing business as "Central Georgia Rehabilitation Hospital."[8]

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4 Provider's Position Paper at 1. Provider's Post-Hearing Brief at 2.

5 Tr. at 11 and 15. Exhibits P-H and P-I.

6 Tr. at 11 and 12. Exhibit P-I.

7 Tr. at 66. Exhibit P-A at ¶ 11 and Exhibit P-B.

8 Tr. at 14. Exhibit P-I.

- During all times relevant to this appeal, from 1985 through August 31, 1990, the Provider has been owned by the Partnership (LI and the Authority) or the Authority. The Provider has never been sold by the Partnership or the Authority to an unrelated party and leased back to the Partnership or the Authority to operate as a Medicare provider. Further, at all times relevant to this appeal, the Authority had no ownership interest directly or indirectly in ReLife. Nor did ReLife have any ownership interest directly or indirectly in the Authority. During all times relevant to this appeal, no owner, representative, or employee of ReLife was employed by the Authority, or was otherwise positioned so that he or she could significantly influence or affect, directly or indirectly, ReLife's actions or policies.[9]

- The Medicare related organization principles relied upon by the Intermediary, 42 C.F.R. § 413.17, and Provider Reimbursement Manual, Part I ("HCFA Pub. 15- 1") § 1011.2, apply to transactions between related parties. The Medicare sale and leaseback principles apply to a transaction between unrelated parties and contemplate a simultaneous sale of the property by the provider to an unrelated entity followed by the unrelated entity leasing the property back to the original provider.

- Health South, Inc., a publicly-held corporation, acquired all the stock of ReLife in a transaction that closed on December 24, 1994. Health South, Inc. is the successor in interest to ReLife and now pursues this appeal as the interested party.

PROVIDER'S CONTENTIONS:

The Provider contends that the Intermediary's adjustments are improper since ReLife and the Authority are not related organizations.[10] Pursuant to 42 C.F.R. § 413.17(a): "[r]elated to the provider means that the provider to a significant extent is associated or affiliated with or has control of or is controlled by the organization furnishing the services, facilities or supplies."[11]

With respect to being associated with or affiliated with the Authority, the Provider contends that no common ownership existed between itself and the Authority pursuant to 42 C.F.R. § 413.17(b)(2), which states:[12]

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[9] Tr. at 16-17.

[10] Provider's Position Paper at 5. Provider's Post-Hearing Brief at 5.

[11] See also HCFA Pub. 15-1 § 1000.

[12] Provider's Position Paper at 7. Provider's Post-Hearing Brief 10.

> [c]ommon ownership exists if an individual or individuals possess significant ownership or equity in the provider and the institution or organization serving the provider.

42 C.F.R. § 413.17(b)(2); see also HCFA Pub. 15-1 § 1002.2.

The Provider notes its witness' affidavit which states: "during all times relevant to the relationships between the Authority and Lakeshore/ReLife prior to the execution of the lease, neither party had any ownership interest in the other party [and] none of the principals had any ownership interests in the other party."[13] Also, the Provider notes the Intermediary's agreement that:"[a]t all times relevant to this appeal, the Authority had no ownership interests directly or indirectly in ReLife," and "[a]t all times relevant to this appeal, ReLife had no ownership interests directly or indirectly in the Authority. Supra at Stipulation of Facts.

With respect to "control," the Provider asserts that the Authority did not have the power to influence ReLife or its provider facility.[14] Regulations at 42 C.F.R. § 413.17(b)(3) state: [c]ontrol exists if an individual or an organization has the power, directly or indirectly, significantly to influence or direct the actions or policies of an organization or institution. See also HCFA Pub. 15-1 § 1002.3.

The manual further states:

> the term "control" includes any kind of control, whether or not it is legally enforceable and however it is exercisable or exercised. It is the reality of the control which is decisive, not its form or the mode of its exercise. The facts and circumstances in each case must be examined to ascertain whether legal or effective control does, in fact, exist.

HCFA Pub. 15-1 § 1004.3.

The Provider argues that on or about August 31, 1990, the Authority acquired LI's 50 % ownership in the Provider, and terminated the partnership. At that moment all prior relationships between the Authority and LI, which ReLife inherited solely by virtue of its acquisition of LI in 1987, ended. Therefore, at the time the Authority entered into the lease with ReLife, there was no common control of the Authority and ReLife.

The Provider also asserts that the "control test" contemplates a single individual or entity in a position to exercise influence or control over both the supplier and the provider. See HCFA

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[13] Exhibit P-C at 11.

[14] Provider's Position Paper at 8. Provider's Post-Hearing Brief at 10.

Pub. 15-1 §§ 1004.3, 1004.4. Respectively, the Provider argues that at the time of the lease there was no such individual or entity in a position to exercise influence over both the Authority and ReLife. The Provider again refers to its witness' affidavit, which states: "nor did any officer or director of either party serve as an officer or director of the other party or was in a position to control or improperly influence the other party."[15]Also, as noted in the Stipulation of Facts, above, the Intermediary agrees that "[d]uring all times relevant to this appeal, no owner, representative, or employee of ReLife was employed by the Authority, or was otherwise positioned so that he or she could significantly influence or affect, directly or indirectly, the Authority's actions or policies."[16]

The Provider acknowledges the Intermediary's disagreement with the statement that: "no owner, representative, or employee of the Authority [was] in a position to influence, directly or indirectly, the actions of ReLife."[17] However, the Provider argues there is proof that there was no such person in a position of influence. Exhibit P-D are copies of minutes of special Board meetings of the Authority for August 28 and September 26, 1990. These documents show the names of the Board members and the officers of the corporation. Accordingly, these persons would have been the Board members and officers of the Authority on August 31, 1990, when the lease with ReLife was signed. Exhibit P-E are pertinent pages of the form 10-K report that ReLife filed with the Securities and Exchange Commission for fiscal year ended September 30, 1991. These documents show the Executive Officers of ReLife on August 30, 1990. Clearly, the Boards and officers of the Authority and ReLife were separate and distinct at the time the lease was signed, and there was no individual in a position to exercise control or influence over both corporations.

The Provider also acknowledges the Intermediary's argument that control is evidenced by the fact that the Provider's advisory board was composed of essentially the same members, some representing ReLife and some representing the Authority, both before and after the facility was leased to ReLife. In response, the Provider notes that the composition of an advisory board has no bearing on whether ReLife and the Authority were related parties for purposes of the lease transaction. ReLife and the Authority may have equal representation on the Provider's advisory board, but the fact remains that they were separate and distinct entities that had no common ownership or control at the time they entered into the lease. More importantly, the Provider asserts that it was required to create the advisory board under

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[15] Exhibit P-C at 11.

[16] Tr. at 17. Exhibit P-A at ¶ 26.

[17] Provider's Position Paper at 9. Provider's Post-Hearing Brief at 11. Exhibit P-B at 1.

Georgia Hospital Authority Law.[18] See Ga. Code Ann. § 31.770 et seq. (1997). As stated at the hearing:

> [b]asically, the Board was put in there as our way of complying with the Georgia Hospital Authority's law that said, in effect, that the lessor has got to retain some control over the lessee corporation to assure that the lessee doesn't make charges that are greater than reasonable in light of the investment they had in it.

Tr. at 44.

The Provider also contends that judicial and administrative precedent supports its position that the Authority and ReLife are not related organizations.[19] In Biloxi Regional Medical Center v. Bowen, 835 F.2d 345 (D.C. Cir. 1987) ("Biloxi"), the United States Court of Appeals for the District of Columbia set forth the analysis for determining whether parties are related for purposes of applying the Medicare related organizations rule. Essentially, the Biloxi Regional Medical Center ("Center") successfully appealed the decision of the United States District Court for the District of Columbia, which upheld the Board's decision that the Center and the City of Biloxi ("City") were related parties.

The Center, a Mississippi not-for-profit corporation, had assumed the operation of a hospital formerly known as Howard Memorial Hospital. The City, as well as three other health care entities, were signatories to the agreement. Under the terms of the agreement, the Center agreed to make monthly rental payments to the City in an amount determined by an independent appraisal firm. The appraisal firm determined that the fair market rental value for the hospital was $800,000 annually. The Center claimed about $450,000 in rental payments as a reasonable and reimbursable Medicare cost. However, the intermediary denied all but $93,000 of the claimed rental payments on the ground that the Center and the City were organizations related by common control.

The Board affirmed the intermediary's decision on the basis that a clause in the agreement allowed the City to take title to the proceeds of the hospital upon the expiration of the lease with the Center. Later, the Court of Appeals found that the Board relied upon other factors, as well, in concluding that the Center and the City were related organizations. Those factors are as follows:

(1) The City had the power to veto four of the nine members selected for the Center's Board of Directors;

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[18] Provider's Position Paper at 10. Provider's Post-Hearing Brief at 15.

[19] Provider's Position Paper at 10. Provider's Post-Hearing Brief at 6.

(2) The City provided financial assistance to the Center for constructing the new facilities;

(3) The City had the right to take title to all furniture, equipment, etc. upon the expiration of the lease with the Center;

(4) A clause in the earlier agreement with the previous operator of the hospital encouraged the City to lease the hospital; and

(5) The City had the right to extend the Center's deadline for substantially completing the new facilities without additional compensation from the Center.

The Center appealed the decision of the Board, and the district court granted summary judgment in favor of the Board. The district court found the Board's decision was supported by substantial evidence and did not examine all of the factors relied upon by the Board. However, the district court appeared to view the City's power to veto four members of the nine member Board of Directors for the Center as "sufficient in itself to sustain the finding of relatedness on the ground that the City controlled RMC."

The Court of Appeals, however, found the City's veto power to be unpersuasive, in and of itself, in determining whether the City and the Center were related. The appellate court explained that "whatever potential role the mayor's veto power conferred upon the City in its relations with the Center, that role cannot without more be equated with the power directly or indirectly, significantly to influence or direct the actions or policies of "[the Center]. Accordingly, the Court of Appeals concluded that the decisions of the Board and the district court were in error and reversed.

The Provider asserts that the decision in Biloxi is significant because it confirms that the literal terms of the related party rule require that the initial focus of the inquiry be on the provider, in this case, ReLife, Inc. d/b/a Central Georgia Rehabilitation Hospital, and the supplier entity or owner of the rehabilitation hospital, in this case, the Authority.[20] The decision also suggests that business or other relationships outside the context of the particular provider and supplier may not be used by intermediaries to manufacture a finding of significant common ownership and/or control in the provider-supplier relationship.

Moreover, the Provider asserts that both the Board and the Administrator of the Health Care Financing Administration ("HCFA") have followed this approach in other cases.[21] For example, in Clifton Care Center v. Blue Cross and Blue Shield Association, PRRB Dec. No. 78-D10, March 6, 1978, Medicare & Medicaid Guide (CCH) ¶ 28,938, aff'd. HCFA Admin. May 5, 1978, Medicare & Medicaid Guide (CCH) ¶ 29,033, a general partnership had owned

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[20] Provider's Position Paper at 12.

[21] Id. See also Provider's Post-Hearing Brief at 8.

the real estate and equipment of a skilled nursing facility as well as the provider entity itself. The assistant administrator of the facility then purchased all of the stock of the provider entity and became its owner and administrator. Thereafter, he entered into a lease agreement with the general partnership. Despite the intermediary's contention that the parties were related by control, a majority of the Board concluded that there was no control and that the various agreements were negotiated at arms-length.

The Board also determined that the intermediary had failed to show that the rental rate was unreasonable. Both parties had submitted evidence that the Board found inconclusive on this point. Two members of the Board dissented. While acknowledging that the parties were not related under the strict terms of the regulations, the dissenters felt that the totality of the circumstances, including the nature and timing of the agreements, created a situation in which the "intent of the Medicare program" could only be carried out by affirming the intermediary's adjustment.

On appeal, the HCFA Administrator affirmed the Board's decision. The Administrator reasoned that none of the factors relied upon by the intermediary, i.e., prior relationships between the provider and the lessor, low acquisition price for the stock, nature of the liabilities assumed by the provider, and simultaneous negotiation of the sale and lease agreements, constituted control. Essentially, the lessor and the assistant administrator were not related at the time that the lease became final.

The Provider asserts that common business dealings and lengthy business associations were also addressed in Tennessee Nursing Medical Services, Inc v. Blue Cross and Blue Shield Association, PRRB Dec. No. 93-D100, September 28, 1993, Medicare & Medicaid Guide (CCH) ¶ 41,760, decl'd. rev. HCFA Admin., November 9, 1993.[22] In that case, the intermediary claimed that the provider and its management company were related parties. Among the evidence the intermediary cited as a basis for this conclusion were the facts that:

- The owner of the management company had previously held stock in the provider and had been on its board of directors. He had returned the stock and resigned from the board as a result of having been found to be related to the provider for purposes of other, earlier services that he had furnished. The management company's contract with the provider, however, had been entered into after its owner had returned the provider's stock and resigned from its board.

- The owners of the management company and the provider jointly owned a medical services administrative company that managed home health agencies.

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[22] Provider's Position Paper at 13. Provider's Post-Hearing Brief at 9.

Despite these and other factors cited by the intermediary, the Board concluded that the "long-standing relationship" between the provider and the management company did not "in and of itself"reflect the power to control.

Thus, the Provider maintains that the Court of Appeals' decision in Biloxi as well as Board decisions confirm that prior business relationships are not relevant to an application of the related party rules. Although the Authority and ReLife had prior business dealings, such dealings are not sufficient to create a control relationship between the two entities.

The Provider contends that the terms of the lease entered between the Authority and ReLife were the result of arms-length bargaining.[23] The Intermediary, in its Position Paper, argues that the lease agreement did not reflect an arms-length transaction in the free market because "[n]o other parties were given any opportunity to negotiate a lease." The Provider notes that the HCFA manual explicitly states that the requirement of an "open, competitive market" is merely intended to "assure that the item being supplied has a readily discernible price that is established through arms-length bargaining by well informed buyers and sellers." HCFA Pub. 15-1 § 1010(b). Therefore, the Provider asserts that the parties were not required to negotiate with other potential lessees. The Provider also notes, however, that the possibility of negotiating with other parties was contemplated. During an impasse that developed between LI and the Authority, LI explored the interest of other parties in obtaining its share of the Partnership.[24]

Moreover, the Provider argues that the Intermediary offers no evidence that the terms of the lease exceeded a fair market price. Although the Intermediary's witness repeatedly referred to the amount of the lease, the witness readily admitted that he did not make a determination that the lease amount was unreasonable because the Intermediary had already concluded that the parties were related. The Provider asserts that the lease, in fact, yielded a return to the Authority of 18% on its investment, which was not unheard of in the financial climate of 1990. Also, this rate of return incorporated several components including working capital, such as furniture and equipment, in addition to the buildings.[25]

The Provider also explains that while the lease transaction did confer economic benefits for each party, the mere existence of such benefits cannot be construed as evidence that the lease terms were unreasonable. It was in ReLife's best interest to pay only fair market value for the lease since it would not derive any benefit from paying the Authority an unreasonable amount for use of the hospital facility. The Provider notes its witness' testimony that the terms of the lease were negotiated in an intensively adverse atmosphere, and that the amount of rent was

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[23] Provider's Position Paper at 14. Provider's Post-Hearing Brief at 12.

[24] Tr. at 36, 41, and 58.

[25] Provider's Post-Hearing Brief at 17-18. Tr. at 47, 63, 68, and 103-105.

one of the more difficult negotiating points.[26] Also, the terms of the lease were developed by a task force comprised of a group of individuals representing the Authority, while ReLife was represented by its own attorneys who were separate and distinct.[27]

The Provider asserts that other provisions of the lease also support the conclusion that ReLife and the Authority are not related parties.[28] For example, the termination provision that requires surrender of the facility to the Authority is not probative of control. See Biloxi Regional Medical Center v. Bowen, 835 F.2d 345, 352 (D.C. Cir. 1987) (holding that a lease provision giving assets and property to lessor was not illustrative of relatedness between the lessor and lessee). Additionally, the alteration provision of the lease is not evidence of control by either ReLife or the Authority. This provision allows ReLife to alter the facility without the Authority's consent unless the alterations result in a structural change. The Board has held that even an alteration provision that confers absolute autonomy to a lessee is not evidence of control. See Columbia Regional Hospital v. Blue Cross and Blue Shield of Missouri, PRRB Dec. No. 91-D12, Dec. 27, 1990, Medicare and Medicaid Guide (CCH) ¶ 38,975, vac'd. and rem'd., HCFA Admin., February 23, 1991.

Moreover, the Provider argues that several provisions of the lease provide compelling evidence of the arms-length relationship and negotiations between the parties.[29] Under the Negotiation to Renew provision, if, upon expiration of the lease, the Authority wanted to enter into a new lease, sublease, or sale of the property, or even take over the operation of the Provider, it was free to do so, subject only to an obligation to negotiate such an agreement with the Lessee. Significantly, if such an agreement was not reached by the end of the ninth year of the lease, then both parties were relieved of any obligation to negotiate such an agreement. In the Health Care Service Standards provision, the Lessor recognized the increasing demand in the Macon, Georgia, community for rehabilitation services and acknowledged the "independence and experience" of the Lessee in providing specialized rehabilitation services. And, under the Termination Due to Low Occupancy provision, ReLife had the right to terminate the lease "in the event for any six months the occupancy of the Provider falls below an average daily census of thirty patients."

The Provider contends, solely for purposes of argument, that even if the previous managementagreement between LSS and the Partnership created a related organization, that relatedness would not extend to the new lease that was negotiated between ReLife and the Authority. In Newhall Community Hospital v Blue Cross and Blue Shield Association, PRRB

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[26] Provider's Position Paper at 15. Provider's Post-Hearing Brief 13.

[27] Tr. at 37, 48 and 53.

[28] Provider's Position Paper at 15.

[29] Provider's Position Paper at 16. Provider's Post-Hearing Brief at 13.

Dec. No. 97-D12, December 3, 1996, Medicare and Medicaid Guide (CCH) ¶ 44,922 ("Newhall"), the Board held that a new lease agreement between a provider and an unrelated third party was not between related parties, even though there was a prior underlying agreement between related parties. Under the facts in Newhall, the provider was engaged in a lease agreement with a corporation in which the provider's president owned a significant share. Subsequently, the president sold his interest and the provider negotiated a new lease with the corporation. Also, even if the management agreement between LSS and the Partnership, which ReLife inherited when it acquired LSS, was between related parties, any related party relationship terminated with the termination of the Partnership and the management agreement.

The Provider disagrees with the Intermediary's argument that the transfer of working capital and repayment provisions in the Operations Agreement is evidence that the Authority and ReLife are related.[30] The Provider asserts that not only do these provisions fail to demonstrate any common ownership or control between the Authority and ReLife, the fact that ReLife was required to repay the working capital with interest is evidence that the transaction was arms-length. As to the Intermediary's comment that: "[t]his is not typically an arrangement included in a lease," the Intermediary offers no evidence to support that conclusion. The Provider maintains that an unrelated party lease, reached through arms-length negotiations, may include any arrangement the parties agree upon.

Finally, the Provider rejects the Intermediary's assumption that the $2,000,000 escrow account that was established at the time the lease was entered was due to concern that Medicare would have some questions regarding the new arrangement.[31] The Provider asserts that these funds were escrowed as insurance against any Medicare overpayments that may have been made to the Provider in the preceding fiscal year. Discussions of this escrow account are provided in Exhibit P-D in the minutes of the board's special meeting held on August 28, 1990. In addition, testimony proffered at the hearing confirms the purpose of the escrowed funds. Prior to entering the lease, the Authority had outside auditors perform due diligence on ReLife. The auditors identified that the Provider had likely been overpaid approximately $2,000,000 by Medicare, and the escrow was set up to protect against this potential debt.[32]

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[30] Provider's Position Paper at 17. Provider's Post-Hearing Brief at 14. Tr. at 47.

[31] Provider's Position Paper at 17.

[32] Provider's Post-Hearing Brief at 16. Tr. at 45-47.

INTERMEDIARY'S CONTENTIONS:

The Intermediary contends that its adjustments to the lease expense and interest expense paid by the Provider to the Authority are proper. The adjustments are based upon Medicare's related party rules at 42 C.F.R. § 413.17 and HCFA Pub. 15-1 § 1000ff, which limit program payments for services, facilities, and supplies furnished to a provider by a related party to the cost of the related part.[33]

The Intermediary contends that the Provider and the Authority are related based upon the element of "control." Pursuant to 42 C.F.R. § 413.17(b): "[r]elated to the provider means that the provider to a significant extent is associated or affiliated with or has control of or is controlled by the organization furnishing the services, facilities or supplies." Moreover, 42 C.F.R. § 413.17(b)(3) states: [c]ontrol exists if an individual or an organization has the power, directly or indirectly, significantly to influence or direct the actions or policies of an organization or institution." See also HCFA Pub. 15-1 § 1002.[34]

The Intermediary asserts the Authority had "control"or the power to directly and significantly affect the Provider based upon the following considerations:

- The Authority and LI, as partners, had veto power over the Provider's dealings. Through this veto power the Authority was able to keep ReLife from becoming the legal owner of half the Partnership. However, in substance, ReLife actually owned half the Partnership.[35] ReLife received 50 % of the Partnership's profits when it was dissolved. As stated in footnote 5 to ReLife's audited financial statements (Exhibit I-A): "as consideration for ReLife allowing MCCG[36] to acquire Lakeshore's partnership interest, ReLife received a cash distribution of $503,177 in partial settlement of 50% of the earnings of CGRC[37] through July 30, 1990. ReLife recorded this cash distribution as equity from earnings in partnership interest at September 30 of 1990 . . . " The Intermediary maintains that this footnote implies there was significant control of the Provider in this transaction. The only way the Authority could obtain the hospital was with the consent of Lakeshore; however, at this point, ReLife was making

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33 Tr. at 20-22.

34 Id.

35 Intermediary's Position Paper at 4. Tr. at 87.

36 "MCCG" is the acronym for Medical Center of Central Georgia which references the Authority.

37 "CGRC"is the acronym for Central Georgia Rehabilitation Center, the Provider facility.

the decisions with respect to the Provider's operations as indicated by the above footnote.

- Between 1987 and 1990 ReLife managed the Provider through its ownership of Lakeshore System Services through a management contract.[38]

- The lease agreement between the Authority and ReLife was not an arms length transaction. The sale of LI's partnership interest to the Authority and the signing of the lease agreement with ReLife took place simultaneously. Without the lease agreement the sale of the partnership interest would not have taken place. Again, joint control by the Authority and ReLife is evident. The Authority could not buy the property without giving ReLife the lease, and ReLife would not sell the partnership to the Authority without the lease. No other parties were given an opportunity to negotiate a lease for the facility as would be the case in an arms length-free market situation. Note that the Partnership Transfer Agreement (Exhibit I-D) is a 3 party agreement with the Authority, ReLife, and LI.[39]

- Essentially, the same operation existed after the termination of the partnership between the Authority and LI and the lease of the facility to ReLife.[40] The only change resulting from the sale and lease transaction was that the Authority no longer participated in the revenue generated by the Provider's operations, but received its revenue in the form of rent.

- The Provider presented no information to support the reasonableness of the lease cost.[41] Prior to the sale and lease of the facility, the Provider's annual depreciation on building and equipment was approximately $373,221. The lease cost became $1,350,000 per year, although nothing changed operationally for Medicare patients. Through the lease the authority received more annual rent than they paid for the partnership ($1,071,000). The net book value of the building and equipment at August 31, 1990, was approximately $7,170,000. In comparison, the total rent to be paid over a 10 year period is over $14,000,000. The Intermediary also notes that ReLife was required to open an escrow account of $2,000,000 at the commencement of the lease "to protect against Medicare/Medicaid underpayments. . . ". See "Letter Agreement Regarding Escrow" included in Exhibit I-E.

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38 Intermediary's Position Paper at 4.

39 Id. Tr. at 91.

40 Tr. at 24.

41 Intermediary's Position Paper at 5. Tr. at 92.

- Both the Authority and ReLife must agree on decisions concerning management of the Provider.[42] The partnership in effect from 1985 through 1990 between LI and the Authority was a 50-50 partnership. The partnership was managed through a 6 member advisory board with each partner appointing 3 members. Each partner had 1 vote so that agreement between both partners was necessary to make decisions concerning the management of the Provider. A replica of this advisory board was created between the Authority and ReLife. See page 5 of the Operation Agreement included in Exhibit I-D. Essentially, the Authority would seat 3 members of a Board of Directors and ReLife would seat 3 members. The chief executive officer of each entity would automatically qualify for the board as 2 of the 6 representatives. The board members appointed by the Authority would cast 1 vote collectively as would the ReLife appointees. The responsibilities of the board, enumerated on page 14 of the agreement, include the appointment of medical staff, approval of bylaws, and determining if ReLife received a rate of return on its investment in excess of what is permitted in OCGA 31-7-75.

- Section III of the Operation Agreement prohibits ReLife from entering any arms length management contracts without the prior written approval of the Authority.[43]

- As part of the Operations Agreement all of the existing working capital at 8/31/90 ($2,000,000) was transferred to ReLife with repayment to be made at the end of the 10 year lease with interest. However, no periodic payments were to be made, and the document is not very definitive about the interest rate. The Provider accrued interest for the first year at 4.5% which is certainly a discounted rate, which is not a typical arrangement in a lease.[44]

CITATION OF LAW, REGULATIONS AND PROGRAM INSTRUCTIONS:

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

§ 1395x(v)(1)(A)	-	Reasonable Cost

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

§§ 405.1835-.1841	-	Board Jurisdiction
§ 413.17ff	-	Cost to Related Organizations

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[42] Intermediary's Position Paper at 5. Tr. at 88.

[43] Intermediary's Position Paper at 6.

[44] Id.

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

§ 1000ff - Cost to Related Organization

4. Case Law:

Biloxi Medical Center v. Blue Cross and Blue Shield Association, PRRB Dec. No. 86-D20, November 12, 1985, Medicare & Medicaid Guide (CCH) ¶ 35,129, decl'd. rev. HCFA Admin., January 2, 1986, aff'd. DC D of C 1986, Medicare & Medicaid Guide (CCH) ¶ 35,824, 835 F. 2d 345 (D.C. Cir.1987).

Clifton Care Center v. Blue Cross and Blue Shield Association, PRRB Dec. No. 78-D10, March 6, 1978, Medicare & Medicaid Guide (CCH) ¶ 28,938, aff'd. HCFA Admin., May 5, 1978, Medicare & Medicaid Guide (CCH) ¶ 29,033.

Tennessee Nursing Medical Services, Inc v. Blue Cross and Blue Shield Association, PRRB Dec. No. 93-D100, September 28, 1993, Medicare & Medicaid Guide (CCH) ¶ 41,760, decl'd. rev. HCFA Admin., November 9, 1993.

Columbia Regional Hospital v. Blue Cross and Blue Shield of Missouri, PRRB Dec. No. 91-D12, December 27, 1990, Medicare and Medicaid Guide (CCH) ¶ 38,975, vac'd. and rem'd. HCFA Admin., February 23, 1991.

Newhall Community Hospital v Blue Cross and Blue Shield Association, PRRB Dec. No. 97-D12, December 3, 1996, Medicare and Medicaid Guide (CCH) ¶ 44,922, decl'd. rev. HCFA Admin., January 20, 1997.

5. Other:

Ga. Code Ann. § 31.770 et. seq. (1997).

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

The Board majority, after consideration of the facts, parties' contentions, evidence presented, testimony elicited at the hearing, and Provider's post-hearing brief, finds and concludes that the Provider is not related to the Authority, the lessor of its physical plant and equipment. Therefore, the Intermediary's adjustments based upon Medicare's related organization principles are improper.

The Board majority finds that 42 C.F.R. § 413.17(a) limits program payments for the cost of services, facilities, and supplies furnished to a provider by a related party to the cost of the related part. In this context the term "related" means that a provider is either significantly

associated with the supplying organization or has control of or is controlled by that organization. 42 C.F.R. § 413.17(b).

In the instant case, the Intermediary limited program payments for the costs incurred by the Provider (or ReLife) for services furnished by the Authority. The specific adjustments made by the Intermediary are based solely upon the "control" element of the regulations as no contentions are made regarding a significant association between the parties.

The fundamental argument raised by the Intermediary is that ReLife and the Authority were actually partners at the time the Authority negotiated to acquire LI's 50 percent ownership in the Provider's plant and equipment while simultaneously leasing the facility to ReLife. The Intermediary maintains that this partnership was established in 1987, when LI essentially transferred its 50 percent ownership in the Provider to ReLife through an escrow transaction.

The Intermediary asserts that the partnership established between ReLife and the Authority clearly indicates that the element of "control" existed between these two parties. In particular, ReLife could not become the legal owner of LI's interest without the Authority's approval, and the Authority could not acquire full ownership in the hospital's facilities without giving the lease to ReLife. The Intermediary concludes that the "control" aspects of the relationship established in 1987, did not allow other parties an opportunity to negotiate a lease for the facility. As a result, the terms of the lease reflect less than an arm's length transaction. Specifically, the annual lease payments made to the Authority of $1,350,000 greatly exceed the annual depreciation expense of approximately $373,000 previously reimbursed by the program; both the Authority and ReLife must agree on decisions regarding the Provider's operations through the establishment of an advisory board; ReLife may not enter into a management agreement concerning the facility without the Authority's approval; an escrow account had to be established by ReLife to protect against Medicare overpayments; and, all of the Provider's working capital was transferred to ReLife with repayment to be made at the end of the lease with no interim payments.

The Board majority, however, finds the Intermediary's argument unpersuasive. Pursuant to 42 C.F.R. § 413.17(b)(3), control exists if an individual or organization has the power, either directly or indirectly, to influence the actions or policies of another organization. While the 1987 escrow transaction apparently granted ReLife ownership privileges in the Provider's operation, there is no evidence that these privileges provided either ReLife or the Authority with "control" over the other entity.

With respect to the arm's-length of the sale and lease agreement, the Board majority finds that both parties were motivated to change the existing arrangement. ReLife was interested in operating the Provider in a totally for-profit environment while the Authority had several concerns about being involved with a for-profit organization. However, there is no evidence that either party, ReLife or the Authority, could compel the other to enter the agreement. Clearly, either party could have walked away from the ensuing negotiations; they could have

continued to operate the Provider under the existing arrangement, or could have dissolved it under amicable terms or through a court of equity, etc. The Board majority also notes that neither ReLife nor the Authority had any ownership interest in the other party, nor did they share any officers or directors. The terms of the lease were developed by a task force comprised of several individuals which had also explored the possibility of dissolving the partnership through other means. According to testimony, the terms of the sale and lease agreement were negotiated over an extensive period of time under adversarial conditions.

The Board majority also finds no indication that either ReLife or the Authority has "control" over the other party based upon the terms of the lease. The Intermediary expressed concern that the amount of the lease was significantly greater than the depreciation expense previously charged to the program. However, the Intermediary did not question the reasonableness of the lease amount, and there is no evidence in the record indicating that it is unreasonable or out of line with the lease costs of other similar facilities.

The Intermediary also argues that the advisory board established by the lease clearly indicates the Authority's control over the Provider. The Board majority disagrees. Testimony elicited at the hearing explains that the establishment of an advisory board where a lessor has equal representation and voting authority as a provider is required by Georgia State law. Its purpose is to help the lessor assure that a lessee's charges remain reasonable. Moreover, the Board majority finds that the responsibilities of the subject advisory board are strictly limited to matters concerning medical staff, and making recommendations to the Provider's Administrator with respect to other issues. The Board majority finds these responsibilities significantly different and lacking "control" as compared to the responsibilities and control of a provider's legal, corporate, board of directors.

The Board majority finds that the provision of the lease which prohibits ReLife from entering into a management agreement with a third party without the Authority's approval is also no indication of control. The provision states, in pertinent part:

> ReLife shall not enter into any management agreement concerning the Rehabilitation Facility with any party other than an affiliate, parent or subsidiary of ReLife or a party controlled by ReLife . . . without the prior written approval of the Medical Center [the Authority]. Medical Center shall act in good faith with respect to any approval required hereunder.

Operation Agreement at 8 (See Exhibit I-D).

Clearly, the restriction placed on ReLife by this provision is designed to provide the Authority, as the lessor of valuable property, a means to help protect its investment.

The Board majority finds that the terms of the lease concerning the establishment of an overpayment escrow account, and the transfer of working capital to the Provider are no indication of control. As noted in the minutes to a special meeting held by the Authority, the escrow account was necessary to protect against Medicare overpayments for the fiscal year ended September 30, 1990, which is the reporting period prior to the sale of the facility to the Authority and its lease to ReLife. With respect to the transfer of the Provider's working capital, the Board notes that the parties were free to negotiate any terms they wish. Even so, the actual transfer of the Provider's working capital does not appear unreasonable since it requires repayment in full with interest. The fact that no interim payments are required is irrelevant.

Finally, the Board majority finds that the purpose of Medicare's related organization principles is to avoid the payment of a profit factor to a provider through a related organization, or to avoid payment of artificially inflated costs which may be generated from less than arm's length bargaining. HCFA Pub. 15-1 § 1000. The Board majority does not find either the payment of a profit factor or the payment of artificially inflated costs present in the instant case.

DECISION AND ORDER:

The sale and lease of the Provider were not transactions between related organizations. The Intermediary's adjustments based upon Medicare's related organization principles are reversed.

Board Members Participating:

Irvin W. Kues
James G. Sleep
Henry C. Wessman, Esq. (Dissenting Opinion)
Martin W. Hoover, Jr., Esq.
Charles R. Barker

Date of Decision: February 25, 1999

FOR THE BOARD:

Irvin W. Kues
Chairman

I dissent.

There are some situations, like marriage, where the term "related party" is so evident it is axiomatic - making the need for legal proof superfluous.

In my opinion, the instant case is such a superfluity. This is a situation where you simply would not have a related organization issue coming out, if you would not have had related parties going in. The entire scenario is based on relatedness, and but for that relatedness, this case would not be before the PRRB. This is not a negative tautology, but rather, a positive one. But for the relatedness going in, the Intermediary would not have accurately, at least in my opinion, applied the Medicare related party/organization principles. But for that prior, and ongoing relatedness, the lease expense and interest expense audit adjustments were appropriate.

The 'marriage" relationship between Lakeshore, Inc. ("LI") and the Macon-Bibb County Hospital Authority (a/k/a Medical Center of Central Georgia) ("Authority") began in 1985. It included the for-profit, wholly-owned subsidiary of Lakeshore, Lakeshore System Services, Inc. ("LSS") in a management agreement to operate the Provider (Central Georgia Rehabilitation Hospital, or "CGRH"). In 1987, LI sold all of the LSS stock to ReLife, Inc. ("ReLife", now known as "HealthSouth", the successor-in-interest), a publicly held corporation. A series of "mini-relationships" between ReLife and the Authority between 1987-90 ultimately resulted in the "Partnership" between LI (LSS managed), the Authority, and its "product", CGRH, being terminated. Contemporaneously, through a "lease agreement", the Authority leased, under Georgia law, the Provider CGRH to ReLife. It was at this point that the Intermediary, correctly, I
believe, determined that the Authority and Relife, in producing the Provider (CGRH), were related parties for Medicare purposes, under the rubric of "control", and limited to cost of ownership of approximately $373,221, versus Provider-listed rents of $1.35 Million for years 1-5, and $1.5 Million for years 6 - 10 of a ten year lease.

Here's what was in existence going in. From 1985 to 1990, LI and the Authority had a 50 - 50 partnership, each provided 3 members to the 6 member Board of Directors of the Provider. Through both ownership of the structure (Authority) that housed the Provider, and day-to-day management (ReLife via LSS) there was no question that both "parents" were related in reference to the "product"/Provider, CGRH.

After dissolution of the initial partnership, "control" remained the linchpin of relatedness. I find at least three (3) compelling evidences of such control/relatedness.

1) The Authority (a/k/a Medical Center of Central Georgia), along with LSS (now HealthSouth via ReLife) shared veto power over the actions of one-another via the partnership agreement concerning the Provider which was in effect from 1985 - 90. Intermediary Position Paper, Exhibit E. The "control" element is

evidenced as effectuated during dissolution in 1991, when ReLife's audited financial statement noted: ". . . as consideration for ReLife allowing MCCG to acquire Lakeshore's partnership interest, . . ." (emphasis added) Intermediary Position Paper, Exhibit A, Footnote 5, ReLife Audited Financial Statements.

2) One strong indicator of "non-control" is a free-market, arms-length buy/sell or lease agreement. There is no evidence of this occurring in this case, in fact, the parties at interest here - the Authority, LI, ReLife, those who signed the Partnership Transfer Agreement, (Intermediary Position Paper, Exhibit D) did not, at any time, even entertain the concept of "free market". Provider Post-Hearing Brief at 12-14. The outcome of the "negotiations" was preordained - post hoc ergo propter hoc, signaling total control, both of the process, and of the parties-at-interest. It also demonstrates control of the financial terms - where actual pre-lease depreciation of $373,221 (Tr. At 112) translates to an annual lease cost of $1.35 Million for 5 years, than $1.5 Million for the next 5; a total of $14.2 Million over 10 years, on a building and equipment valued at $7.1 Million in 1990. Intermediary Position Paper, Exhibit B, at 4.

3) The Board of Directors a/k/a "Advisory Board" for the Provider (CGRH), was made up of equal representation from the Authority (3 members) and ReLife (HealthSouth) (3 members). Intermediary Position Paper, Exhibit D; Provider Post-Hearing Brief at 15. While the Provider maintains that the Board is advisory only, and created solely for the purpose of satisfying Georgia Hospital Authority Law, See Ga. Code Ann. §31.770 et seq. (1997) id., the point is that Georgia law doesn't just require an advisory board in the name of advice, it requires a Board as evidence of control in a lease arrangement of the type entered into here. Tr. at 44. According to the stated responsibilities of this interconnecting/controlling Board (Intermediary Position Paper, Exhibit D), it had control over factors such as Medical Staff appointments; bylaws, rules, regulations of the facility; recommendations regarding kinds and quality of services to be offered; input on facility budget; revision of long-range plans of the facility, and determinations of rate-of-return to ReLife on its investment in CGRH. Id. All of this speaks to considerable symbiosis between the Authority and ReLife (HealthSouth) relevant to the operation of their Provider/product, CGRH. Evidence, in my opinion, of significant control/relatedness, one to the other, through the "Advisory" Board of Directors.

Further, the plain meaning of Georgia Code requires inter-related control that is sufficient, I believe, to assign "relatedness" to the parents of the product in relation to the product - in the instant case, the Authority to ReLife (HealthSouth) via CGRH. (Provider Position Paper, Exhibit C at 2-3) It is, after all, the Provider/product, CGRH, who is appealing in this case, appealing because of the nuances of relationship to the parents, which, under Georgia

law, must demonstrate inter-related "control", the very "trigger" to Medicare relatedness contested here, in order to operate in a lawful manner.

42 C.F.R. § 413.17 "Cost to related organizations" is clear on its face. Costs applicable to services, facilities and supplies furnished to a provider by organizations related by common ownership or control " . . .must not exceed the price of comparable services, facilities, or supplies that could be purchased elsewhere." In my opinion, there is ample evidence of "relatedness" of the parents in the instant case. Conversely, there is a dearth of evidence of "unrelatedness", as noted by the inability of one partner to shed the other relevant to this project ("veto power"); the post hoc ergo propter hoc of the coupling/decoupling/recoupling process - the partnership, partnership dissolution, Task Force, lease scenario (Provider Position Paper, Exhibit H); and, finally, the straightforwardness of Georgia Code (Ga. Code Ann. § 31.770 et seq (1997) which wisely demands evidence of relatedness and control in ventures such as the Authority/ReLife (HealthSouth) marriage to produce the Provider/product in the instant case. In this case, the Provider has the burden of proving that the audit adjustment was not warranted, they did not succeed.

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Henry C. Wessman, Esquire