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Is a Statutory Hospital Merger a Bona Fide Sale? Recent Cases Demonstrate that the Deal's Financial Structure Is Critical

The regulatory status of a statutory merger between hospitals can have significant financial ramifications. As noted in the November 18, 2009, [article](#)¹ on this issue, 42 C.F.R. § 413.134(f) allows realization of gains or losses from the disposition of depreciable assets on a merged entity only if the merger qualifies as bona fide sale. Hospital mergers do not always meet this important criterion.

In *St. Luke's Hospital v. Sebelius*, the U.S. District Court for the District of Columbia held that the Centers for Medicare and Medicaid Services (CMS) Administrator properly determined that a statutory merger between hospitals was not a bona fide sale because the acquired entity did not receive reasonable consideration for its assets.² Based on this decision, the surviving entity in the *St. Luke's* merger has not been able to claim a Medicare loss for the merged entity's \$2.9 million in depreciable assets.³

However, in *UPMC-Braddock Hospital v. Sebelius*, the U.S. Court of Appeals challenged a District Court holding that a hospital merger was not a bona fide sale.⁴ In *UPMC*, as in *St. Luke's*, a key factor in the District Court's decision was that the transaction lacked reasonable consideration. The District Court noted that the surviving entity received \$26 million in assets and \$13 million in liabilities and that the large difference between the figures cast doubt on whether the merger involved a bona fide sale.

On appeal, UPMC argued that the \$26 million asset figure was inaccurate due to overvalued real estate and buildings, and was in fact closer to \$16 million. According to this assessment, the difference between assets and liabilities was much smaller than what the District Court had assumed when it decided to deny the depreciation claims. The appellate court held, based on the reduced asset figure, that the consideration could be reasonable. Third Circuit remanded the case back to the District Court to determine whether a bona fide sale occurred based on the revised figures.

¹ http://www.agg.com/media/interior/publications/Rubinger_Grozone-Statutory_Merger_Hospital_not_Bona_Fide_Sale.pdf
² No. 08-0883 (D.D.C. Sept. 30, 2009).
³ *St. Luke's Hospital* has appealed this case to the D.C. Circuit and oral arguments are set for early May.
⁴ (CCH) ¶1303,275 (3rd Cir. Jan. 20, 2010).



Client Alert

As these cases demonstrate, hospitals and other health entities need to consider the regulatory ramifications of mergers, consolidation and other forms of ownership transfer. The CMS and its intermediaries will decide how to handle certain claims from merged entities based on the merger's regulatory status. In *St. Luke's* and *UPMC*, the mergers' underlying financial structures played a significant role in the CMS determinations and court holdings. Healthcare entities should consider such cases when structuring a merger.

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