

# COALITION FOR NONPROFIT HEALTH CARE

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## *RESEARCH, EDUCATION, ADVOCACY*

### **Nonprofit Healthcare—Under Scrutiny or Under Siege?**

Attorneys General and labor unions have started using a health system's nonprofit status against it, challenging corporate business practices, charity care records, and proposed transactions in state courts and the court of public opinion. The essence of these high-profile challenges is that the health system's conduct violates state laws governing charities or doesn't live up to public expectations. If you are targeted by an AG investigation or a union "corporate campaign," you won't emerge unscathed. These challenges have financial, operational, and reputational consequences for the hospitals and health plans involved.

CNHC's 2001 CEO Education Session (summarized below) examined the causes of the se inter-related developments, identified specific "casualties," and explore pro-active measures nonprofit health care organizations can adopt to reduce their exposure.

Why Now? Several factors make increased AG scrutiny a growing trend. First, conversions and the cry for regulation brought hospitals to the forefront and familiarized AG staffs with health care issues. The highly-publicized AHERF failure turned up the heat, as has growing labor union criticism of nonprofits used as an organizing technique. AGs protect the public interest as they see it, and have been emboldened by these developments and public outcries over proposed conversions and closures that "It's our hospital." Health care issues were the dominant focus at the 2001 Annual Meeting of the National Association of Attorneys General. Shortly thereafter, the National Women's Law Center published a monograph illustrating how nonprofit corporate and charitable trust laws can be used to challenge hospital mergers. It includes contact information for AG offices in every state.

AGs in some cases are applying significant public and private pressure on the board (through allegations of breach of fiduciary duty or mismanagement) to remove senior management or divest an affected corporate entity, in order to force a change in the allegedly improper activity. Intense media coverage adds significantly to the pressure on volunteer directors and can undermine their willingness to litigate legitimate disputes.

What Are the Consequences? Attorneys General have broad discretion to fashion relief. Vigorous application of nonprofit corporate and charitable trust law to health care business transactions can impose substantial costs or other disadvantages on health care organizations, sometimes with dramatic results, including:

- **Forced Breakup:** Optima Health Care, Manchester, N.H. (1999-2000);
- **Forced Divestiture:** Intracoastal Healthcare, West Palm Beach, Fla. (2001); Allina Health System, Minneapolis, Minn. (2001);
- **Blocked Closure:** Manhattan Eye, Ear & Throat Hospital, New York City, N.Y. (1999); St. Mary's Hospital, West Palm Beach, Fla. (2001);
- **Threatened Removal of Board:** Intracoastal; Allina; Palm Healthcare Foundation (Palm Beach, Fla.);

- **Mandated Funding Increase:** Driscoll Foundation, Corpus Christi, Tx. (2001); or
- **Allegations of Corporate Waste, Loss of Auditor Independence:** Allina.

What's Next? Likely areas of increased AG scrutiny include: (i) intra-system financial transfers, including “upstreaming” of corporate funds and cross-guarantee master indenture financing arrangements; (ii) exercise of independent judgment by corporate affiliates and exercise of control by the parent organization; (iii) mergers; (iv) accessing restricted gifts; (v) executive and board compensation; and (vi) facility closures, consolidations, and downsizing.