You Can't Take The Money And Run

Court Prohibits Nonprofit Hospital Chain from Removing Community Assets

On May 21, 2003, the South Dakota Supreme Court issued a very important decision in the case of Banner Health System v. Lawrence E. Long, 663 N.W.2d 242 (2003). This case sets several precedents in the application of charitable trust law to nonprofit health care corporations. The court explicitly held that the assets of a nonprofit health care corporation, as well as the proceeds from the sale of those assets, are subject to the law of charitable trust. It also held that an out-of-state corporation must leave charitable assets with the local community upon divestiture. Consumers Union submitted an amicus brief to the court in this case.

Over the past 25 years, attorneys general have been applying the law of charitable trust to nonprofit health care corporations, resulting in the transfer of over $16 billion to health care foundations from former nonprofit hospitals and health plans. Yet, there is scant case law directly addressing whether, in the absence of an explicit "conversion statute," these charitable corporations are legally obligated to set aside their assets for the benefit of the community. The Banner Health System case is therefore a very important development in this area of the law.

By making it clear that a community hospital truly belongs to the community, the Banner case should embolden health care advocates seeking to fight the corporatization of health care. Many nonprofit hospital chains have begun to behave like for-profits by putting bottom-line interests over the health care needs of the community. Advocates across the nation can use the Banner case to fight this trend. Under Banner, a nonprofit hospital chain must act in the interests of each community in which it operates, and cannot sacrifice those interests to the interests of the corporate parent. Moreover, the chain cannot unduly "profit" from the sale of a community hospital. Any net profits from the sale must remain with the community, even if the hospital is sold to another nonprofit organization.

Case Background: The South Dakota Supreme Court took this case as a "certified question" from the U.S. District Court. The court agreed to answer a fundamental question – whether South Dakota law "recognizes any legal theory that would subject any of the assets of a nonprofit corporation or proceeds from the sale of those assets to an implied or constructive charitable trust in the absence of an express trust agreement."

The court answered the question in the affirmative. With this question of law settled, the case is proceeding to trial in U.S. District Court. Assuming the facts as alleged by the Attorney General are proven at trial, the trial court could impose an implied trust on the proceeds from the sale of these facilities, thus requiring those funds to remain in their respective South Dakota communities.

Facts: In 2002, the nonprofit Banner Health System (Banner) sold seven South Dakota hospitals and nursing homes to another nonprofit. At that time, Banner made it clear it intended to remove the proceeds

from South Dakota to reinvest in its other nonprofit facilities in Arizona and Colorado. While the sale was in progress, the South Dakota Attorney General informed Banner that the facilities were restricted by an implied charitable trust, and that the proceeds could not be removed from the communities in which the facilities were located. Banner then sued the Attorney General in U.S. District Court.

The South Dakota Attorney General argued Banner "never paid a nickel" for these facilities, and that the facilities belonged to their communities. For decades, a succession of nonprofit operators transferred the facilities and their charitable assets to other organizations that acted as fiduciaries of that trust, with no money changing hands. Despite these facts, Banner, the current fiduciary, claimed it had no obligation to the communities that built and paid for these hospitals and nursing homes.

Banner's attempt to remove the proceeds from the sale of these South Dakota facilities is part of a larger effort, announced in the fall of 2001, to divest from facilities in seven states and remove charitable assets. Banner has also sued the Attorneys General of New Mexico and North Dakota in federal court for asserting charitable trust authority. The New Mexico case settled in the spring of 2002 for nearly $14 million. The North Dakota case has been dismissed by a federal judge, and is currently proceeding in state court.

Important Precedents: The Banner Health System case sets the following important legal precedents:

- The court imposed a geographical limit on a charitable trust -- The case sets a precedent for local protection of charitable assets held by multi-state non-profit corporations, and requires those assets to remain with the local communities upon divestiture. In so doing, the case makes it clear there are geographical limits on a charitable trust. A nonprofit hospital chain cannot remove charitable assets from the community that built a hospital, even if it intends to reinvest those funds in its other nonprofit hospitals elsewhere.

- The court held that charitable trust restricts the proceeds of these sales, even though the facilities were sold to another nonprofit -- This case also sets a ground-breaking precedent for charitable trust protection of assets in a nonprofit to nonprofit transaction. The proceeds from these sales must remain with the community, even though the facilities themselves will continue to be operated as nonprofits.

- The court made it clear that charitable assets are protected by an implied/constructive trust – The court held that, if the facts as alleged by the Attorney General are proven at trial, the trial court would have the authority to impose an implied/constructive charitable trust based on theories of unjust enrichment, breach of fiduciary duties, and improper amendment of the charitable corporation's articles of incorporation.

- The court held that a trust would arise if the seller was unjustly enriched by the sales – The court held that, if the trial court were to find that Banner was unjustly enriched by the removal of the proceeds from the local communities at the expense of those communities, the trial court would have the power

to impose a constructive trust on those proceeds. In other words, a nonprofit hospital chain cannot "profit" from the sales of its hospitals. It must leave any excess profit with the community.

- The court held that Banner's corporate officers have a fiduciary duty to act in the best interests of the communities served by the facilities – The court also held that Banner's corporate officers may have violated their fiduciary duty to these South Dakota facilities. The Attorney General submitted as evidence a letter written by the CEO of Banner saying the sales of these facilities were "in the best interest of Banner," rather than in the best interest of the communities served by the facilities. The court discussed this letter and concluded that a breach of fiduciary duty may have arisen, reasoning that a fiduciary agent is prohibited from using trust property for its own benefit, or from entering into a transaction that "would pose an interest adverse to the interests of the beneficiaries."

- The court found that Banner could not escape its charitable trust obligations by amending the articles of incorporation of the South Dakota facilities – In addition, the court agreed with the Attorney General that a constructive charitable trust may arise when a nonprofit corporation amends its articles of incorporation to alter pre-existing restrictions on the use and distribution of its charitable assets. A corporate predecessor had amended the articles of incorporation in 1993 to remove a provision requiring the assets to remain in the local communities upon dissolution. The court held that this provision still applied to assets held prior to 1993, reasoning that, "[a]ny other rule of law would allow a charitable nonprofit corporation to eviscerate the charitable purpose for which it was formed without recourse for those who donated funds for that purpose." The court concluded that, "[t]o the extent that a charitable trust is imposed on one of its predecessor corporations, Banner took the assets subject to that trust and would likewise be bound thereby."

- The court made it clear that the existence of a Nonprofit Corporations Code does not abrogate charitable trust requirements – The court rejected an argument made by Banner that the nonprofit corporations statute is the only applicable law in this case, and that trust law did not apply. The court said that the rules of statutory construction require it to read statutes together, and that there was nothing in the code to indicate the legislature intended to abrogate common law and statutory trust provisions with regard to nonprofit corporations when it passed the nonprofit corporations code.

The Banner Health System case is a rare judicial precedent that requires very broad protection of charitable assets when a hospital or nursing home is sold. For more information, please contact Consumers Union.