



2012-080

STATE OF ALABAMA  
OFFICE OF THE ATTORNEY GENERAL

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Health Care Authorities – Leases

The Health Care Authority of Morgan County – City of Decatur (“Morgan County HCA”) may enter into the proposed lease without the approval of the Morgan County Commission and City of Decatur if: (1) the contracts, cash, medical records, inventory, and accounts receivable that are being conveyed under the lease do not constitute substantially all of the assets of the Morgan County HCA, the disposition of which would not materially and significantly reduce or impair the level of hospital or health care services rendered by the authority, and (2) the amount to be paid by the Health Care Authority of the City of Huntsville for the Morgan County HCA’s interest in the health care

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system at the end of the lease is not nominal consideration.

The Morgan County HCA may not sell its interest in the health care system at the end of the lease under the terms of the lease agreement without the approval of the Morgan County Commission and City of Decatur.

Dear Sirs:

This opinion of the Attorney General is issued in response to your requests on behalf of The Health Care Authority of the City of Huntsville and the Health Care Authority of Morgan County – City of Decatur.

#### QUESTION

Is The Health Care Authority of Morgan County – City of Decatur required to seek the approval of the governing bodies of its authorizing subdivisions, the Morgan County Commission and the City of Decatur, before entering into the described lease agreement?

#### FACTS AND ANALYSIS

Your request states as follows:

The Health Care Authority of Morgan County – City of Decatur ("Morgan County HCA") and The Health Care Authority of the City of Huntsville ("Huntsville HCA") are public corporations established under sections 22-21-310 through 22-21-344 of the Code of Alabama. ALA. CODE §§ 22-21-310 to 22-21-344 (2006). The Morgan County HCA owns certain health care assets within Morgan County, including Decatur General Hospital, Decatur General West

Behavioral Medicine Center, and Decatur General Oncology Center (collectively, the "Morgan County Facilities"). The Morgan County HCA also serves as the general partner of the Surgery Center of Decatur and as a limited partner of the Decatur Ambulatory Surgery Center (collectively, the "Surgery Centers"). The Huntsville HCA owns certain health care assets within Morgan County, including Parkway Medical Center and Hartselle Medical Center (the "Huntsville Facilities").

The Morgan County HCA intends to enter into a Lease Agreement with the Huntsville HCA, pursuant to which the Morgan County HCA would: (a) lease all of its real property, buildings, personal property, equipment and assets, including the Morgan County Facilities, to the Huntsville HCA; (b) transfer and assign its ownership interest in the Surgery Centers to the Huntsville HCA; and (c) transfer and convey all of its contracts, cash, medical records, inventory, and accounts receivable to the Huntsville HCA.

During the term of the Lease Agreement, the Morgan County Authority would retain ownership of the Morgan County Facilities and leased assets.

Pursuant to the Lease Agreement, the Huntsville HCA will operate the Morgan County Facilities, the Surgery Center of Decatur, and the Huntsville Facilities, along with certain other health care facilities that may be developed by the Huntsville HCA during the term of the Lease Agreement, as a single, integrated health system for the benefit of the citizens of Morgan County and surrounding communities (the "Healthcare System").

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The Lease Agreement has an initial term of forty (40) years and provides the Huntsville HCA the option to extend the initial term for four (4) additional ten (10) year terms.

Your request further states that, on termination of the lease, the Morgan County HCA would have the option to purchase the Huntsville HCA's interest in the health care system at 75 percent or 50 percent of the fair market value of the system, depending on what the actual value is at that time. If the Morgan County HCA elected not to exercise its option, the Huntsville HCA would be required to purchase the Morgan County HCA's interest at 25 percent of fair market value.

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Section 22-21-318(a)(7) of the Code of Alabama authorizes a health care authority to acquire and hold title to real and personal property and to dispose of that property under certain conditions as follows:

(7) To receive, acquire, take and hold (whether by purchase, gift, transfer, foreclosure, lease, devise, option or otherwise) real and personal property of every description, or any interest therein, and to manage, improve and ***dispose of the same*** by any form of legal conveyance or transfer; provided however, that the authority ***shall not, without the prior approval of the governing body of each authorizing subdivision***, have the power to dispose of (i) ***substantially all its assets, or*** (ii) ***any health care facilities the disposition of which would materially and significantly reduce or impair the level of hospital or health care services rendered by the authority***; and provided further, that the foregoing proviso shall not be construed to require the prior approval of any such governing body for the mortgage or pledge of all or substantially all its assets or of any of its health care facilities, for the foreclosure of any such mortgage or pledge or for any sale or other disposition thereunder[.]

ALA. CODE § 22-21-318(a)(7) (2006) (emphasis added). This provision requires the governing body of the authorizing subdivision for the health

care authority to approve any sale or disposition of substantially all of the assets of the health care authority or approve the disposition of any health care facilities, the disposition of which would materially and significantly reduce or impair the level of hospital or health care services rendered by the authority.

This Office has previously determined that a lease agreement that does not change the ownership of an authority's assets (the authority retains title throughout the term of the lease) is not required to be approved by the governing body that authorized the creation of the authority. Opinions to Honorable Frank Burt, Jr., Chairman, Baldwin County Commission, dated December 30, 1999, A.G. No. 2000-057 and to Honorable Robert S. Presto, Attorney, Escambia County Commission, dated January 9, 1996, A.G. No. 96-00090.

The proposed lease provided with your request states, in pertinent part, as follows:

8.11 ***Government Authorizations.*** *No sale* of the Decatur General Facilities, the Morgan County Facilities or the Healthcare System pursuant to this Article 8 ***shall occur prior to*** Lessee and/or ***Lessor***, as applicable, ***obtaining*** all necessary Government Authorizations, including without limitation, the ***approval(s) of*** the applicable ***City and County governing bodies***, if then required by Alabama law. The Lessee and Lessor shall work together in good faith to effectuate the intent of this Section.

8.12 ***Reversion of Leased Assets.*** If upon expiration or termination of this Lease:

(i) the necessary Government ***Authorizations approving a sale*** pursuant to this Article 8 (as specifically described in Section 8.11) ***are not obtained***, including without limitation, the approval(s) of the applicable City and County governing bodies, if then required by Alabama law; and

(ii) the Lessee and Lessor do not mutually agree in writing to extend the term of this Lease or enter into a replacement lease agreement, then the Decatur General Facilities, including the Premises and Buildings, and all improvements made thereto, ordinary wear and tear excepted, as well as Lessee's interest in the Surgery Centers, *shall revert to Lessor*, and Lessee and Lessor shall cooperate to achieve an orderly turnover of such assets and interests to ensure that such facilities are fully operational as of the earliest date (the "Effective Reversion Date") on which the Lessor, or its designee, can effectively operate the Decatur General Facilities, Premises and Buildings and provide continuity of patient care in compliance with all applicable laws, regulations, licensing, accreditation and contractual requirements. Upon the reversion of the assets and interests to the Lessor, all rights and benefits belonging to Lessee under this Lease shall revert back to the Lessor. In addition, on the Effective Reversion Date, Lessee shall transfer to the Lessor:

(a) all consumables, inventories and medical and non-medical supplies maintained at or for the Decatur General Facilities;

(b) all tangible personal property, of every kind and nature, whether owned or leased by Lessee, and maintained at or for the Decatur General Facilities, including, without limitation: all instruments; medical and non-medical equipment, machinery, and furniture; books and records, including, without limitation, medical documentation, payor verification, mailing lists, and related documentation; and telephone numbers, facsimile numbers, electronic addresses, and passwords used in connection with the Decatur General Facilities;

(c) Lessee's leasehold interest in those leases where the Lessee is a tenant of leased property related to the operations of the Decatur General Facilities;

(d) all cash, accounts receivable and accounts payable regarding items or services provided to, by or at the Decatur General Facilities;

(e) to the extent permitted by contract or law, all rights under contracts, leases, Medicare, Medicaid and third-party payor provider agreements, Government Authorizations and other intangible assets as are necessary to allow the continued operation of the Decatur General Facilities;

(f) all trade secrets and other confidential information concerning the operation or use of the Decatur General Facilities not in the public domain; and

(g) the benefit and use of the names "Decatur General", "Decatur General Hospital" and "Decatur General West".

*Proposed Lease Agreement*, Morgan County HCA-Huntsville HCA, §§ 8.11 & 8.12 (emphasis added).

The leases addressed in the *Burt* and *Presto* opinions were traditional leases not triggering the operative provision of section 22-21-318(a)(7) of the Code. The lease provisions in the *Presto* opinion stated that the leased property was to be returned on termination of the lease. In contrast, although the instant lease leaves ownership of the leased assets of the Morgan County HCA with the authority during the term of the lease, it does provide for a possible change of ownership at the end of the lease. The lease includes an option to purchase the assets of the Huntsville HCA by the Morgan County HCA and requires the reverse sale should the Morgan County HCA decline to exercise that option.

Nonetheless, in compliance with the plain language of section 22-21-318(a)(7), the lease specifically states that the sale cannot occur without the approval of the Morgan County Commission and the City of Decatur. If those approvals cannot be obtained, then the leased assets, including the ownership interests in the Surgery Centers, revert to the Morgan County HCA and ownership remains with the authority.

It is noted that the lease does provide for a change of ownership with regard to certain assets. You state that “contracts, cash, medical records, inventory and accounts receivable” are “*conveyed*” to the Huntsville HCA. Accordingly, the parties may enter into the proposed lease without the approval of the Morgan County Commission and City of Decatur if the contracts, cash, medical records, inventory, and accounts receivable do not constitute substantially all of the assets of the Morgan County HCA. Whether these assets are substantially all of the assets of the Morgan County HCA is a factual determination that must be made by the Morgan County HCA, as this Office does not make factual determinations.

Moreover, although this agreement does not fit neatly within the category of leases considered by the Alabama appellate courts, the case law on whether an instrument is, in fact, a lease or a “conditional sale” also leads to this conclusion. American Jurisprudence has stated the issue as follows: “The substance of the transaction generally prevails over the form, and designing sale to appear in form as lease does not alter the true nature of the transaction.” 2 AM. JUR. 2d *Sales* § 34 (2012).

The Alabama Supreme Court has also set forth principles to guide examination of agreements containing options to purchase. The Court has stated that “a ‘lease’ allowing the lessee to purchase at a ‘nominal consideration’ the subject-matter of the lease is to be considered a security agreement rather than a ‘true’ lease.” *Lawson State Cmty. Coll. v. First Cont’l Leasing Corp.*, 529 So. 2d 926, 929 (Ala. 1988), *overruled on other grounds by Berner v. Caldwell*, 543 So. 2d 686 (Ala. 1989). *See also, Sharer v. Creative Leasing Inc.*, 612 So. 2d 1191 (Ala. 1993).

The Court has elaborated further as follows:

One of the distinguishing features between a conditional sale and a lease is whether or not the lessee is obligated in all events to pay the total purchase price of the subject of the contract. If

return of the property is required or permitted the instrument is a lease; but *if* on the other hand *the so-called lessee is absolutely obligated to pay the purchase price*, even though such a price is designated as rental or hire, *the contract is one of sale*.

*State v. Kershaw Mfg. Co.*, 273 Ala. 215, 217, 137 So. 2d 740, 742 (Ala. 1962) (emphasis added).

Although the lease provides for the Huntsville HCA's purchase at less than fair market value (25 percent), that percentage of the value of the entire health care system may not be nominal consideration like the \$1.00 found to be a sham in *Lawson*. Whether this purchase price is nominal consideration is a factual determination that must be made by the parties, as this Office does not make factual determinations.

Furthermore, it is entirely possible, under the terms of the lease, that the Huntsville HCA may not purchase the assets of the Morgan County HCA. The obligation of the Huntsville HCA to purchase is triggered 40 years' hence and only on the occurrence of three events, a decline by the Morgan County HCA under its option to purchase the Huntsville HCA's interests in the health care system, approval by the Morgan County Commission, and approval by the City of Decatur. Therefore, the Huntsville HCA is not *absolutely* obligated under the terms of the proposed lease to purchase, and Morgan County HCA is not absolutely obligated to sell.

#### CONCLUSION

The Health Care Authority of Morgan County – City of Decatur may enter into the proposed lease without the approval of the Morgan County Commission and City of Decatur if: (1) the contracts, cash, medical records, inventory, and accounts receivable that are being conveyed under the lease do not constitute substantially all of the assets of the Morgan County HCA, the disposition of which would not materially and significantly reduce or impair the level of hospital or health care services rendered by the authority; and (2) the amount to be paid by the Health Care Authority of the City of Huntsville for the Morgan County HCA's interest in the health care system at the end of the lease is not nominal consideration.

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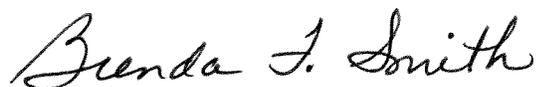
The Morgan County HCA may not sell its interest in the health care system at the end of the lease under the terms of the lease agreement without the approval of the Morgan County Commission and City of Decatur.

I hope this opinion answers your question. If this Office can be of further assistance, please contact Ward Beeson of my staff.

Sincerely,

LUTHER STRANGE  
Attorney General

By:

A handwritten signature in cursive script that reads "Brenda F. Smith".

BRENDA F. SMITH  
Chief, Opinions Division

LS/GWB

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