PROVIDER REIMBURSEMENT REVIEW BOARD DECISION

2003-D62

PROVIDER – Jeanes Hospital Philadelphia, Pennsylvania	**DATE OF HEARING -** June 1, 2002
Provider No. 39-0080	Cost Reporting Period Ended June 30, 1996
vs.	
INTERMEDIARY – Mutual of Omaha Insurance Company	**CASE NO.** 99-0584

INDEX

ISSUE:

Was the Intermediary's determination of loss on sale of assets proper?

BACKGROUND

Governing Statues and Regulations:

This dispute arises out of the Intermediary's failure to reimburse depreciation the Provider claims is due under the Medicare program of the Social Security Act, 42 U.S.C. §§ 1395 et seq., on a reasonable cost basis for the June 30, 1996 cost report year. The amount in contention relates to the Provider's claimed loss on the disposal of assets when Temple Central Hospital, Inc., and Jeanes Hospital merged. Temple Central Hospital, Inc. is the surviving entity.[1]

The Medicare program was established in 1965 under Title XVIII of the Social Security Act (the "Act") to provide health insurance to the aged and disabled. 42 U.S.C. §§ 1395 – 1395cc. The Health Care Financing Administration ("HCFA"), now the Centers for Medicare and Medicaid Services ("CMS"), is the operating component of the Department of Health and Human Services charged with administering the Medicare program.

The Secretary's payment and audit functions under the Medicare program are contracted out to insurance companies known as fiscal intermediaries. Fiscal intermediaries determine payment amounts due the providers under the Medicare law and under interpretative guidelines published by CMS.

Id.

At the close of its fiscal year, a provider must submit a cost report to the fiscal intermediary showing the costs it incurs during the fiscal year and the proportion of these costs to be allocated to Medicare. 42 C.F.R. § 413.20. The fiscal intermediary audits the cost reports and determines the total amount of Medicare reimbursement due the provider. It then issues a Notice of Program Reimbursement ("NPR"). The NPR sets forth the individual expenses allowed and disallowed by the intermediary. 42 C.F.R § 405.1803. A provider dissatisfied with the intermediary's final determination of total reimbursement may file an appeal with the Provider Reimbursement Review Board ("Board") within 180 days of the NPR. 42 U.S.C. § 1395oo(a); 42 C.F.R. § 405.1835.

Under the Medicare statute, a provider is entitled to claim as a reimbursable cost the depreciation (i.e., the loss of value over time) of the buildings and equipment used to provide health care to Medicare patients. An asset's depreciable value is set initially at its "historical cost," generally equal to the purchase price. 42 C.F.R. § 413.134(a)(2)(b)(1).

[1] See Provider's Post Hearing Brief at Exhibit P-5.

To determine annual depreciation, the historical cost is then prorated over the asset's estimated useful life. 42 C.F.R. §413.134(a)(3). Providers are then reimbursed, on an annual basis, a percentage of the yearly depreciation equal to the percentage the asset is used for the care of Medicare patients.

The calculated annual depreciation is only an estimate of the asset's declining value. If an asset is ultimately sold by the provider for less than the depreciated basis calculated under Medicare (equivalent to the "net book value" and equal to the historical cost minus the depreciation previously paid, see 42 C.F.R. § 413.134(b)(9)), then a "loss" has occurred since the sales price was less than the estimated remaining value. In that event, the Secretary assumes that more depreciation has occurred than was originally estimated and, accordingly, provides additional reimbursement to the provider. Conversely, if the asset is sold for more than its depreciated basis, then a "gain" has occurred, and the Secretary takes back or "recaptures" previously paid reimbursement. 42 C.F.R. § 405.415(f)(1).

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

Jeanes Hospital ("Provider") is located in Philadelphia, Pennsylvania. Pursuant to the terms of a November 17, 1995 affiliation agreement,[2] the Provider merged on July 1, 1996, with Temple Central Hospital, Inc., which was a subsidiary of Temple University Health System, Inc. Temple Central Hospital, Inc. was the surviving corporation and was renamed Jeanes Hospital. Both the prior entity (Jeanes Hospital) and the new Jeanes Hospital are non-profit corporations.

Mutual of Omaha, ("Intermediary") issued a Notice of Program Reimbursement ("NPR")[3] on May 28, 1998, for the year ended June 30, 1996, disallowing the $ 16,338,246[4] claimed loss. The Intermediary's disallowance was based on the grounds that the transfer was between related parties and not bona fide. The Intermediary considered the parties to be related by virtue of a November 17, 1995 affiliation agreement, which preceded the actual merger by almost eight months. In addition, the Intermediary found that the parties to the merger were related parties because directors of the pre-merger Jeanes Hospital were members of the board of the post-merger Jeanes Hospital and retained the power to significantly influence the actions of the merged entity. Furthermore, the Intermediary found that the transfer of assets was not bona fide because Jeanes Hospital is still operating in the same fashion after the merger as before the merger, including continuation of its name and certain programs.

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[2] Exhibit I-2.
[3] Exhibit I-5.
[4] See Intermediary's Final Position Paper at P-2.

The Intermediary also argues, in the alternative, that if the transfer was a bona fide sale between unrelated parties, certain financial commitments made by Temple totaling $12,000,000[5] should be included in the sales price of the hospital.

The Provider requested a hearing before the Board and has met the jurisdictional requirements of 42 C.F.R. §§ 405.1835-405.1841. The amount of Medicare reimbursement at issue in this appeal is $16,338,246.

The Provider was represented by Terry Coleman, Esq., of Ropes & Gray. The Intermediary was represented by Terry Gouger of Mutual of Omaha.

PROVIDER'S CONTENTIONS:

The Provider asserts that Jeanes Hospital determined on its own initiative, without Temple's involvement, that it should seek affiliation with a larger health system. At that time, it was the prevalent view in Philadelphia that a community hospital unaffiliated with a larger hospital system and lacking a network of physician practices to refer patients was a long-term financial risk. This was exactly the situation Jeanes Hospital was in when it began to consider its options for the future.

Jeanes Hospital discussed its sale with a number of other health care systems and hospitals, including: Allegheny Health, Education and Research Foundation; Jefferson Health Systems; Graduate Health System; University of Pennsylvania Health System ("Penn"); and Albert Einstein Healthcare Network. Negotiations with the Penn were particularly elaborate. Jeanes Hospital and Penn signed a memorandum of understanding expressing the intention of the parties that Penn would assume control over Jeanes Hospital following a period of due diligence investigation and the preparation of a definitive agreement. Negotiations between Penn and Jeanes Hospital were, however, terminated about three months into the due diligence review. On May 12, 1995, Jeanes Hospital's board of directors devoted its entire meeting to reviewing and comparing proposals for affiliation from both Penn and Temple.[6] The board decided to proceed with a letter of intent with Temple.

The Provider contends that Temple and Jeanes Hospital were unrelated parties prior to the merger. The June 30, 1996 merger was preceded by a definitive agreement to merge dated November 17, 1995. This "affiliation agreement" was entered into after arm's length negotiations.[7] The affiliation agreement included all the terms of the merger and

[5] See Intermediary's Final Position Paper, P-19.
[6] Exhibit P-5.
[7] Exhibit P-6.

provided that the merger would take place subject to certain conditions, such as obtaining regulatory approvals, opinions of counsel, approvals of lenders, and after the completion

of other routine acts that precede mergers. The Provider argues that this agreement did not make the merger one between related parties.

The Provider also contends that there is no basis under the related organizations rules to conclude that unrelated parties to a transfer of assets transaction can be considered related parties based on post-merger events. Although the Provider Reimbursement Manual ("PRM") sets forth, at length, the rules on related organizations, it does not contain any provision stating that a transfer of assets between unrelated parties can be considered a related-party transaction based on the relationship of the parties after the transaction. There is no discussion whatever that "continuity of control," the concept relied on by the Intermediary, between the transferor and transferee can convert unrelated organizations into related parties.

Indeed, to the contrary, the Provider points out that the Medicare Intermediary Manual's provisions on change of ownership focus exclusively on whether the organizations were unrelated prior to the transaction. Thus, the provision on statutory mergers in CMS Pub. 13-4 § 4502.6 requires that the parties be unrelated in order to allow a gain or loss on the sale and a revaluation of the acquired assets. The Manual's example finds that requirement satisfied because the companies involved "were unrelated parties prior to the transactions."

The only Medicare manual provision concerning transactions that create a relationship between parties is CMS Pub. 15-1 §1011.1 which provides a "special application" of the related organizations rule:

> Contracts Creating Relationship If a provider and a supplying organization are not related before the execution of a contract, but common ownership or control is created at the time of execution by any means, the supply contract will be treated as having been made between related organizations.

The Provider argues that the fact that this provision is denominated as a "special application" indicates that the basic related organizations rules do not address the situation and that a special rule was necessary to extend the related organizations rules to a situation in which the parties were unrelated prior to the transaction. By its terms, however, this provision is limited to supply contracts -- not the sale of assets or a merger.

When CMS Pub. 15-1 §1011.1 was added, the nearby section 1011.4 entitled "Purchase of Facilities from Related Organizations" was renumbered but not otherwise changed.

Section 1011.4 addresses asset purchases “from an organization related to the purchaser by common ownership or control” and subjects such purchases to the related organization rules.

In any event, the Provider contends that the minority of Quaker directors on the board and the continued employment by the Provider of some of the managers from the pre-merger Jeanes Hospital do not give the pre-merger Jeanes board members and managers control of the Provider for several reasons.

First, the powers of the Provider’s board are severely limited and the important powers are lodged in the parent corporation, Temple University Health System (“TUHS”), rather than in the Provider. The affiliation agreement and implementing by-laws withhold significant powers from the Provider’s board. These powers are retained by the sole member, Temple University Health System.[8]

Second, the Quaker representation on the board has a minority vote.

Third, the agreement to make an effort to govern by consensus does not give the minority directors any special power. Moreover, the Provider’s policy expressly provides only for “reasonable best efforts” at achieving consensus “so long as such practice is consistent with the time constraints of prudent business practices.” The Provider argues that this expression of cooperative spirit hardly confers some special power on the minority directors.

Fourth, TUHS actively manages the Provider and the other hospitals in its system and it directly controls many significant activities. As a result, the management of the Provider has only limited authority.

Finally, TUHS controls the operation of the Provider in the same manner as it controls its other subsidiaries. The Provider argues that the fact that there is no difference in the way that TUHS relates to the Provider compared to the way in which TUHS relates to its other subsidiaries demonstrates that the pre-merger Jeanes directors have no special influence or capacity to control the Provider.

The Provider points to North Iowa Medical Center v. Blue Cross and Blue Shield Ass’n, PRRB Dec. No. 2000-D52, May 2, 2000, Medicare and Medicaid Guide (CCH) ¶ 80,442, as being the Board case most directly on point. In response to the intermediary’s claim in that case that the sale was a related party transaction because of carryover board members, the Board held that, even though the directors had influence, “the degree to

[8] Exhibit P-8.

which that influence exists is less than is needed to 'direct' the actions of the corporation." The

Board's decision was upheld by the district court. North Iowa Medical Center v. Department of Health and Human Services, 196 F. Supp. 2d 785 (N.D. Iowa 2002).

The Provider also relies on Monsour Medical Center v. Heckler, 806 F.2d 1185, 1192 (3d Cir. 1986), in which the court held:

> The regulation governing depreciation, although it does not speak of control or relatedness, requires a purchaser of a care providing facility to demonstrate 'that the sale was bona fide . . . ' We interpret this regulation as addressing the 'bona fides' of a sale at the time of that sale."

(emphasis added.)[9]

The court thus held that the proper inquiry was whether the parties were related at the time of the transaction - not whether they were related after completing the transaction.

The Provider also argues that the merger was bona fide even though the "Jeanes Hospital" name was retained by the merged entity. Temple agreed to support and maintain various Jeanes programs and Temple agreed not to alter the Jeanes mission statement for at least five years after the merger. There is nothing in the Medicare rules or prior cases that in any way suggests that the acquiring entity must change the operations of an acquired hospital in order to make the acquisition bona fide. Retaining the name and programs of a hospital like Jeanes, which has strong ties to the community it serves, is simply a decision about hospital operations, not an indication that the transaction was a sham.

The Provider further contends that the only case cited by the Intermediary on this point, Lamb Healthcare Ctr. (Littlefield, Tex.) v. Mutual of Omaha Ins. Co., PRRB Dec. No. 2000-D18, Feb. 20, 2000), Medicare & Medicaid Guide (CCH) ¶ 80,394 ("Lamb") does not support its position. That case involved the transfer of a hospital from one governmental unit to another within Lamb County, Texas. In that case, the intermediary had contended that the parties were related because both entities were controlled by the people of Lamb County and that the county residents suffered no overall loss as a result of the transfer. The Board did not accept those contentions, however, but ruled that the sale was non-bona fide because there had been no arm's length negotiations between the governmental entities. In the instant case, it is uncontested that there were arm's length negotiations. Moreover, the argument in Lamb that the Lamb County residents controlled

[9] Exhibit P-20.

both parties to the transaction has no relevance to the present case, where Jeanes and Temple were not subject to common control at the time of the merger.

With regard to the Intermediary's alternative argument, the Provider believes that it properly calculated the sales price as $69,214,000, based on the payment of $1,000,000 to the transferor, the Anna T. Jeanes Foundation, and the $68,214,000 of assumed liabilities. The sales price does not properly include the value of certain commitments made by Temple, namely: (1) the $4,000,000 that Temple agreed it would contribute to the post-merger entity if necessary to meet its loan covenants; (2) the $7,000,000 that Temple agreed to spend to develop a base of primary care physicians in Jeanes' service area; and (3) Temple's agreement to cover up to $1,000,000 of any operating losses in Jeanes' Adult Day Care Program at a rate of up to $200,000 per year for five years. The Provider contends that it properly excluded these amounts from the sales price, in that the purchase price is defined in CMS Pub. 13-4 § 4504 as the "'consideration given' to the seller in an acquisition." (emphasis added). Any consideration given to someone other than the seller is therefore not part of the sales price. None of the amounts cited by the Intermediary were to be paid to the transferor but were amounts that might be expended to support the post-merger entity. Indeed, Temple's commitment of $7,000,000 to establish a primary care physician base was not even payable to the post-merger entity but, rather, was a payment to be made by Temple to one of its other subsidiaries, Temple Physicians, Inc.

INTERMEDIARY'S CONTENTIONS:

The Intermediary contends that Jeanes and Temple were related parties because they entered into an agreement to merge about eight months before the actual merger took place. In addition, they were related parties because directors of the pre-merger Jeanes remained on the board of the post-merger Provider and are able to significantly influence the Provider's actions. Under the terms of the affiliation agreement, the Anna T. Jeanes Foundation, which controlled Jeanes prior to the merger, has the right to nominate directors of the post-merger Provider that are a majority of the board members and have a total of one less vote than the total votes cast by directors nominated by Temple. In addition, the affiliation agreement states that the Provider's board of directors is to make decisions by consensus so long as such practice is consistent with the time constraints of prudent business practices. Furthermore, since a majority of the all the directors constitutes a quorum, the directors nominated by the Anna T. Jeanes Foundation could have the majority vote if some of the Temple-nominated directors were absent.

The Intermediary contends that the Provider's board has significant powers under its by-laws. It has the power to adopt annual operating and capital budgets subject to TUHS approval. It has the power to appoint and remove all members of the medical staff and employees. Under the bylaws, the board has the duty and responsibility for the ultimate conduct of the corporation, including the responsibility to conduct an annual written self-evaluation of the Board's performance, periodic re-examination of the relationship of the board to the total hospital community, orientation and ongoing training and education of the board, and review and approval of the Provider's risk and safety programs.

The Intermediary asserts that 42 C.F.R. § 413.17 governs whether parties will be considered related for purposes of a sales transaction. Specifically, the Intermediary points to 42 C.F.R § 413.17(b)(3) which states:

> (3) *Control*. Control exists if an individual or an organization has the power, directly or indirectly, significantly to influence or direct the actions or policies of an organization . . .

In the instant case, the Intermediary contends that the entire body of facts and circumstances points to a relationship that can be defined as a related party relationship created at the time of the merger. For example, the pre-merger entity retained a 47 percent voting interest in the new entity. The Chairman and Vice-Chairman of the new entity were board members of the old entity, and the senior officers of the former entity continued on with the new entity and became the President/CEO, Treasurer/CFO, and Secretary. Also, the pre-merger entity retained four of the five positions on the Executive Committee, which has and exercises the authority of the board.

The Intermediary also points to the October 28, 1995 minutes of the Jeanes Board of Directors citing that the principal benefits of the proposed Temple affiliation were to preserve the Friends

of the Quakers influence on the hospital's mission and governance. In that vein, the Intermediary cites the fact that the Provider's mission was continued for at least five years. In addition, the Provider retained a favorable land lease for five years and continued receipt of interest income from Trust funds.

In summary, the Intermediary contends that the Provider preserved its influence which was significant and substantial. That preservation was significant enough to define a related party transaction.

The Intermediary also argues that if Jeanes and Temple were not related at the time of the merger, they should nevertheless be considered related organizations under section CMS Pub. 15-1 § 1011.1 of the PRM, which states:

> If a provider and a supplying organization are not related before the execution of a contract, but common ownership or control is created at the time of execution

> by any means, the supply contract will be treated as having been made between related parties.

The Intermediary contends that this provision applies to all transactions and not just to supply contracts as contended by the Provider.

Finally, the Intermediary contends that the Provider has incorrectly computed the sales price and resultant loss on the sale of assets by excluding the contingent consideration of $12,000,000. Specifically, the commitments made by Temple prior to the merger agreement were of value to the Provider and were an inducement to the merger. As such, they should be viewed as consideration given to the Provider prior to the actual execution of the merger, even though the monies were not remitted until afterward. The Intermediary cites the testimony of the Provider's witness who stated that the commitments would serve to stabilize and enhance the Provider's future revenue stream, which in turn would allow the Provider to continue its mission.[10]

The Intermediary recognizes that the Medicare regulations and policy instructions are silent as to how to value the sales price. However, Medicare policy at CMS Pub. 13-4 § 4504.1 advises that reliance should be placed on generally accepted accounting principles. Accounting Principles Board Opinion 16 states, in part:

> Contingent consideration, or consideration not paid at the time of the transaction, . . . which is determinable at the date of the acquisition, should be included in determining the cost of an acquired company and recorded at that date.

In addition, it states that "the cost of an acquired company recorded at the date of an acquisition represents the entire payment including contingent consideration."[11]

The Intermediary further contends that the commitments made by Temple were an impelling influence on the merger agreement. This is supported by a statement in the Provider's position paper that reads: "[a]s in the Jeanes-Temple merger, Temple induced these mergers by agreeing to carry on and improve certain aspects of the hospital's programs."[12]

<u>FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION</u>:

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[10] Tr. at 126-127.
[11] Exhibit I-18.
[12] Provider Position Paper at 7-8.

The Board, after consideration of Medicare law and guidelines, the parties' contentions and the evidence presented, finds and concludes that the parties to the merger were unrelated as that term is used in 42 C.F.R. § 413.134. Thus, revaluation of assets and recognition of gain or loss incurred as a result of the merger is required.

The parties agree that the transaction at issue here was a merger and that the regulation at 42 C.F.R. § 413.134, "Depreciation: Allowance for Depreciation Based on Asset Costs" is applicable. Section 413.134(1)(2) defines a statutory merger as "a combination of two or more corporations under the corporation laws of the State, with one of the corporations surviving." Jeanes and Temple Central Hospital, Inc. merged their corporations and operations with Temple Central Hospital, Inc. surviving. The two hospitals worked out the financial and operational details as evidenced by a comprehensive affiliation agreement.

Pursuant to the agreement, Jeanes merged on July 1, 1996 with Temple Central Hospital Inc. (TCH), a subsidiary of Temple Clinic Health System, Inc. TCH was the surviving corporation and was renamed Jeanes Hospital. In acquring the assets of Jeanes Hospital through a statutory merger, Temple assumed the Jeanes liabilities ($68,214,000) and paid $1 million to the foundation which controlled Jeanes Hospital prior to the merger.

The Medicare regulation at 42 C.F.R. § 413.134(k)(2)(i) provides for the reimbursement effect of a merger as follows:

> If the statutory merger is between two or more corporations that are unrelated (as specified in §413.17), the assets of the merged corporation(s) acquired by the surviving corporation may be revalued in accordance with paragraph (g) of this section. If the merged corporation was a provider before the merger, then it is subject to the provisions of paragraphs (d)(3) and (f) of this section concerning recovery of accelerated depreciation and the realization of gains and losses.

The first question to be decided by the Board is, therefore, whether the merger was between unrelated parties. It is undisputed that Jeanes and Temple were unrelated to each other prior to the merger, but the Intermediary argues that the phrase "between related parties" requires that the merger transaction be examined for relationships after the transaction as well. It directs us to the related party regulation at 42 C.F.R. § 413.17, which states, in pertinent part:

> *(b) Definitions. (1) Related to the provider*. Related to the provider means that the provider to a significant extent is associated or affiliated with or has the control

> of, or is controlled by the organization furnishing the services, facilities, or supplies.
>
> (2) *Common Ownership*. Common ownership exists if an individual or individuals possess significant ownership or equity in the provider and the institution or organization serving the provider.
>
> (3) *Control*. Control exists if an individual or an organization has the power, directly or indirectly, significantly to influence or direct the actions or policies of an organization or institution.

In particular, the Intermediary relies on subsection (3) that discusses control. It contends that because the board of the new entity was composed of board members of the two merging entities, there is a "continuity of control" that results in the parties being related. The Intermediary contends that this relationship between the old and new entities disqualifies the transaction from revaluation of assets. In support, the Intermediary cites the August 7, 2001 CMS publication entitled: "Clarification of the Application of the Regulations at 42 C.F.R. § 413.134(1) to Mergers and Consolidation involving Non-profit Providers." The August 2001 "clarification" states, in part:

> [W]hether the constituent corporations in a merger or consolidation are or are not related is irrelevant; rather, the focus of the inquiry should be whether significant ownership or control exists between a corporation that transfers assets and the corporation that receives them.

The Board finds the plain language of the merger regulation dispositive of the Intermediary's argument. The text, specifically, "if the merger is between two or more corporations that are unrelated" is crystal clear. The related party concept will be applied to the entities that are merging.

The Board, therefore, concludes that the plain language of the regulation bars application of the related party principle to the merging parties' relationship to the new entity. The evolution and construction of the regulation reflects the Secretary's deliberate rejection of the position proposed by the Intermediary and a determination that only the relationship of the merging parties before the consolidation is relevant to whether assets would be revalued. The Board's conclusion is further buttressed by the Secretary's interpretive guidelines published long before the August, 2001 "clarification." With regard to mergers, CMS Pub. 13-4 § 4502.6 states, in part: "Medicare program policy permits a revaluation of assets affected by corporate mergers between unrelated parties."

The Board finds that the very nature of a merger would likely result in some overlap of board members between the merging corporation and the surviving entity as well as a continuation of other operations and personnel of the old organizations. It is implicit in

the evolution of the regulation that the Secretary considered these factors but rejected them from the determination of whether a revaluation to the new owner was permissible.

For the same reasons, the Intermediary's arguments that the transaction fails the traditional test of "bona fide" and "arm's length" are also without merit. With respect to the concept of a bona fide sale, the Board notes that the Provider determined on its own initiative, absent any Temple involvement, that it should seek affiliation with a larger health system. The record indicates the Provider discussed its sale with the Allegheny Health System, the University of Pennsylvania, the Jefferson Health System and the Albert Einstein Healthcare Network. Negotiations with the University of Pennsylvania resulted in the signing of a memorandum of understanding to merge. However, negotiations ultimately failed, and the affiliation agreement with Temple was pursued.

The Board finds that the affiliation agreement included all the terms of the merger and covered items such as obtaining regulatory approval, opinions of counsel, approvals from lenders, as well as all other elements of due diligence. The record indicates a lengthy negotiation as to the acquisition price for the Provider's assets. Both sides were represented by counsel. The Board finds nothing in the law or regulations that indicates that documenting the plan of merger or the significant period of time between the affiliation agreement and the merger results in the transaction being between related parties. In Monsour Medical Center v. Heckler, 806 F. 2d 1185, 1192 (3d Cir. 1986), the court held that:

> The regulation governing depreciation, although it does not speak of control or relatedness, requires a purchaser of a care providing facility to demonstrate that the sale was bona fide. We interpret this regulation as addressing the "bona fides" of a sale at the time of that sale.

Based on a review of the evidence in the record, the Board concludes the merger transaction to be one which was at "arm's length."

Regarding the continuity of control issue, the Board is not persuaded by the Intermediary's argument that some pre-merger directors on the surviving Provider's board and continued employment of some of the pre-merger managers results in the merging Provider having control over the post-merger entity. The Board finds that the evidence revealed that the powers of the surviving entity's board are severely limited, as the important, controlling powers vest in the Temple University Hospital System. This position is supported by the Board decision in North Iowa Medical Center v. Blue Cross and Blue Shield Association , PRRB Dec. No. 2000-D52, May 2000, Medicare and

Medicaid Guide (CCH) ¶ 80,442, wherein the Board held that even though the directors had influence, the "degree" to which that influence exists is less than is needed to "direct" the actions of the corporation.

That concept was upheld in North Iowa Medical Center v. Department of Health and Human Services, 196 F. Supp. 2d 785 (N.D. Iowa 2002).

The Board also finds that the Intermediary has presented the alternative position that if the merger was deemed to be a transaction resulting in a loss on the sale of assets, the Provider has understated the sales price by $12,000,000.

The Board finds that the affiliation agreement contains a section entitled "Certain Additional Covenants." Included therein are several elements that the Intermediary deemed to be financial commitments benefiting the Provider. They include: (1) a $4,000,000 guarantee that Temple agreed it would contribute to the post-merger entity, if necessary, to meet certain loan covenants, (2) $7,000,000 that Temple agreed to spend to develop a base of primary care physicians in the Provider's service area, and (3) an agreement to cover up to $1,000,000 of any operating losses in the Provider's adult day care program.

A closer look at the language in the affiliation agreement reveals that the covenants are only effective upon or following the effective date of the merger. Under the terms of the merger, TCH (the surviving entity) assumed all the liabilities of the Provider, and the Provider ceased to exist. Thus, an argument can be made that the covenants only serve to recite the fact that TCH is promising to support areas in the facility and/ or, is making financial commitments that it is already legally obligated to make as a result of the merger. In effect, TCH is actually enhancing its investment since the development of a physician network serves to benefit the overall Temple Health System. While the Provider may have been delighted to see these promises/enhancements, it has no recourse in the event that Temple reneges. The promises were made to support the post- merger entity. The pre-merger entity, the Provider, no longer exists.

The Board finds that if the Provider had extremely serious concerns about these items it could have bargained for their inclusion as part of the merger agreement and demanded a like amount of cash. Since this was not done, it can be implied that the promises were not viewed by the Provider as deal breakers. Rather, the Provider was content to settle for the unenforceable promises that its old facility would continue on, hopefully in an improved financial state.

The Board finds that the Intermediary's argument citing the applicability of APB 16 is without merit. First, APB 16 appears to be applicable to how a purchaser of an entity would value assets that it acquires and how to account for contingent amounts paid at a later date. APB 16 does not indicate that its principles apply, by extension, to a selling party. Second, although the general language of APB 16 talks about the inclusion of "contingent consideration," it appears to clearly contemplate that an amount determined based on a very specific formula, such as earnings over a period of time, will be paid out

to the owners of the company acquired. The Board finds, in the instant case, that the contingencies here were to enhance the surviving entity which had already taken on the liabilities. If the type of contingencies identified in this case were imputed as part of the selling price, it would serve to keep the transaction open indefinitely. Unknown liabilities could arise at any time, and acceptance of all liabilities is part of the original agreement.

DECISION AND ORDER:

The Intermediary's determination to deny the Provider's loss on sale of assets resulting from a merger was improper and is reversed. The Intermediary's argument to include an additional $12,000,000 in the sales price is without merit.

BOARD MEMBERS PARTICIPATING:

Suzanne Cochran, Esquire
Gary B. Blodgett, D.D.S.
Martin W. Hoover, Jr., Esquire
Elaine Crews Powell, C.P.A.

DATE: September 26, 2003

FOR THE BOARD:

Suzanne Cochran, Esq.
Chairman