PROVIDER REIMBURSEMENT REVIEW BOARD DECISION

2005-D55

PROVIDER –
Muhlenberg Hospital Center
Bethlehem, Pennsylvania

Provider No.: 39-0263

vs.

INTERMEDIARY –
BlueCross BlueShield Association/
Veritus Medicare Services

DATE OF HEARING –
October 21, 2004

Cost Reporting Period Ended -
November 20, 1997

CASE NO.: 00-3322

INDEX

ISSUE:

Whether the Intermediary's adjustment disallowing the Provider's loss on sale of assets is proper?

MEDICARE STATUTORY AND REGULATORY BACKGROUND

This dispute arises under the Federal Medicare program administered by the Centers for Medicare and Medicaid Services (CMS), formerly the Health Care Financing Administration (HCFA). The Medicare program was established to provide health insurance to the aged and disabled. 42 U.S.C. §§1395-1395cc. CMS is the agency of the Department of Health and Human Services responsible for administering the Medicare program. CMS' 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 Medicare law, regulations and interpretative guidelines published by CMS. See, 42 U.S.C. §1395(h), 42 C.F.R. §§413.20-413.24.

During the fiscal period in issue, Medicare allowed a provider to claim as a reimbursable cost the depreciation (i.e. the loss of value over time) of property, plant and equipment used to provide health care to Medicare patients. An asset's depreciable value was set initially at its "historical cost," generally equal to the purchase price. 42 C.F.R. §413.134(a)(2)(b)(1). To determine annual depreciation, the historical cost was then prorated over the asset's estimated useful life in accordance with one of several methods. 42 C.F.R. §413.134(a)(3). Providers were then reimbursed on an annual basis for a percentage of the yearly depreciation equal to the percentage of the asset used for the care of Medicare patients.

The calculated annual depreciation was only an estimate of the asset's declining value. If an asset was 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" had occurred, since the sales price was less than the estimated remaining value. In that event, the Secretary assumed that more depreciation had occurred than was originally estimated and accordingly provided additional reimbursement to the provider. Conversely, if the asset was sold for more than its depreciated basis, then a "gain" had occurred and the Secretary took back or "recaptured" previously paid reimbursement. 42 C.F.R. §405.415(f)(1). A *bona fide* sale of assets was one of the events that triggered a recalculation of depreciation. 42 C.F.R. §413.134(f).[1]

[1] The Balanced Budget Act of 1997 (Pub. L. No. 105-33, §4404, codified at 42 U.S.C. 1395x(v)(1)(O)) ("BBA 97") amended the Medicare statute to provide that the allowance for depreciation after a sale of assets would be based on the historical cost of the assets less depreciation (i.e., the depreciated book value of the assets). CMS then issued amended regulations stating that Medicare would no longer allow a selling provider to file a cost report restating its depreciation to reflect the loss on sale (or, in the case of a gain, to require recapture of the overstated depreciation), even if the market value of the assets is less (or greater) than the depreciated book value at the time of the disposition. The regulatory amendment applies to asset changes of ownership occurring on or after December 1, 1997.

STATEMENT OF THE CASE AND PROCEDURAL HISTORY**:**

Muhlenburg Hospital Center (Provider) was a nonprofit, acute care hospital located in Bethlehem, Pennsylvania. In 1994, the Provider hired a consultant to determine whether it could continue to be a viable independent hospital or whether it should affiliate with another entity. The Provider considered various types of associations with other organizations; however, the primary concern was the best way to fulfill its obligation to the community.[2] The Provider, after considering various options, sold the hospital to Lehigh Valley Health Services Organization, Inc. (LVHSO).

The Provider filed its final cost report and included a loss as a result of the sale of its assets to LVHSO. The Intermediary disallowed the loss on the basis that the sales price was an assumption of liabilities which was substantially less than the Provider's cash and cash equivalents. The purchase price included a skilled nursing facility[3] and an assisted living facility,[4] but these facilities were not [5] included in the asset evaluation conducted by Deloitte and Touche.[6]

The valuation prepared by Deloitte and Touche indicated that the fair market value (FMV) for the hospital assets was $62,640,000 as of November 20, 1997.[7] As of the date of the sales transaction the Provider had a net book value of $104,408,209.[8] At the time of the conveyance, LVHSO agreed to assume $43,336,847 of the Provider's liabilities[9], pay $20 million to the Muhlenburg Hospital Foundation,[10] pay the transaction costs, expand the health care services offered on the Provider's campus and increase the size of the LVHSO Board to 25 members to include 5 members from the Provider's Board.

PARTIES' CONTENTIONS:

The Provider asserts that the sale of its assets to LVHSO constituted a *bona fide* sale because the price was agreed to by unrelated parties that bargained in good faith and agreed to the allocation of the price with respect to the assets sold. The Provider believes this complies with the regulatory requirements of 42 C.F.R. §413.134(f)(2) and that the Intermediary has not demonstrated that the sale was not at FMV. The assets sold had a net book value of $104,408,209 and the assumed liabilities were $43,336,847, or approximately 41% of the net book value. The consideration included the obligation to provide services to the Bethlehem community, a contribution of up to $20 million to the Muhlenburg Foundation[11] and, in the event of a sale of the facility, to give 20% of the

---

[2] Tr. at 28, 45, 47, 85-86, 120, 169.
[3] Tr. at 176.
[4] Tr. at 186.
[5] Tr. at 176 and 186.
[6] Provider Position Paper Ex. P-12
[7] Id. at 3.
[8] Provider Position Paper at 4.
[9] Id at 9.
[10] Tr. at 135-136 .
[11] But see, Ftnt. 9-the payment to the foundation was not part of the consideration.

proceeds to a charitable foundation dedicated to the support of programs and projects in the community served by the Provider.

The Intermediary contends that the Provider did not receive reasonable compensation for its assets; therefore, there was no *bona fide* sale as envisioned by 42 C.F.R. §413.134(f). The Provider allocated the purchase price only to fungible assets, and nothing was allocated to its property, plant and equipment. Furthermore, the Provider's calculation of the "loss on sale" included values assigned to intangible assets in the Deloitte and Touche appraisal. Given the fact that the Provider sold its tangible assets for far less than their FMV and net book value, the Intermediary argues that no part of the purchase price should be allocated to intangible assets. The Intermediary concludes that because of the lack of consideration, a *bona fide* sale did not take place and there was no loss on sale.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DISCUSSION:

The Board, after consideration of the Medicare statute and regulations, the parties' contentions and the evidence presented, finds that the Provider is not entitled to a loss on sale. The transaction involving the Provider and LVHSO did not meet the criteria for a *bona fide* sale because the sale price for the assets did not equate to the cash and cash equivalents. Further, there was no valuation furnished for other facilities sold other than the witness' testimony that the SNF[12] and assisted living facility[13] had a negative book value and that these assets were transferred to LVHSO as part of the sale. The evidence demonstrates that Provider did not receive the fair market value as consideration for these assets transferred in the sale transaction.

DECISION AND ORDER:

The Board finds that the Provider is not entitled to reimbursement for a loss on sale because it failed to demonstrate that the transaction between itself and LVHSO was a *bona fide* sale. The Intermediary's adjustment is affirmed.

Board Members Participating

Suzanne Cochran, Esquire
Martin W. Hoover, Jr., Esq.
Gary B. Blodgett, DDS
Elaine Crews Powell, CPA
Anjali Mulchandani-West

[12] Tr. at 182.
[13] Tr. at 186

FOR THE BOARD:

DATE: August 12, 2005

Suzanne Cochran
Chairperson