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August 29, 2003

Dwight Hamilton, Esq.  
Acting Chair  
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Suite 500  
1600 Broadway  
Denver, CO 80202

Dear Mr. Hamilton:

This is to further my letter of August 19, 2003.

I was troubled by the citation in the comment to section 4, Standard of Care; Prudence, of the proposed revision of the Uniform Management of Institutional Funds Act to Stern v. Lucy Webb Hayes Nat'l Training School, 381 F. Supp. 1003 (D.D.C. 1974) for the proposition that the trend in not-for-profit corporations is toward the business judgment rule. As time has passed, I have become more troubled, hence this further letter.

First even in the business corporation context, the business judgment rule's efficaciousness is uncertain. See D.J. Block, et al., The Business Judgment Rule (5<sup>th</sup> ed. 1998).

In the nonprofit corporate context, the truth is, as Seton Hall Law School's Kathleen Boozang, Esq. observed in a recent monograph, the outline of which is enclosed, that the Stern case has had no clear following. I don't know whether or not Kathleen has yet published her monograph, but I feel sure she would share it with you if you are interested. Some states are business judgment rule states, some are charitable trust states and some, like New York, are uncertain. New York Not-for-Profit Corporation Law section 720-a, for example, applies only to third party actions against uncompensated directors and officers, not to actions inter se or by the Attorney General, and section 717(b) carefully qualifies its experts' reliance provisions. Even the business judgment rule states quickly abandon that presumption at the first sign of fiduciary abuse. E.g., Janssen v. Best & Flanagan, 2003 Minn. Lexis 278 (Minn. Sup. Ct. May 22, 2003).

There is a recent student note on this subject, Note, The Business Judgment Rule: Should It Protect Nonprofit Directors?, 103 Colum. L. Rev. 925, 927, 942-45 & nn. 13, 14, 71 &

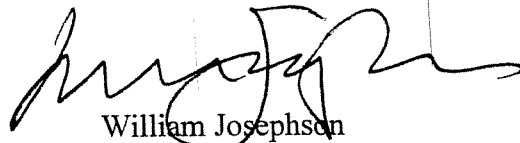
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80 (2003), which actually could be a lot better than it is, for example, it does not even cite the seminal New York trial court case, Manhattan Eye and Ear Hospital v. Spitzer, 186 Misc.2d 126, 715 N.Y.S.2d 575 (Sup. Ct. N.Y. County 1999) (edited opinion)

When one considers that UMIFA is intended to apply to trusts as well as other noncorporate entities, the comment seems to me to be at best incomplete.

Sincerely,

A handwritten signature in black ink, appearing to read 'William Josephson', written in a cursive style.

William Josephson  
Assistant Attorney General-in-Charge  
Charities Bureau

cc: Prof. Susan N. Gary, Reporter ✓

# **OVERVIEW OF STRUCTURE AND HISTORICAL CONTEXT OF NOT-FOR-PROFIT HEALTH CARE SYSTEMS**

**Kathleen M. Boozang, J.D., LL.M.**  
**Associate Dean**  
**Director, Health Law & Policy Program**  
**Seton Hall University School of Law**

## **I. Overview**

- A. Evolution of Systems
  - i. Basic Structure of Health Care System
  - ii. Prevalence and success of mergers
  - iii. Forms of mergers
  
- B. Attorney General Challenges to not-for-profit boards' decisions
  - i. Context
    - 1. Recent Examples
  - ii. History
  - iii. Legal Theories
    - 1. Corporate Law
    - 2. Statutory Charitable Trust Theory
    - 3. Common Law Charitable Trust Theory
  - iv. Public policy implications

## II. Evolution of Systems

## III. Attorney General Challenges to not-for-profit boards' decisions

### A. Context

- i. What is a charitable corporation? What is the state's relationship to the charitable corporation? Who has primary responsibility for oversight over the charitable health care entity (Attorney General vs. Commissioner of Health vs. IRS)
- ii. How are nfp hospitals catching the attention of Attorneys General?
  1. Concerns about oversight of assets of charitable corporation – perceptions of greed and neglect.
  2. Perceptions of conflict of interest
  3. Concerns about loss of local community control
  4. Concerns about charitable dollars leaving the state to subsidize out-of-state sister-entities
  5. Concerns about effect of conversion from nfp to for-profit
  6. Becoming ensnarled in disagreements about nfp board's business decisions
  7. Concerns about access to (reproductive) services
    - a. Short detour: Ethical & Religious Directives
- iii. What is the role of the Attorney General

1. When does an attorney general have legal authority to intercede or approve of decisions of an nfp board
2. What are the legal basis and parameters on the attorney general's authority
3. What is the process for review or oversight by the attorney general of the nfp
4. What is the standard of review of an nfp board decision by an attorney general
5. What weight should the attorney general give to the nfp's compliance with, or approval by all other governing state and federal oversight agencies, including the IRS, Department of Health, Department of Insurance, Medicare, etc.

B. Recent Examples

i. New Hampshire: Optima

<http://www.state.nh.us/nhdoj/CHARITABLE/optimal.html>

ii. Minnesota: Allina Health System

iii. New Mexico: Banner

iv. New Jersey: St. Elizabeth's

C. The Law

- i. Evolution of the law governing charitable corporations: a quick survey

To what extent a charitable corporation is to be governed by laws applicable to charitable trusts is a vexed question to which the authorities give irreconcilable answers. *City of Paterson v. Paterson General Hospital*, 235 A.2d 487 (N.J. Super. Ct. 1967).

It must be conceded that in this state, and throughout the country as a whole, supervision of the administration of charities has been neglected. Charities in this State, whether or not incorporated, are, in general, only subject to the supervision of the Attorney General. The manifold duties of this office make readily understandable the fact that such supervision is necessarily sporadic. 235 A.2d 495.

The charitable corporation is a relatively new legal entity which does not fit neatly into the established common law categories of corporation and trust. As the discussion below indicates, however, the modern trend is to apply corporate rather than trust principles in determining the liability of the directors of charitable corporations, because their functions are virtually indistinguishable from those of their 'pure' corporate counterparts. *Stern v. Lucy Webb Hayes National Training School*, 381 F. Supp. 1003 (D.C. Cir. 1974).

- ii. Trying to make sense of current law:

1. Three categories

- a. Revised Model Nonprofit Corporation Act
- b. Statutory Charitable Trust
- c. Common Law Charitable Trust
- d. Creative Lawyering

2. Why it matters whether corporate or charitable trust law applies
  - a. Director liability vs. attorney general oversight
3. Revised Model Nonprofit Corporation Act (1987)
  - a. New Jersey: Paterson, St. Elizabeth's
4. Statutory Charitable Trust
  - a. New Hampshire: Optima
5. Common Law Charitable Trust
  - a. Necessary and Essential to distinguish between express charitable trust and states that treat all charitable corporations as charitable trusts
  - b. Express Charitable Trust
    - i. How to identify
    - ii. Legal implications

The line of demarcation at which point the courts will interfere with the discretion of those governing a public charity reasonably is the point of substantial departure by the governors (or Board) from the dominant purpose of the charity, and, unless the directors so administer it that there is *such a substantial departure from the charity's dominant purpose* as to amount to a perversion of it the court will not interfere. *Taylor v. Baldwin*, 247 S.W. 2d 741 (Mo. 1952). Cf. *Greil Memorial Hosp. V. First Alabama Bank of Montgomery*, 387 So.2d 778 (Ala. 1980)(testamentary gift to charitable corporation made for sole purpose of hospital for tuberculosis was a charitable trust which assets could only be used for that purpose, despite change in treatment of TB; abandonment of purpose caused legacy to lapse); *Attorney General v. Hahnemann Hospital*, 494 N.E.2d 1011 (Mass. 1986)(where assets of charitable trust dedicated to operation of homeopathic hospitals are so intertwined with other hospital funds, board would violate fiduciary duties if it dedicated funds from trust, or funds donated prior to

change in corporate purpose by donees who understood purpose to be governed by trust, to a new purpose).

c. Charitable Corporations deemed Charitable Trusts

Queen of Angels Hospital v. Younger, 66 Cal.  
App. 3d 359 (Ct. App. 1977); Holt v. College  
of Osteopathic Physicians and Surgeons, 394  
P.2d 932 (Cal. 1964)

D. Public Policy Implications