

# PROVIDER REIMBURSEMENT REVIEW BOARD HEARING DECISION

2000-D18

**PROVIDER -**  
Lamb Healthcare Center  
Littlefield, Texas

**DATE OF HEARING-**  
January 29, 1999

Provider No. 45-0698

Cost Reporting Period Ended -  
July 31, 1991

**vs.**

**INTERMEDIARY -** Mutual of Omaha

**CASE NO.** 94-1750

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ISSUE:

Did the Intermediary properly disallow the Provider's claim of an allowable loss on the sale of assets through a transaction that transferred ownership of all hospital assets and liabilities from Lamb County Hospital Authority to Lamb County, Texas?

STATEMENT OF THE CASE AND PROCEDURAL HISTORY:

The Provider, Lamb County Hospital Authority ("LCHA") d/b/a Lamb Healthcare Center, is a 75-bed, short term hospital located in Littlefield, Texas. On its Medicare cost report for the ten month period ended July 31, 1991, the Provider reported three cost adjustments on Worksheet A-8 that were described as a loss on sale.<sup>1</sup> These adjustments were categorized as capital-related costs with a loss amount of \$1,436,772 reported for buildings and fixtures and \$79,007 reported for movable equipment. A desk review of the filed cost report was performed by Mutual of Omaha ("Intermediary") and additional supporting documentation for the loss on sale adjustments was requested from the Provider. Upon review of the submitted documentation,<sup>2</sup> the Intermediary found the documents to be incomplete and insufficient in supporting a bona fide sale between unrelated parties that would warrant the allowance of the losses claimed on the Provider's cost report. On September 13, 1993, the Intermediary issued an NPR which included audit adjustments which disallowed the claimed losses.<sup>3</sup>

The Provider appealed the Intermediary's determination to the Provider Reimbursement Review Board ("Board") pursuant to 42 C.F.R. §§ 405.1835-.1841 and has met the jurisdictional requirements of those regulations. The Intermediary estimates the Medicare reimbursement amount in controversy to be approximately \$749,000. The Provider was represented by Nolan Greak, Esquire, and the Intermediary's representative was Richard D. Slezak of Mutual of Omaha.

PROVIDER'S CONTENTIONS:

In order to provide the Board with a clear understanding of the disputed issue, the Provider presented the following factual contentions and summary of events which led to the reported loss on sale of the hospital facility:

1. LCHA was formed on December 24, 1974, pursuant to the Orders of the Commissioners' Court under Article 4437(e) of the Texas Revised

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<sup>1</sup> Intermediary Exhibit I-1.

<sup>2</sup> Intermediary Exhibit I-3.

<sup>3</sup> Intermediary Exhibit I-4.

Civil Statutes Annotated.<sup>4</sup> The Commissioners' Court is the controlling governing body for Lamb County and consists of the county judge and four county commissioners elected by the citizenry of Lamb County.

2. The Commissioners' Court had the authority to appoint three of the seven Board of Directors of LCHA, but had no other authority to act with regards to LCHA and was not responsible for any obligations/debts of LCHA.
3. LCHA had no authority to tax, nor did it receive any money from Lamb County. In 1978, LCHA authorized a Revenue Bond issuance of \$6.5 million for the construction of a hospital facility. These Bonds were to be paid from revenues generated from the operations of the hospital.<sup>5</sup>
6. LCHA was required to maintain a sinking fund and make periodic payments into the fund. However, LCHA's net revenues were not sufficient to maintain the payments into the sinking fund and a default was declared by the Trustees. No default ever occurred on the payment of the Bonds, and bondholders have continued to receive all funds owed to them. Current outstanding holders of Revenue Bonds is in excess of \$4.0 million.
7. After the default was declared, LCHA executed a Lease Agreement with American Healthcare Management, Inc. to provide for the payment of the Revenue Bonds. Before the Trustees would allow LCHA to lease the hospital, it required adequate security for payment of the bondholders be placed with the Trustees. This was accomplished by American Healthcare Management, Inc. loaning to LCHA the sum of \$5.7 million which was secured by a lien in favor of American Healthcare Management, Inc. on the real property, improvements and equipment of the hospital.<sup>6</sup> Under the lease agreement, rental payments of approximately \$75,000 per month were made to LCHA.
8. American Healthcare Management, Inc. also discovered the operation of the hospital to be unprofitable, and eventually filed a Voluntary

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<sup>4</sup> Provider Exhibit P-1.

<sup>5</sup> Provider Exhibit P-2.

<sup>6</sup> Provider Exhibit P-4.

Chapter 11 Petition in the United States Bankruptcy Court for the Northern District of Texas, Dallas Division. In the bankruptcy proceeding, a settlement was reached in which American Healthcare Management, Inc. subleased the hospital and improvements to Futura Health Care Services, Inc. which was approved by Order of the Bankruptcy Court.<sup>7</sup>

9. Under the terms of the sublease, if Futura defaulted in the payments of the lease to LCHA, then LCHA would have the right to offset all sums owed to American Healthcare Management, Inc., and require American Healthcare Management, Inc., to return the 5.7 million Revenue Refunding Bond marked “PAID IN FULL”, together with a release of all liens. This was conditioned upon American Healthcare Management, Inc., having the right to regain possession and operation of the hospital in the event of a default by Futura.<sup>8</sup>
10. A default occurred under the terms of the sublease with Futura, but American Healthcare Management, Inc., never exercises its rights to regain possession and operation of the hospital. Instead, American Healthcare Management, Inc., surrendered all rights under the terms and provisions of the Lease Agreement, and returned the \$5.7 million note marked “PAID IN FULL” and a release of all liens securing the payment of such note.<sup>9</sup>
11. LCHA regained possession of the hospital on October 27, 1988. Thereafter, pursuant to §263.021 of the Texas Health and Safety Code, the citizens of Lamb County filed a petition with the Lamb County Commissioners’ Court to call an election to establish the Lamb County Hospital. A county hospital has the authority, when created, to tax.<sup>10</sup>
12. The election passed, and the Lamb County Hospital Board of Managers was created. None of the Board of Directors of LCHA was

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<sup>7</sup> Provider Exhibit P-5.

<sup>8</sup> Provider Exhibit P-6.

<sup>9</sup> Provider Exhibits P-8, P-9 and P-10.

<sup>10</sup> Provider Exhibits P-11, P-12, P-13, P-14 and P-15.

appointed by the Commissioners' Court to the Board of Managers for Lamb County Hospital.<sup>11</sup>

13. Lamb County, Texas, had other options in purchasing or operating a hospital for the citizens of Lamb County, Texas. Lamb County, Texas, heard a request from the Amherst Hospital, which is located approximately six (6) miles from the Littlefield hospital, and was offered the chance to purchase this hospital.
14. Lamb County, Texas, elected to purchase from LCHA the real property, improvements and all equipment. Such purchase was documented in the ordinary and normal way. Such documentation included a Contract for Sale, Deeds, Resolutions, and Bill of Sale. No promissory notes or other contracts existed between LCHA and Lamb County.<sup>12</sup>
15. Under the terms and provisions of this purchase, Lamb County accepted the responsibility for assuring payment to all of the original outstanding bondholders of the \$6.5 million of Revenue Bonds. Even though secured for payment by defeasance, and the fact that the Trustee has in its possession certain government bonds that should be adequate to pay the Bonds, there is no guarantee that such shall occur. Prior to the transfer of the hospital to Lamb County, Lamb County had no liability on such Bonds nor could Lamb County use county funds to pay LCHA's debt.
16. The Lamb County Hospital Board of Managers also assumed all of the outstanding accounts payable and other debts on the operations of the hospital. In addition to the contingent liability on the Bonds, LCHA owed sums in the amount of approximately \$250,000. Therefore, Lamb County Hospital Board of Managers states that such is an arms length transaction and a bona fide sales price.
17. After the transfer to Lamb County, the Commissioners' Court was required to take an active role in the management of the hospital. The Commissioners' Court approves the budget of the hospital, approves

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<sup>11</sup> Provider Exhibits P-17 and P-18.

<sup>12</sup> Provider Exhibits P-20, P-21, P-22 and P-23.

all payments and issues checks to meet the hospital's obligations, including payroll.

The Provider contends that the sales transaction between LCHA and Lamb County, Texas was a bona fide sale between two separate entities which were controlled by two separate groups of individuals. The only association between Lamb County and LCHA was the creation of LCHA by the Commissioners' Court and the appointment of three of the seven Board of Directors of LCHA by the Commissioners' Court. Lamb County had no control over the operations of LCHA, was not responsible for any of LCHA's debts or obligations, and could not benefit from any profits generated by LCHA. LCHA decided to sell the hospital to Lamb County only after experiencing two unsuccessful long-term leases.

Whereas the Intermediary relies on the definition of related parties set forth in 42 C.F.R. § 413.17, no common ownership or control existed between LCHA and Lamb County. The evidence shows that the two separate and distinct entities were controlled by two separate and distinct Boards, and no individual served on both the Board of Directors for LCHA and on the Board of Managers for Lamb County Hospital.<sup>13</sup> Further, no member of the Board of Directors had any power, directly or indirectly, to substantially influence Lamb County, Texas, or the Board of Managers of Lamb County Hospital. With respect to the Commissioners' Court of Lamb County, the Provider asserts that the Commissioners' Court could not and did not control LCHA. While the Court could appoint a minority of the Directors of LCHA (three of the seven Directors), such minority appointments could not substantially control the operations of LCHA. The Board of Directors of LCHA acted independently of and without supervision from the Commissioners' Court. By contrast, Lamb County Hospital works directly with and is supervised by the Commissioners' Court. As to the Intermediary's contention that the citizens of Lamb County owned and/or controlled both LCHA and the Lamb County Hospital, the Provider insists that the evidence demonstrates that the citizens of Lamb County had no ownership interest or control over LCHA. The citizens of Lamb County were not responsible for the debts of LCHA nor could they reap the benefits of its profits.

In further support of its position, the Provider refers to the Board's decision in Eastland Memorial Hospital v. Blue Cross and Blue Shield Association/Blue Cross and Blue Shield of Texas, PRRB Dec. No. 96-D37, June 20, 1996, Medicare and Medicaid Guide (CCH) ¶44,478 ("Eastland"). In the Eastland case, the provider responded to ten factors of relatedness which the court outlined in the decision rendered for Hospital Affiliates International, Inc. v. Schweiker, 543 F. Supp 1380 (E.D. Tenn. 1982) ("HAI, Inc."). The Provider believes the current case before the Board can be distinguished from the HAI, Inc. decision as follows:

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Provider Exhibits P-17 and P-18.

HAI, Inc.

LCHA Sale to Lamb County

1. The idea to form a nonprofit corporation to own the hospital originated with the proprietary corporation.

The Lamb County Hospital District was originated by a petition of the taxpayers of Lamb County and not by LCHA.

2. HAI intended to manage the hospital all along, and without the management contract none of the rest of the transaction would likely have occurred.

LCHA never intended to manage the Hospital after the transaction was completed. LCHA transferred complete management and control to Lamb County.

3. HAI laid all the preliminary groundwork, and that, in a manner of speaking, created a buyer.

LCHA had nothing to do with the petition of the taxpayers of Lamb County for the creation of the Lamb County Hospital.

4. An HAI employee convened the first board meeting of the nonprofit corporation.

No member of LCHA's Board of Directors was or has been on or participated in a meeting of the Board of Managers of Lamb County.

5. The management contract gave HAI broad powers and was for a long duration.

There was no contract of any nature whatsoever between LCHA and Lamb County, Texas, concerning the management of the Hospital. Management of LCHA existed separate and apart from the management of Lamb County.

6. HAI loaned \$200,000.00 to the nonprofit corporation, on which to begin operations, because the nonprofit corporation had no assets of its own.

LCHA did not loan any funds or provide any support to Lamb County, Texas. Lamb County certainly has assets of its own.

7. HAI still owned the underlying fee simple in the real estate.

LCHA did not own any of the real estate after the transaction. All of the rights, title and interest in and to the real property was deeded to Lamb County, Texas.

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| 8. The board of the nonprofit corporation solicited no other bids for the management contract.                               | Lamb County, Texas, not only attempted to find other parties interested in either buying or leasing the Hospital, but had, in fact, leased it to two separate entities over a 10 year period prior to selling the Hospital to Lamb County, Texas. |
| 9. The contract was approved with only minor changes eight days after it was presented to the nonprofit corporation's board. | The Contract of Sale between LCHA and Lamb County, Texas, was negotiated over a period of time and Lamb County had other options in purchasing a hospital.  |
| 10. Each party to the contract could terminate unilaterally only for cause.  | Neither party had the right to terminate the contract.  |

In the Eastland decision, the Board decided the case against that provider based on several factors. The Provider believes the factors relied upon in Eastland are distinguishable from the facts in the instant case as follows:

1. In the Eastland case, there was no documentation to support the sale; the provider failed to provide any sales agreement or other corroborative evidence. In this case, there is a Contract of Sale, Deed, Resolutions, Bills of Sale, all of which are normal and support normal documentation in bona fide sales. LCHA has properly documented the sale of the hospital to Lamb County. In fact, the Intermediary does not dispute that there was a legal transfer of the hospital between two separate legal entities.
2. The Board found that the creation of the hospital district was actually conceived by Eastland Hospital's board of directors. LCHA had nothing to do with the creation of the hospital district. The creation of the hospital district was initiated by a petition of the taxpayers of Lamb County. Such hospital district was created by virtue of a law that existed at such time and which was created by the Texas Legislature. LCHA had nothing to do with the creation of this law, and such law provides not only for Lamb County to established such districts, but all other counties in the State have basically the same right to do so. A hospital district can only be created upon the petition of the taxpayers of such individual county. LCHA had no power to nor did it initiate the formation of the hospital district.
3. Additionally, the Board found that if there was a bona fide sale, the reimbursement should be disallowed to Eastland Hospital because it was a transaction between "related parties." The Board found that the Eastland board of directors and the new

entity which purchased the hospital had common members on both boards. In fact, there was four or five common members of each respective board. These directors were found to have the ability and opportunity to exercise significant control over any negotiations or transactions between the two entities. In the instant case before the Board, the evidence has shown that LCHA and Lamb County did not have common Directors, and neither Board had the right to control the other Board. LCHA had no control whatsoever over Lamb County's decision as to whether or not to purchase the hospital.

The Provider further contends that, although a statute provided that the citizens of Lamb County could petition LCHA to prevent a sale or closing of the hospital, such statute provided LCHA no alternatives if the citizens voted to stop the sale or closing of the hospital. Texas Health and Safety Code §264.031 provides in part "the hospital may be sold or closed only if a majority of the qualified voters on the question approve the sale or closing." Nowhere in the Texas statutes does it provide any guidance as to what happens if the voters veto the sale or closing. Since the citizens of Lamb County could petition to and elect to block LCHA from selling or closing the hospital, LCHA's only option would still be to close the hospital because LCHA had no money to continue. Eventually, regardless of the wishes of the citizens of Lamb County, the hospital would have to close because of a lack of funds.

In summary, the Provider concludes that the Intermediary incorrectly determined that the transaction was between related parties and that the loss should be disallowed. The evidence clearly indicates that no common ownership and/or control existed between LCHA and Lamb County, and that the loss on the sale of the hospital should be allowed.

#### INTERMEDIARY'S CONTENTIONS:

The Intermediary contends that the transfer of ownership of the assets and liabilities of LCHA to Lamb County, Texas, constituted an intragovernmental transfer of Lamb Healthcare Center and, thus, was a transaction between related political entities. Accordingly, the Provider is not entitled to Medicare reimbursement as an allowable loss on the sale of assets under the related organizations principles set forth in 42 C.F.R. §413.17. The Intermediary does not dispute that a legal transfer of the hospital occurred, and that LCHA and Lamb County are separate legal entities. However, these facts are not significantly relevant in this dispute because the principal consideration under Medicare regulations is the relationship between the two entities.

The Intermediary argues that the Commissioners' Court, as the controlling governing body of Lamb County, had the power to control both LCHA and the Lamb County Board of Managers who operated the hospital after the transfer. In accordance with Texas law, the Commissioners' Court

exercised this power initially when it appointed the Board of Directors of LCHA,<sup>14</sup> and also appointed the Board of Managers of Lamb County Hospital.<sup>15</sup> The fact that these directors and managers may not have been the same people does not diminish the Commissioners' Court control over those governing bodies. It is this relationship that causes the sale to be treated, for reimbursement purposes, as though Lamb County (moreover, the residents of Lamb County) were both the buyer and the seller.

The Intermediary contends that no overall loss was actually sustained by the county residents when the transfer took place. At the core of this dispute is the fact that the Provider could not show that the transfer of the hospital was an arms length transaction and constituted a bona fide sale between unrelated parties. An arms length transaction that is bona fide presumes that neither party is under coercion and that reasonable consideration was contemplated and given. Based on the testimony of the Provider's witness, no negotiations were held to determine the value or reasonable selling price of the hospital facility.<sup>16</sup> The primary consideration was to transfer the hospital from a political entity that could not use tax money to support the hospital's operation, to another governmental arm that had the power to generate operating funds through taxation. The transfer was made solely to reallocate jurisdictional responsibility and to facilitate the financial administration to assure the survival of the hospital. As a result of the transfer, the citizens of Lamb County experienced no financial gain or loss, and Medicare reimbursement should not be impacted by such a transfer of jurisdictional responsibility.

The Intermediary also notes that the Provider indicated no significant change in the status of the hospital, either for Medicare cost reporting purposes or for financial statement purposes. On the HCFA Form 339 filed with its Medicare cost report for the period ended July 31, 1991, the Provider responded to the question of whether significant assets were sold during the period by stating that the Lamb County Hospital District had taken over the hospital.<sup>17</sup> With respect to the financial statements prepared by LCHA's outside accounting firm for the financial period ended July 31, 1991, the "Notes to Financial Statements" included the following:

Note 10 - Subsequent Events

August 1, 1991 the Hospital Authority transferred ownership of the Hospital to the County. The County assumed all assets and liabilities.

Intermediary Exhibit I-7.

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<sup>14</sup> Intermediary Exhibit I-9, p. 6.

<sup>15</sup> Intermediary Exhibit I-10, p. 5.

<sup>16</sup> Tr. at 56-57.

<sup>17</sup> Intermediary Exhibit I-6.

The Intermediary contends that, had LCHA sustained a substantial loss of any kind, the “Notes to Financial Statements” should have and would have disclosed the transaction using terms in addition to “transferred” and “assumed.” As to the Provider’s reliance on the decisions rendered in Eastland and HAI, Inc., the Intermediary questions the purpose of this effort. The Intermediary places no particular reliance on either case, and does not consider the decisions any sort of benchmark for deciding the merits of the Provider’s case before the Board.

In summary, the Intermediary concludes that the Provider has failed to demonstrate that the sale of the hospital was an arms length transaction and a bona fide sale between unrelated parties. Accordingly, there is no recognizable loss sustained in the sale and transfer of all assets and liabilities of the hospital for Medicare reimbursement purposes.

CITATION OF LAWS, REGULATIONS AND PROGRAMS INSTRUCTIONS:

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

§1395x(v)(1)(A) - Reasonable Cost

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

§§ 405.1835-.1841 - Board Jurisdiction

§ 413.17 - Cost to Related Organizations

§ 413.134 et seq. - Depreciation: Allowance for Depreciation Based on Asset Costs

3. Case Law:

Hospital Affiliates International, Inc. v. Schweiker, 543 F. Supp. 1380 (E.D. Tenn. 1982).

Eastland Memorial Hospital v. Blue Cross and Blue Shield Association/Blue Cross and Blue Shield of Texas, PRRB Dec. No. 96-D37, June 20, 1996, Medicare and Medicaid Guide (CCH) ¶ 44,478.

FINDINGS OF FACT CONCLUSION OF LAW AND DISCUSSION:

The Board, after consideration of the facts, parties’ contentions, evidence presented, testimony elicited at the hearing and post-hearing briefs, finds and concludes that the Provider is not entitled to an allowable loss on the transfer of assets from LCHA to Lamb County, Texas.

The Board believes that the relationship between LCHA and Lamb County does not permit a definitive ruling that the entities are related organizations under 42 C.F.R. § 413.17. However, the Board finds their affiliation to be sufficient to conclude that the transfer of assets was not consummated through a bona fide, arms-length transaction. An arms-length transaction implies a standard of dealing that reflects no motivation other than those normally expected on the part of two unconnected parties transacting in good faith in the ordinary course of business. The facts and evidence in this case, coupled with the continuum of events which led to the transfer of the assets, clearly reveals that the transaction was a sale of convenience between governmental entities which shared the same self-serving goal of perpetuating the existence of a hospital facility for the citizens of Lamb County.

The Board notes that the record is void of any evidence that the sales transfer was a bona fide, arms-length transaction which emanated from genuine contract negotiations between the buyer and the seller. Moreover, no evidence was presented which would show an attempt by either party to construct an evaluation of the assets. The sale price was merely determined by the assumption of outstanding liabilities of approximately \$497,000, which did not take into consideration the value of the fixed assets which had a book value of \$1,585,900. In the absence of meaningful negotiations to determine a reasonable selling price for the hospital facility, the Board concurs with the Intermediary's position that the primary consideration was to transfer the hospital from a political entity that could not generate tax money to support the hospital's operation to one that could generate operating funds through taxation. It is the Board's conclusion that the Provider did not incur a loss on the disposal of assets under the provisions of 42 C.F.R. § 413.134(f) because the sale was not a bona fide, arms-length transaction.

The Board finds the transfer of responsibility from LCHA to Lamb County was necessary to subsidize the financial operation of the hospital, which was essential for its continued existence. It is the Board's conclusion that the transfer of ownership is essentially an intergovernmental transfer of facilities which is governed by the regulatory provisions of 42 C.F.R. §413.134(h). This regulation states in part:

The basis for depreciation of assets transferred under appropriate legal authority from one governmental entity to another is as follows:

...

(3) If neither paragraph (h) (1) nor (2) of this section applies, for example, the transfer was solely to facilitate administration or to reallocate jurisdictional responsibility, or the transfer constituted a taking over in whole or in part of the function of one governmental entity, the basis for depreciation is -

(i) With respect to an asset on which the transferor has claimed depreciation under the Medicare program, the transferor's basis under the Medicare program prior to the transfer. The method of depreciation used by the transferee may be the same as that used by

the transferor, or the transferee may change the method as permitted under paragraph (d)(2) of this section: . . .

DECISION AND ORDER:

The Intermediary properly disallowed the Provider's claim of an allowable loss on the sale of assets through a transaction that transferred ownership of all hospital assets and liabilities from LCHA to Lamb County, Texas. The Intermediary's determination is affirmed.

Board Members Participating:

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

**Date of Decision:** February 10, 2000

For The Board

Irvin W. Kues  
Chairman