

Protecting Charitable Assets in Hospital Conversions: An Important Role for the Attorney General

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INTRODUCTION

Nonprofit to investor-owned hospital conversions have increased in frequency in the past decade, which has generated public concern at the local, state, and national levels.⁵ Between 1980 and 1993, 147 hospitals converted from nonprofit status to investor ownership,⁶ and between 1994 and 1997, 206 conversions occurred.⁷ Simply put, in just four years, there were 59 more hospital conversions than in the previous 14-year period. Public concern over the increased frequency of hospital conversions is warranted because hospital conversions have become the largest potential redeployment of charitable assets in the history of the United States.⁸ As evidenced by the conversion of Health Midwest, Kansas is not immune to this trend. On April 1, 2003, Hospital Corporation of America (HCA) acquired substantially all of Health Midwest's assets located in Kansas and Missouri. The sale price of Health Midwest's assets across both states was \$1.125 billion, making it the largest hospital conversion ever to occur in this nation.⁹

One of the many roles of an attorney general is to protect the interests of the community in which he/she resides throughout the hospital conversion process.¹⁰ Ordinarily, an investor-owned hospital system's primary motive in acquiring a not-for-profit system is to increase its size and to maximize profits. More often than not, maximizing the profits of an investment conflicts with the hospital's responsibility to promote charitable care and serve the best interests of the community.¹¹ This article will demonstrate that the authority of the Kansas Attorney General to review a hospital conversion is limited and ambiguous. Kansas lacks any express statutory language granting the Attorney General authority to review hospital conversions. Thus, no statutory authority exists to justify, in many cases, a necessary intervention. While unlikely, it is a distinct possibility that future hospital conversions in Kansas will not have to obtain regulatory approval.

In many states, litigation has fostered the dispute over whether charitable trust law or corporate law should govern hospital conversions. In response to this ambiguity, many states have enacted legislation clarifying the role government officials perform in reviewing a hospital conversion.¹² In Kansas, the state legislature has attempted on two occasions to pass legislation governing the sale of nonprofit hospitals. Neither bill was successful or effective.¹³ Part I of this article demonstrates

the need for a comprehensive hospital conversion law in Kansas by analyzing the litigation surrounding the sale of Health Midwest to HCA. Part I also shows the need for Kansas to adopt a hospital conversion statute clarifying the legal authority for the Attorney General to review such a transaction. Part II of this article explains why the Attorney General must have such authority. Part III discusses the various hospital conversion laws in Rhode Island, Nebraska, California, and Virginia, which have proven effective and how they can be useful guidelines for Kansas legislators in drafting hospital conversion legislation. Finally, Part IV explains why it is imperative that Kansas legislators use the statutory schemes of Rhode Island and Nebraska as guidelines to implement an effective hospital conversion law that preserves charitable assets in Kansas before a major hospital conversion in the state occurs again.

I. HEALTH MIDWEST, et al. v. PHILL KLINE: CASE STUDY OF IMPORTANCE OF ATTORNEY GENERAL STATUTORY AUTHORITY TO REVIEW HOSPITAL CONVERSIONS.

A. HCA's Acquisition Of Health Midwest

1. Health Midwest

Prior to April 1, 2003, Health Midwest was an integrated healthcare delivery system chartered as a Missouri public benefit corporation providing hospital and related medical services in the greater Kansas City metropolitan area.¹⁴ Although Health Midwest was chartered in Missouri, it owned and operated medical-related assets in both Missouri and Kansas. Moreover, Health Midwest Johnson County, a subsidiary of Health Midwest, was incorporated as a nonprofit corporation in Kansas. Because the Internal Revenue Service considers healthcare to qualify as a charitable purpose,¹⁵ Health Midwest and its subsidiaries were classified as Section 501(c)(3) organizations under the Internal Revenue Code (IRC) and qualified for federal tax exemptions under Section 501(a) of the IRC. Furthermore, Health Midwest Johnson County and the other Health Midwest subsidiaries in Kansas were exempt from Kansas personal, real property, sales, and income taxes.¹⁶ The tax exemptions effectively functioned as subsidies to Health Midwest's Kansas entities. The exemptions were considered justified because the organization was considered to be providing a direct benefit or service to the surrounding community while not collecting a profit from the activity.

2. Hospital Corporation of America (HCA)

Hospital Corporation of America (HCA) is the largest investor-owned hospital system in the United States. Formally known as Columbia/HCA, the Nashville-based corporation is publicly traded on the New York Stock Exchange (NYSE).¹⁷ HCA, through its subsidiary HCA Midwest, currently owns and operates five medical facilities in Kansas and nine in Missouri. Ownership of three of the five Kansas hospitals resulted from the sale of Health Midwest's assets.¹⁸

3. Reasons for Sale

Prior to the conversion, Health Midwest experienced financial difficulties in operating its nonprofit hospital system. Operational losses increased from \$17.7 million in 1999 to \$25 million in 2000.¹⁹ Moreover, net revenues were increasing at a rate slower than the increase in overall expenses, which resulted in a growing loss of operating margin.²⁰ Health Midwest also believed that it needed to invest in new technology and improve its aging facilities. According to Health Midwest, these financial losses and an inability to invest in capital improvements compelled it to consider selling its system's assets to another nonprofit or investor-owned healthcare system.²¹ The decision to sell, according to the Health Midwest executives, occurred after receiving letters from both HCA and Ardent health systems stating an interest in purchasing the Health Midwest system.²² Once the decision was made to sell, Health Midwest used a bidding process to determine the ultimate buyer.²³ HCA eventually outbid Ardent and Tenet, another interested investor-owned health system.²⁴ The final bid from HCA was \$1.125 billion, which became the purchase price of Health Midwest.²⁵

4. January 21, 2003 – Memorandum of Understanding (MOU) between the Missouri Attorney General and Health Midwest

The Attorneys General in both Kansas and Missouri²⁶ asserted their authority to review the sale of Health Midwest to HCA. However, Health Midwest was not convinced that either state's Attorney General possessed statutory or common law authority to review the sale. Thus, in November 2002, Health Midwest initiated actions against both Attorneys General in their respective states. On Jan. 21, 2003, Health Midwest and the Missouri Attorney General reached a settlement in the Missouri action. Health Midwest agreed, in their Memorandum of Understanding (MOU) with the Missouri Attorney General, to form from the proceeds of the sale a

single Missouri-based foundation to own and manage all of the proceeds from the sale of Health Midwest to HCA.

The Kansas Attorney General viewed the terms of the MOU as unfavorable to the healthcare needs of the Kansas communities previously served by Health Midwest. Although the MOU proposed to establish spending targets for Kansas, no guarantee existed in the MOU that the Kansas charitable assets of Health Midwest would remain in Kansas. Moreover, the leadership of the proposed foundation reduced the number of Kansas residents on the Board of Directors, who would theoretically view the healthcare needs of Kansas residents as a priority. Before the conversion, Health Midwest's Board of Directors consisted of 16 Kansas residents and four Missouri residents. The MOU, however, changed the composition of the Board to one dominated by Missouri residents.²⁷ In effect, Missouri would have exclusive ownership of the charitable funds and total control of the Board, thus designating to the State of Missouri the power to identify the Kansas healthcare needs and determine, what allocation, if any, to be made to Kansas.

II. HOSPITAL CONVERSION: PUBLIC OPINION AND HEALTH POLICY

A. Public Opinion

Historically, Americans have viewed nonprofit hospitals as dedicated to the mission of providing charitable healthcare.²⁸ The increasing trend of nonprofit to investor-owned hospital conversions has incited public debate that the quality and quantity of charitable care historically provided by these converted hospitals would be threatened.²⁹ Although public opinion is mixed concerning the relative merits of investor-owned versus nonprofit hospital systems,³⁰ studies have shown that the concerns expressed by opponents of investor-owned systems are legitimate.³¹ The studies show that conversions to an investor-owned system often result in staffing cuts, discontinuation of vital community health services, and even hospital closures.³² Moreover, studies have demonstrated that investor-owned hospitals will not commit to providing the same level of charity care to the indigent or to promote the general health of the communities they serve as well as nonprofits.³³

Besides the conversion to investor-owned, communities are also concerned with the conversions of locally owned hospitals to national chains.³⁴ Locally owned hospitals are often viewed as more responsive to community needs than hospitals operated by a national chain, fueling the concern that the less receptive national corporation will reduce or eliminate particular services that provide community benefits.³⁵ Receptivity played a large role in the Health Midwest conversion. Not only did the control of Kansas City area hospitals transfer to Nashville-based HCA, but

charitable assets once located in Kansas were proposed to be managed by an out of state foundation. A Missouri-based foundation that owns and manages Kansas' charitable assets arguably would not be as responsive to the community needs of Kansas residents as well as a Kansas-based foundation.

Although the Health Midwest conversion primarily concerned urban hospitals,³⁶ future conversions could pose a threat to the general health of Kansas citizens living in rural areas. Hospital closures among rural hospitals are often closely related to conversions.³⁷ Moreover, evidence suggests that rural hospital closures adversely effect area employment and earnings that may persist up to five years.³⁸ The notion that any type of community can be affected, negatively or positively, by a hospital conversion has led to support from residents of states without explicit statutes providing regulatory oversight for the sale of a hospital; these residents have shown their support by demanding such legislation from their state legislators.³⁹

B. Health Policy Concerns with Investor-Owned Hospital Systems

Comparing the benefits nonprofit hospitals provide to the communities they serve to the benefits investor-owned hospitals provide is not only complicated but also subjective.⁴⁰ However, the statistics comparing nonprofit to investor-owned hospitals provide useful insight on the disparity of benefits. A study in the *New England Journal of Medicine* concluded that investor-owned hospitals are lower in quality than nonprofit hospitals.⁴¹ The study notes the following about investor-owned hospitals: they are three to 11 percent more expensive; they spend more on overhead and administrative costs; they hire fewer nurses; they provide less charity care; they provide patients with fewer hospital days; and they have more post-operative complications and preventable adverse events than nonprofit hospitals.⁴² Moreover, the study cited two recent studies that found death rates to be six to seven percent lower in nonprofit hospitals and 25 percent lower in teaching hospitals than in investor-owned hospitals.⁴³ Last, the study found that communities dominated by investor-owned hospitals tended to have substantially higher Medicare costs⁴⁴ and more rapid price increases.⁴⁵

Another problem associated with investor-owned hospitals involves their treatment of uninsured patients.⁴⁶ In early 2003, the Los Angeles-based advocacy group, *Consejos de Latinos Unidos*, accused HCA of price-gouging uninsured patients.⁴⁷ Some HCA hospitals had charged uninsured patients up to four times more than the hospitals charged patients with private insurance for the same procedure.⁴⁸ Many uninsured patients could not afford to pay these inflated bills and faced legal action from HCA.⁴⁹ However, HCA was able to record these unpaid medical expenses as bad debt in their accounting books.⁵⁰ This practice of inflating charity care levels

poses potential dilemmas in hospital conversions from a nonprofit to investor-owned system. Investor-owned hospital systems may promise to maintain or exceed the dollar value of charitable care in their asset purchase agreements, similar to the one between HCA and Health Midwest; however, the preceding situation shows that investor-owned hospitals may be able to provide less care by price-gouging uninsured patients.

III. LEGAL PRINCIPLES GOVERNING NONPROFIT HOSPITAL CONVERSIONS

Although several states have enacted legislation regulating the sale and conversion of nonprofit hospitals,⁵¹ the legal structure governing hospital conversions in most states is unclear and left to judicial interpretation. Historically, the Attorney General is the government official charged with the oversight responsibility of charitable assets.⁵² In nearly all of the states with conversion legislation, the Attorney General is designated to oversee the conversion process.⁵³ In states without conversion laws, the Attorney General claims the authority to review hospital conversions through charitable trust law and common law.⁵⁴ Opponents to Attorney General review assert that Attorneys General have no such common law authority because hospital conversions are a matter of corporate law, not trust law.⁵⁵ The conflict between corporate law and charitable trust law was present in the litigation between Health Midwest and the Kansas Attorney General and will be present in future hospital conversions unless states enact hospital conversion statutes.

A. Principles of Charitable Trust Law

Historically, the Attorney General's authority to review the sale of charitable assets arose from common trust law principles.⁵⁶ Charitable trust law still plays a significant role in determining whether the sale of a nonprofit hospital is permissible under the restrictions of the nonprofit trusts and in analyzing acceptable uses for the proceeds generated from the sale of the hospital.⁵⁷

The *Restatement (Second) of Trusts* § 348 defines a charitable trust as “a fiduciary relationship with respect to property arising as a result of a manifestation of an intention to create it, and subjecting the person by whom the property is held to equitable duties to deal with the property for a charitable purpose.”⁵⁸ Moreover, the treatise states that a property may be devoted to charitable purposes not only by transferring it to individual trustees to hold it for such purposes, but also by transferring it to a charitable corporation.⁵⁹ It expresses that, ordinarily, charitable corporations should be held to the same rules and principles as charitable trusts.⁶⁰ The *Restatement (Second) of Trusts* § 348(f) also charges state Attorneys General with the

responsibility to oversee that the fiduciary duties of a charitable trust are being upheld.⁶¹

Where the property is given to a charitable corporation without restrictions as to the disposition of the property, the corporation is under a duty, enforceable at the suit of the Attorney General, not to divert the property to other purposes but to apply it to one or more of the charitable purposes for which it is organized.⁶²

The *Restatement (Second) of Trusts* §§ 372 and 376 apply the principles of charitable trusts to hospitals and nonprofit institutions.⁶³ The *Restatement (Second) of Trusts* § 372 provides that any trust designated to the promotion of health is charitable⁶⁴ and that trusts are not charitable when the property or income derived from them are devoted to a private use.⁶⁵ Because nonprofit hospitals are created by a trust⁶⁶ and their property and proceeds are not intended for private use, nonprofit hospital systems are charitable in purpose and should be governed by charitable trust law. When a nonprofit hospital is sold to an investor-owned system, the use of the property is no longer dedicated to a charitable purpose. Following the above principles, the *Restatement (Second) of Trusts* supports the argument that the state Attorneys General have the power to review whether board members of a non-profit corporation are carrying out their fiduciary duties established in the charitable trust.

The *cy pres* doctrine also provides authority for Attorneys General to review hospital conversions.⁶⁷ Although *cy pres* is a doctrine of common law, it is incorporated into statutory law in the Kansas,⁶⁸ whereby the Attorney General is notified and given the opportunity to be heard in every *cy pres* proceeding.⁶⁹ The *cy pres* doctrine applies when the trustees of a charitable trust seek to use the assets of the trust for a purpose other than the purpose stated in the trust.⁷⁰ In a *cy pres* proceeding, the trustee must establish that: “(1) it has become impossible, or at least impracticable, to accomplish the stated purpose of the trust, and (2) the proposed alternative use of trust assets comes as close as present circumstances permit to fulfilling the original intent of the donor.”⁷¹

Because nonprofit hospitals are dedicated to charitable purposes,⁷² the sale of a nonprofit hospital’s assets to an investor-owned system constitutes a change from charitable purpose to a profit-making purpose. Arguably, the purpose of a nonprofit hospital is to operate a hospital and the sale of physical assets constitutes a deviation from the nonprofit corporation’s charitable purpose. Thus, the nonprofit corporation cannot sell its assets without obtaining prior court approval in a *cy pres* proceeding, which automatically requires the Attorney General be given notice and the opportunity to be heard.⁷³

The application of the *Restatement (Second) of Trusts* and the *cy pres* doctrine to hospital conversions suggests the Attorney General should play some role in the oversight of a hospital conversion.

B. Case Law: Nonprofit Hospitals as Charitable Trusts

The courts in both *Queen of Angels Hospital v. Younger*⁷⁴ and *Attorney General v. Hahnemann Hospital*⁷⁵ established that a nonprofit corporation that owns and operates a hospital is properly viewed as a charitable trust, and is not the property of its trustees or directors.⁷⁶ Both cases are examples of a *cy pres* proceeding in which the courts determined whether the actions of a nonprofit hospital's board of directors substantially departed from the corporation's stated charitable purpose. Both courts interpreted the missions of these hospitals narrowly,⁷⁷ thus determining that their actions substantially departed from the dominant charitable purpose of the corporation. While a broad review of case law in this area suggests that the courts' interpretation of a nonprofit hospital substantially departing from its corporate purpose varies depending upon the jurisdiction,⁷⁸ the decisions in both *Queen of Angels Hospital v. Younger* and *Attorney General v. Hahnemann Hospital* demonstrate important and relevant legal principles that apply to hospital conversions.

1. *Queen of Angels v. Younger*

Queen of Angels Hospital was established and incorporated in 1927 as a nonprofit corporation in California.⁷⁹ In 1971, the nonprofit leased its hospital to W.D.C. Services, Inc.⁸⁰ but retained ownership of an outpatient clinic and a convent house.⁸¹ Queen of Angels intended to use the proceeds from the lease to establish and operate outpatient medical clinics that would provide free medical services for the indigent in Los Angeles.⁸² In order to determine the validity of their lease agreement with W.D.C., Queen of Angels filed a declaratory relief action against the California Attorney General.⁸³ Although the lower court ruled in favor of Queen of Angels, the California Appellate Court reversed the ruling in favor of the Attorney General,⁸⁴ who argued that using the assets from the sale for outpatient services constituted an abandonment of the nonprofit's dominant charitable purpose.⁸⁵ In its ruling, the appellate court concluded that Queen of Angels abandoned its primary charitable purpose and violated the terms of the charitable trust imposed on its assets by using the assets, including the proceeds from the lease, exclusively for the purpose of operating outpatient clinics.⁸⁶

2. *Attorney General v. Hahnemann Hospital*

The Mary Ida Converse Trust provided the initial funding for Hahnemann Hospital in 1940, and continued to support the nonprofit hospital corporation through donations and contributions.⁸⁷ In 1984, Hahnemann Hospital entered into an asset purchase agreement with Community Care Systems, Inc. (CCS), a for-profit corporation.⁸⁸ The Massachusetts Attorney General sought to enjoin the sale on the grounds that Hahnemann's board of directors exceeded its authority by approving the sale of its hospital assets.⁸⁹ While the litigation was pending, Hahnemann's board amended its articles of incorporation in order to broaden the corporate purposes of the institution so it could justify using the proceeds from the sale for purposes other than those articulated in the Converse Trust.⁹⁰

The case reached the Supreme Judicial Court of Massachusetts,⁹¹ which held that Hahnemann's hospital assets could be sold to CCS because the trust did not forbid the sale of the assets.⁹² The court also addressed the amendments made by Hahnemann's board to its Articles of Incorporation. Although the amendments were statutorily permitted, the court found the amendments violated the terms of the Converse Trust.⁹³ The court expressed concern that:

By simply amending its charter purposes, a charitable corporation would itself be able to exercise the power to devote funds to new charitable purposes whenever the trustees decided to do so, without any requirement that the new purposes be similar and not contradictory. The public could not be assured that funds it donated would be used for similar public charitable purposes.⁹⁴

Therefore, the court ruled that all unrestricted contributions made prior to the September 1985 amendment were subject to the same restrictions as the contributions from the Converse Trust.⁹⁵ Furthermore, the ruling required that the sale proceeds attributed to the Converse Trust or to unrestricted donations prior to the amendment be subject to the purposes stated in the Converse Trust; otherwise, Hahnemann's board of directors would be in violation of their fiduciary duties.⁹⁶ The significance of this opinion is that courts arguably have the power to force corporate directors to uphold the original purposes of the donations.

C. Principles of Corporate Law

Unlike charitable trust law, corporate law is heavily grounded in statutory law.⁹⁷ The Kansas Corporate Code specifically includes charitable and other nonprofit organizations.⁹⁸ In some instances, nonprofit corporations require separate provisions

from the general corporate code in order to account for the absence of shareholders and stock; nevertheless, nonprofit corporations essentially follow the same legal framework as for-profit corporations.⁹⁹ A corporation's Articles of Incorporation and Bylaws govern its actions, thus giving the corporations legal consent to partake in any activity as authorized by its Articles of Incorporation and Bylaws.¹⁰⁰ If a corporation decides to engage in an activity not stated in its governing documents, then the corporation must amend its Articles of Incorporation to include the activity subject to the constraints of its Bylaws.¹⁰¹

Courts rely on the business judgment rule as the fundamental principle of corporate law that protects the decisions of corporate directors from legal action by its shareholders and the courts unless it can be proven that the director breached one of his/her fiduciary duties.¹⁰² Under the business judgment rule, corporate directors are presumed to act "on an informed basis, in good faith, and in the honest belief the decision was in the corporation's best interest."¹⁰³ The business judgment rule presumes that the board of directors upholds its fiduciary duties when making a corporate decision. The fiduciary duties imposed on corporate directors are the duties of care, loyalty and obedience.¹⁰⁴ The duty of care requires corporate directors to make a reasonable attempt at obtaining all relevant information before taking action.¹⁰⁵ In reference to the sale of a nonprofit hospital's assets, the duty of care requires the board of directors to: (1) ascertain the value of the hospitals assets;¹⁰⁶ (2) consider all competing offers; (3) justify the accepted purchase price;¹⁰⁷ and (4) carefully consider all alternatives to, and ramifications of, the transaction.¹⁰⁸

The duty of loyalty requires corporate directors to disclose actual and potential conflicts of interest in business transactions and act in the best interests of the corporation.¹⁰⁹ The duty of loyalty exists to ensure fair transactions. For example, it forbids corporate directors from undertaking a decision that will result in personal financial gains.

The duty of obedience requires corporate directors to be faithful to the corporation's mission.¹¹⁰ "Although board members may exercise their own reasonable judgment concerning how the organization should best meet its mission, they are not permitted to act in a way that is inconsistent with the central goals of the organization."¹¹¹

The Kansas Supreme Court in *Cron v. Tanner* discussed the need for the business judgment rule:

It is not the function of the court to manage a corporation nor substitute its own judgment for that of the officers thereof. It is only when the officers are guilty of willful abuse of their discretionary power or of bad faith, neglect of duty, perversion of the corporate purpose, or when fraud or breach of trust are involved, that the courts will interfere.¹¹²

Cron v. Tanner concerns a suit against the directors of a bank, not a nonprofit corporation.¹¹³ Although charitable corporations are governed under similar statutory law as for-profits, they are not intended for private purposes and thus should not be subject to the same constraints as for-profits. The business judgment rule is a reasonable measure for governing the board of directors of a for-profit because their positions are responsive to the corporation's shareholders.

Not for profit corporations, such as Health Midwest, have no shareholders. In effect, the shareholders of a nonprofit corporation are the members of the community it serves. In Health Midwest's case, the nonprofit hospital chain served the metropolitan area of Kansas City. Under the corporate code, the board of directors had no accountability toward them. A statute is needed to ensure that when a nonprofit board of directors acts, the needs of the community are being upheld. Many states have enacted such a statute by granting the Attorney General statutory oversight to review the transaction of a hospital conversion.

D. Case Law: Nonprofit Hospitals as Corporations

The District Court in *Health Midwest v. Kline* is not the only court to use a strict corporate law approach to determining whether a hospital conversion was appropriate. The New York Supreme Court in *Manhattan Eye, Ear and Throat Hospital (MEETH) v. Spitzer* also engaged in a corporate law analysis to determine the appropriateness of a hospital conversion. The MEETH court found that the nonprofit's directors violated their fiduciary duty of obedience in approving the proposed sale of charitable corporation's real estate assets, which would have resulted in closure of non-profit hospitals because the directors failed to take into account the hospital's full value as a functioning business or the value of its name. Unlike Kansas, the New York court was able to rely on New York Not-For-Profit Law¹¹⁴ that addressed hospital conversion. MEETH demonstrates the necessity for Kansas legislators to enact a conversion statute receiving court approval for the sale of a nonprofit corporation's assets under Kansas' corporation code.¹¹⁵

1. *Kansas East Conference of the United Methodist Church v. Bethany Medical Center*

In Kansas, only one case has any precedential value for courts to follow when determining the interaction between trust law and corporate law in hospital conversions.¹¹⁶ Bethany Medical Center was established by the Kansas East Conference of the United Methodist Church in 1892. Bethany's original charter

established a nonprofit corporation for the purpose of providing healthcare services to the community in or near Wyandotte County, Kansas.¹¹⁷ Bethany, its charitable foundation, the Bethany auxiliary and the Methodist church solicited charitable contributions to support the operation of a nonprofit hospital.¹¹⁸ Prior to 1972, the Kansas East Conference of the United Methodist Church even elected a majority of Bethany's Board of Trustees.¹¹⁹ However, the Conference, concerned about being held liable for Bethany's activities,¹²⁰ distanced itself from Bethany, and in 1983, the Conference declared itself wholly independent from Bethany.¹²¹

In response to financial pressures, Bethany executed an asset purchase agreement with Galen of KS., Inc., a wholly owned subsidiary of Columbia/HCA, an investor owned hospital system, on July 28, 1997.¹²² On Sept. 26, 1997, Bethany received court approval to enter into the sale, which took place soon thereafter.¹²³ At the time of the sale, Bethany's Articles of Incorporation stated, "Upon dissolution of the Corporation and after payment of just debts and liabilities, all remaining assets shall be distributed to the Kansas City East Conference of the United Methodist Church."¹²⁴ The Conference petitioned the District Court to order the dissolution of Bethany.¹²⁵ Because Bethany would no longer manage the hospital after the sale to Columbia/HCA, the Conference argued that the Bethany would no longer be carrying on its primary charitable purpose. The Conference argued that as a donor under the *cy pres* doctrine, legal authority existed to reclaim its gift because the specified use of the gift was obsolete.¹²⁶ The authority of the Attorney General to review the transaction was upheld by the District Court and not appealed.

Both the District Court and Supreme Court of Kansas refused to order the dissolution of Bethany.¹²⁷ Although the Articles of Incorporation required the assets of Bethany to be distributed to the Conference upon dissolution, the Kansas Supreme Court ruled that the Conference failed to provide any legal justification for the dissolution of Bethany. Furthermore, the Kansas Supreme Court ruled that the corporate code, not trust law, governed the dissolution of Bethany.¹²⁸

2. *Manhattan Eye, Ear, and Throat Hospital (MEETH) v. Spitzer*

In 1869, the Manhattan Eye, Ear, and Throat Hospital (MEETH) was established as a charitable corporation for the purpose of operating and maintaining a specialty hospital¹²⁹ in New York City.¹³⁰ After experiencing financial pressures and obtaining consultants, MEETH's Board of Directors made the decision to sell the corporation's assets.¹³¹ Although MEETH considered offers from various other nonprofit hospital corporations, it also considered selling its assets to real estate developers.¹³² On May 5, 1999, the Board accepted an offer from Memorial Sloan Kettering Cancer Center (MSKCC) to operate a breast cancer facility in the New

Hospital Building and from Downtown, a real estate developer, to use the remaining real estate to build apartments.¹³³

Pursuant to New York Not-For-Profit Law, MEETH had to obtain court approval before it could officially sell its assets to MSKCC and Downtown.¹³⁴ Section 511(d) of the Not-For-Profit Corporation Law required MEETH to show “to the satisfaction of the court, that the consideration and the terms of the transaction are fair and reasonable to the corporation and that the purposes of the corporation or the interests of its members will be promoted.”¹³⁵ In its decision, the New York Supreme Court found that the terms of MEETH’s transaction were neither fair nor reasonable to the corporation and that it failed to promote the interests of the corporation or its members.¹³⁶

There has been no reasoned determination that MEETH cannot continue to operate an acute care, specialty research and teaching hospital, as other medical institutions are proposing to do, and are willing to invest substantial sums to accomplish. MEETH instead chose to sell its real estate, to seek DOH approval to close its hospital, and then apply for judicial imprimatur of this plan.¹³⁷

Therefore, the Court decided not to approve the sale of MEETH’s assets to MSKCC and Downtown.

Not only does *MEETH* provide guidelines for courts to follow when considering whether a Board has upheld its fiduciary duties but it also demonstrates the utility of statutes that distinguish between nonprofit corporations and investor-owned corporations. In *MEETH*, the New York Supreme Court commented on the utility of a nonprofit corporation law like § 511:

Not-for-profit corporations operate under legal regimes designed for traditional for-profit corporations. However, fundamental structural differences between not-for-profit corporations and for-profit corporations render this approach incapable of providing effective internal mechanisms to guard against directors’ improvident use of charitable assets. For example, in the for-profit context, shareholder power ensures that Boards make provident decisions, while in the non-for-profit context, this internal check does not exist. To put it another way, a nonprofit corporation has no “owners” or private parties with a pecuniary state to monitor and scrutinize actions by the directors. This distinction is even more significant in the case of charitable corporations, such as MEETH, where there are no members, because the board is essentially self-perpetuating.¹³⁸

Another potential benefit of the New York Not-For-Profit Corporation Law, is that the Attorney General is a statutory party to petitions involving the disposition of a charitable corporation's assets.¹³⁹ "This is to ensure that the interests of the ultimate beneficiaries of the corporation, the public, are adequately represented and protected from improvident transactions."¹⁴⁰

3. Relevant Kansas Statutes

a. Charitable Organizations and Solicitations Act (COSA), K.S.A. § 17-1760 *et. seq.*

Even though Kansas lacks express statutory authority for the Attorney General to review hospital conversions, the following statutes provide the attorney with an implied authority to review. The Charitable Organizations and Solicitations Act, (COSA) K.S.A. § 17-1760, *et. seq.*, applies to all charitable organizations that solicit funds in the state of Kansas, which includes hospitals organized as nonprofit corporations.¹⁴¹ COSA protects donated funds from being used for purposes other than those stated when the funds were solicited¹⁴² and grants the Attorney General the authority to bring a declaratory judgment action to determine if an act or practice violates the Act.¹⁴³ Violations of COSA pertaining to nonprofit hospitals and conversions include: (1) using charitable donations for purposes other than those stated in the organization's Articles of Incorporation;¹⁴⁴ (2) using donations for purposes other than those stated in the solicitations;¹⁴⁵ and (3) using donations for purposes other than charitable purposes.¹⁴⁶ In *Health Midwest v. Kline*, the Attorney General argued that the use of sale proceeds to create a single out-of-state foundation and to provide executives with excess compensation were both violations of the original purpose of the Articles in soliciting contributions from Kansas residents.

b. Uniform Management of Institutional Funds Act (UMIFA)

Similar to COSA, the Uniform Management of Institutional Funds Act (UMIFA), K.S.A. § 58-3601, *et seq.*, also applies to charitable organizations, including nonprofit hospitals. UMIFA governs the manner in which charitable organizations manage charitable contributions.¹⁴⁷ Under UMIFA, the directors of a nonprofit organization must exercise "ordinary business care" in managing the investment of the organization's funds. In managing such investments, the directors are expected to consider the long and short-term needs of their organization in fulfilling its charitable purposes.¹⁴⁸ When the corporations governing board proposes to modify the purposes to which the charitable fund is devoted, it must obtain consent from the district court and such a proceeding requires the Attorney General's participation.¹⁴⁹ The Attorney

General in *Health Midwest v. Kline* used UMIFA to challenge the creation of a single, out-of-state foundation and excess executive compensation.

**IV. LITIGATION IN HEALTH MIDWEST CONVERSION
(HEALTH MIDWEST v. ATTORNEY GENERAL PHILL KLINE)**

A. Overview

On November 26, 2002, Health Midwest filed a declaratory relief action in the Johnson County District Court against Attorney General Carla Stovall in response to Attorney General Stovall asserting statutory authority to review the sale of Health Midwest to HCA.¹⁵⁰ Attorney General Stovall reacted by filing a counterclaim against Health Midwest, its subsidiaries, and individual board members. In the counterclaim, the Kansas Attorney General petitioned the court to dismiss the members of the Board of Directors of Health Midwest and Health Midwest Johnson County from their positions and to form a Kansas Foundation with the proceeds of the sale of Health Midwest's Kansas charitable assets.¹⁵¹ Attorney General Phill Kline succeeded Stovall in January 2003, and maintained Stovall's position that Kansas was entitled to a separate foundation created from the sale of Health Midwest's Kansas charitable assets and that the Attorney General had the authority to review the transaction. A bench trial commenced on Jan. 27, 2003, in the District Court of Johnson County. The District Court found that a Kansas Foundation was entitled to 20 percent of the proceeds of the assets sold by Health Midwest and the Attorney General had authority to review the transaction. However, the opinion was unclear as to the specific law giving the Attorney General such authority. Health Midwest appealed the District Court's ruling, but before the Kansas Supreme Court had the opportunity to review the District Court's opinion, the parties reached a settlement on March 13, 2003.

B. Arguments

1. Plaintiff (Health Midwest)

During the course of the litigation, Health Midwest contested the Attorney General's authority to prohibit or place conditions on the merger or sale of a nonprofit hospital system's assets.¹⁵² Specifically, Health Midwest attacked the scope of the Attorney General's authority as to the mergers of Kansas nonprofit corporations into Health Midwest¹⁵³ and the sale of assets by Health Midwest to HCA.¹⁵⁴ Health Midwest relied on *Bethany* for the proposition that the sale of a nonprofit hospital system's assets is governed by corporate law and not charitable trust law, thus limiting

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the Attorney General's authority to challenge ultra vires acts and violations of the business judgment rule.¹⁵⁵

Citing *Bethany*, Health Midwest asserted that since Kansas nonprofit corporations are governed by the Kansas Corporate Code,¹⁵⁶ the mergers of Health Midwest's nonprofit hospitals in Kansas¹⁵⁷ into Health Midwest and the subsequent sale of those assets to HCA were also governed by the Kansas Corporate Code.¹⁵⁸ According to Health Midwest, the merger was expressly authorized by K.S.A. §§ 17-6706 and 17-6701. Under K.S.A. § 17-6706, a Kansas nonprofit may merge with another nonprofit corporation in any other state or the District of Columbia as long as the laws of the other jurisdiction permit such a merger.¹⁵⁹ Because Mo. Rev. Stat. § 355.621.1 permits the merger of a Missouri nonprofit corporation into a Kansas nonprofit corporation, Health Midwest argued that K.S.A. § 17-6706 permitted the transfer of assets out of Kansas provided the foreign corporation absorbed the Kansas corporation.¹⁶⁰ Moreover, Health Midwest argued that K.S.A. § 17-6701 would permit the sale of the Kansas nonprofit hospital corporations to another Missouri nonprofit corporation even without the merger.¹⁶¹

Health Midwest further maintained that K.S.A. § 17-6104 is the only statute authorizing the Attorney General to review a sale or merger of a nonprofit corporation.¹⁶² Specifically, Health Midwest noted that K.S.A. § 17-6104 permits the Attorney General to enjoin the "transaction of unauthorized business."¹⁶³ Therefore, Health Midwest reasoned that since the transaction was authorized under K.S.A. §§ 17-6706 and 17-6701, the Attorney General has no statutory authority to review the transaction.¹⁶⁴ Health Midwest claimed that the Attorney General's authority was limited to challenging ultra vires acts or violations of the business judgment rule.¹⁶⁵ Once again, Health Midwest relied on *Bethany*, arguing that corporate law solely governed hospital conversions. Under the business judgment rule, the Attorney General had the burden of proving that the Board of Health Midwest violated their fiduciary duties in approving the transaction with HCA.

2. Defense (Attorney General Phill Kline)

Attorney General Kline's defense focused on three issues. First, the Attorney General asserted that he had both the common law¹⁶⁶ and statutory¹⁶⁷ authority to review the sale of assets by Health Midwest to HCA. Although nonprofit hospitals and systems are governed by statutory nonprofit corporation laws in Kansas, their assets remain subject to principles of charitable trust law, in which the Attorney General has *parens patriae* authority to bring legal actions pertaining to trusts on the behalf of state residents.¹⁶⁸ As discussed earlier, *Queen of Angels* and *Hahnemann* support the assertion of the Attorney General's authority to review hospital conversions.

Moreover, Kansas' *cy pres* statute, COSA, and UMIFA require the Attorney General's participation.¹⁶⁹ Attorney General Kline also distinguished *Bethany* as being inapplicable to this case. Although the ruling in *Bethany* applied corporate law in governing the dissolution of a nonprofit hospital corporation, the Attorney General was a party in the litigation. Kline pointed out that the power of the Attorney General to review the sale was not challenged in *Bethany*, and the district court's opinion reflected the applicability of both corporate law and trust law governing nonprofit hospital conversions.¹⁷⁰

The second issue addressed the responsibility of Health Midwest's executives to uphold their fiduciary duties and avoid violations of COSA. In the opinion of the Attorney General, the Health Midwest Board of Directors violated its fiduciary duties of care, obedience, and loyalty.¹⁷¹ Although Health Midwest may have obtained the highest purchase price through the bidding process it conducted, the Attorney General contended at trial that they violated the duty of care by excluding nonprofit corporations from the bidding process. While nonprofits may not be able to offer as high of a purchase price, the intrinsic value of maintaining nonprofit ownership of the hospital system may make the overall sale more valuable to the community. Also, excluding nonprofit corporations from the bidding process could be construed as a decision to abandon the hospital's mission and primary charitable purpose, which is a violation of the duty of obedience.¹⁷²

The Attorney General argued throughout the litigation that excessive severance packages were awarded to Health Midwest's executives. Health Midwest's CEO received a severance package worth over seven million dollars upon the sale of Health Midwest's hospital assets to HCA,¹⁷³ and Health Midwest's four executive vice presidents and 10 vice presidents received severance packages totaling \$4,495,316.25.¹⁷⁴ In sum, Health Midwest executives received more than 11 million dollars of executive compensation, obtained from the sale of Health Midwest's assets. Thus, millions of dollars, once earmarked for the provision of healthcare to the Greater Kansas City metropolitan area, now reside in the pockets of former Health Midwest executives. The Attorney General argued that the decision to award these "last minute golden parachute payments"¹⁷⁵ were breaches of the directors' fiduciary duties of loyalty and care to the corporation. Moreover, the Attorney General contended that the excessive severance packages constituted a violation of COSA because the severance packages were examples of the misuse of charitable dollars, inconsistent with the use intended and the purpose for which they were solicited.¹⁷⁶ The Attorney General argued that even if he was limited to reviewing the decisions of nonprofit corporate directors under the business judgment rule, the sale should have been enjoined for the violations of fiduciary duties by Health Midwest's Board of Directors.¹⁷⁷

The third issue was the use of the proceeds from the sale. Under Health

Midwest's settlement with Missouri, a single foundation was proposed that neither guaranteed equitable investment in Kansas nor complied with the board membership requirements of Senate Bill 44. The Attorney General presented evidence at trial demonstrating that 20.2 percent of Health Midwest's assets were located in and served Kansas communities. The Attorney General requested the District Court to transfer the Kansas assets into a separate Kansas foundation.

3. District Court's Decision

On Jan. 31, 2003, and following four days of testimony, the District Court issued a ruling. Relying on *Bethany*, Judge Foster ruled that the mergers of the four Kansas subsidiaries into Health Midwest and the sale of Health Midwest's assets to HCA were governed by Kansas corporate law.¹⁷⁸ Moreover, the Court found that charitable trust law and the *cy pres* doctrine did not apply because the Kansas assets were not subject to any specific trust prohibiting their merger or sale.¹⁷⁹ Since the Court applied corporate law, rather than trust law, the Court was bound to presume that the Board of Directors upheld their fiduciary duties under the business judgment rule. Therefore, the Attorney General's authority to review the sale was limited to challenging the Board's business judgment.¹⁸⁰

The Court found neither COSA nor UMIFA applicable to this case. Since COSA applies to "solicited" funds, the Court declared that the funds involved in the case were either generated by the corporation's business or from proceeds from the sale to HCA.¹⁸¹ Therefore, the Court ruled that the severance packages for Health Midwest's executives were not a violation of COSA. Similarly, UMIFA pertains to managed funds and donations, and thus, following the above reasoning also was inapplicable in this case.¹⁸²

According to the Court, Health Midwest and its Kansas subsidiaries satisfied their fiduciary duties in their consideration of the transaction and in their negotiation of the sale price with HCA. However, Judge Foster found that the Attorney General met his burden of proof in challenging Health Midwest's decision to merge into a Missouri Foundation. Judge Foster also declared that the decision was a "perversion of corporate purpose" and that the boards of the Kansas subsidiaries neglected their fiduciary duties to the communities they served.¹⁸³ In order to remedy the Board's negligence, the Court ordered that the net proceeds from the sale attributable to the Kansas corporations remain in Kansas.¹⁸⁴ The Court found 20.2 percent of the assets attributable to the Kansas corporations and the remaining balance would stay in Missouri.¹⁸⁵

4. Appeal to the Supreme Court of Kansas and Settlement

Health Midwest appealed the District Court's decision that Health Midwest Board of Directors breached their fiduciary duties and the "20 percent remedy."¹⁸⁶ Health Midwest settled with the Kansas Attorney General before the appeal was heard. In the Memorandum of Understanding (MOU), Health Midwest agreed that the Attorney General had authority to review the transaction and the Attorney General stated that Health Midwest's Board of Directors exercised sound business judgment.¹⁸⁷ The foundations in Kansas and Missouri were entitled to a 20/80 split of the proceeds from the sale of Health Midwest's assets. In order to expedite the sale of Health Midwest's assets to HCA, the Attorney General agreed to allow the merger of the Kansas corporations into Health Midwest at the time of the closing. On April 1, 2003, Health Midwest closed the sale with HCA.

V. JUSTIFICATIONS FOR A STATUTORY HOSPITAL CONVERSION LAW

Since nonprofit hospitals have no shareholders or "owners," no private party monitors or scrutinizes the actions of hospital directors.¹⁸⁸ Without effective internal mechanisms to guard against corporate directors' improvident use of their hospital system's charitable assets,¹⁸⁹ the community served by the hospital system risks losing large sums of charitable healthcare benefits, which have been entrusted to the community for its residents' access and use. Nonprofit hospital conversions exemplify a decision made by nonprofit corporate directors that may alter the ownership and control of charitable assets that have historically been entrusted to a community. Since the residents of a community have no mechanism to review or enjoin the sale of a nonprofit hospital located in their community, the decisions of nonprofit hospital directors need not be accountable to the community's best interests, which could result in a loss of the community's charitable assets.

Attorneys General in most states use their role as *parens patriae*¹⁹⁰ to justify a review of the sale of nonprofit hospital's assets. This authority is subject to judicial interpretation unless the state has an explicit statute identifying the Attorney General's authority to review hospital conversions.¹⁹¹ In states where the Attorney General does not have express authority to review a hospital conversion, as noted above, the transaction could result in a loss of community assets and a new owner without any obligation to continue the community benefits historically provided by the original hospital.¹⁹² In order to eliminate the risk of this negative outcome, states without hospital conversion statutes¹⁹³ should enact legislation granting their Attorney General at least the legal authority to review a hospital conversion, if not requiring his or her explicit approval. This section outlines four reasons that justify the need for a hospital

conversion statute in Kansas and other states in which the Attorney General does not have explicit statutory authority to review a hospital conversion.

A. Clarifies the Role of the Attorney General

In states without legislation explicitly governing hospital conversions, the Attorney General often intervenes to review the transaction and bases his review authority in charitable trust law. However, the lack of explicit statutory authority leaves the ability of the Attorney General to review hospital conversions up to the courts. Some state courts have applied charitable trust law more favorably to hospital conversions, while others have applied corporate law.¹⁹⁴ Because there is inconsistency in the applicability of corporate versus charitable trust law among state courts, the authority of the Attorney General, without explicit legislation, is ambiguous and limited. The only way to guarantee that the Attorney General has the power to review the sale or merger of a nonprofit hospital and protect communities from losing charitable assets in a conversion is to enact hospital conversion legislation.

B. Provides Corporate Accountability to Compensate for the Absence of Shareholders

In many states, such as Kansas, nonprofit corporations operate through structures designed for investor-owned (for-profit) corporations. With an investor-owned corporation, shareholders may take a derivative action suit against the corporation's board members for violating corporate purposes. Derivative action suits make corporate boards of directors accountable to the interest of their shareholders and ensure that directors make provident decisions.¹⁹⁵

The owners of a nonprofit hospital corporation are essentially the residents of the community the hospital serves because they are the ultimate beneficiaries of the hospital's services. However, community residents are not owners in the traditional sense because they do not hold shares of ownership in the corporation, nor do they have the power to file a derivative action suit against the nonprofit corporation's board. Hospital conversion legislation incorporating Attorney General review ensures that nonprofit hospital directors are held accountable to another authority for making improvident decisions that are not in the community's best interests.

When the review authority of the Attorney General is unclear in hospital conversions, the legal mechanism to ensure that corporate directors are upholding their fiduciary duties to the community they serve is non-existent. Corporate law protects shareholders' interests in decisions made by investor-owned corporations, but it fails to protect community interests in decisions made by nonprofit corporations. Without

Attorney General review, nonprofit hospital directors are impervious to community interests and may make decisions against the best interests of the community and corporation with little legal scrutiny. Nonprofit hospital conversions can be beneficial to communities, but there is no way to ensure that conversions have positive effects without some government oversight ensuring community interests are protected and represented.¹⁹⁶

Applying corporate law to nonprofit hospital conversions fails to prevent corporate directors from receiving excessive compensation packages or “golden parachutes”¹⁹⁷ upon the sale of the nonprofit hospital corporation. Golden parachutes present conflicts of interests for nonprofit board members because they essentially function as financial rewards for selling the corporation’s assets. Financial windfalls such as the ones received by the Health Midwest executives also demonstrate that the vision of the Health Midwest executives may have been skewed to favor the decision to sell Health Midwest’s assets rather than explore other available alternatives. Without explicit authority to review the sale of hospital conversions, the Attorney General cannot protect community assets from going into the pockets of nonprofit executives and corporate directors will not face consequences for the looting of a nonprofit corporation.

C. Protects Charitable Assets from Leaving the State

Losing control and ownership of Kansas charitable assets was a significant concern for the Kansas Attorney General in the Health Midwest review and underscores the need for a hospital conversion statute in the state of Kansas. If the Health Midwest transaction had not resulted in the 20/80 split, Kansas would have lost more than \$100 million in funding for a health foundation. Thus, it is imperative the state legislature clarifies the Attorney General’s authority to review such transactions.¹⁹⁸

Although the Health Midwest conversion is unique because Health Midwest held charitable assets in two states, losing charitable assets to other states should be a relevant concern to the Kansas legislature. On Dec. 4, 2002, the board of directors of The Menninger Clinic, a nonprofit psychiatric hospital located in Topeka, Kansas, approved a plan to move to Houston, Texas, where it would form a partnership with Baylor College of Medicine and The Methodist Hospital.¹⁹⁹ Although Menninger’s move did not involve the sale of a nonprofit hospital to an investor-owned corporation, it did, however, concern the movement of charitable assets outside the state of Kansas.²⁰⁰

Unlike Health Midwest, the board of directors of Menninger submitted its proposal to the Office of the Kansas Attorney General and submitted to his jurisdiction

in order to review the plan to move.²⁰¹ After the review, a Kansas charitable foundation was created to provide mental-health services to low income and uninsured residents of Kansas. By allowing the Attorney General authority to review the transaction, Menninger avoided litigation costs and preserved the original purpose of Menninger's assets in Kansas. However, Menninger's decision to cooperate is not precedent for other nonprofit corporations. In order to ensure that other nonprofit corporations follow Menninger's responsible actions, the Kansas Legislature should enact a hospital conversion statute.

D. Advantage of Statutory Law to Common Law

In states without hospital conversion statutes, most of the authority to review a nonprofit hospital conversion is grounded in common law. When courts decide cases using common law, judges apply their interpretations of relevant decisions from past cases to formulate their rulings.²⁰²

While common law is flexible and permits broad judicial interpretation, statutory law is more rigid and is created by legislatures to be applied by the courts. Statutory law creates a legal framework that the courts are supposed to follow when rendering decisions in legal proceedings. Statutes explicitly state laws and are created to address a legal issue before it transpires. Moreover, legal issues that are governed by explicit statutes tend to have less litigation than issues governed by common law.²⁰³ In Health Midwest, litigation could have been avoided if the Kansas Legislature had previously enacted a hospital conversion statute, which would have settled the dispute over whether hospital conversions are governed by charitable trust law or corporate law, and clarified the authority of the Attorney General to review the sale of Health Midwest to HCA.

VI. STATUTORY LAWS AND MODELS FOR HOSPITAL CONVERSIONS

In response to the increase in hospital conversions throughout the country and the lack of explicit legal oversight of hospital conversions, many states have enacted hospital conversion legislation.²⁰⁴ The purpose of these laws is not to prohibit hospital conversions, but rather to ensure that the conversion to an investor-owned corporation is the best or a necessary option for a nonprofit hospital and the community.²⁰⁵ Nonprofit hospitals generally provide community benefits worth more than their tax exemptions, which suggests that nonprofit ownership of hospitals has value.²⁰⁶ The benefits that a nonprofit hospital provides to a community may be lost in a conversion without effective oversight. According to health policy experts from Georgetown and Brandeis Universities, "a review of the conversion experience reveals that effective

oversight can make the difference between a beneficial or detrimental conversion.”²⁰⁷ States like Rhode Island, Nebraska, and California have developed both comprehensive and effective hospital conversion statutes. States such as Kansas, which lack an explicit legal framework to review hospital conversions, would benefit from enacting similar legislation. The following sections address issues that state legislators should consider in drafting a hospital conversion statute and provide a review of practical hospital conversion statutes enacted in other states.

A. General Guidelines for Hospital Conversion Legislation

All hospital conversion statutes contain the following elements: (1) specification of the state’s authority to oversee and review a hospital conversion transaction; (2) definition of the procedure for review of a hospital conversion; and (3) identification of the types of transactions the statute covers.²⁰⁸ In most states, the authority to review a hospital conversion is granted to the Attorney General; however, other parties like state health agencies may also be granted this power or share it with the Attorney General.²⁰⁹ The scope of the reviewing authority ranges from notification to approval, meaning that the transaction either requires notification to the reviewing authority within a certain time period or it requires the reviewing authority’s approval in order to close the transaction. Although notification requirements give the states some legal oversight in the conversion, they may not be sufficient to protect community charitable assets. Unless the statute explicitly defines a legal transaction and provides protection of charitable assets, a notification requirement will not be sufficient. Requiring the Attorney General and/or the director of the state’s health department to approve the conversion ensures that community interests and assets are protected.

The primary purpose of a hospital conversion statute is to define a procedure for state oversight and review of the transaction.²¹⁰ After the statute defines the authority of the state to review hospital conversions, it should establish a notification process, which includes the time frame for notification and the necessary documentation that the parties involved in the conversion must submit to the state’s review authority.²¹¹ In states that require approval by the Attorney General or other state officials, hospital conversion statutes should establish a set of guidelines for the Attorney General to adhere to in his/her review of the hospital conversion and the standards for an acceptable conversion.

First, the Attorney General should review the valuation and terms of the transaction, which should include, *inter alia*, a review of the bidding process, the valuation process, the management contracts, the parties involved in the transaction, and the seller valuation of the sale price by an independent expert.²¹² Second, the

Attorney General or relevant state authority must ensure in his/her review that the nonprofit hospital's board of directors did not breach any of its fiduciary duties in the sale of the corporation's hospital assets.²¹³ Last, the oversight process should include a requirement assuring that access to care and services for the indigent are sustained.²¹⁴

Other elements state legislators should consider in drafting a hospital conversion statute include: (1) public disclosure of the conversion; (2) a public hearing requirement; (3) how the sale proceeds must be employed; (4) compliance or monitoring provisions; (5) requiring referral to other state agencies or making it an option; (6) a resale provision or right of first refusal for the seller of the hospital; and (7) guidelines for the imposition of remedies and penalties.²¹⁵

B. NAAG Model Hospital Conversions Act

The National Association of Attorneys General (NAAG) adopted a resolution in 1997 to address the problems associated with the increasing rate of nonprofit hospital conversion transactions that occurred in the years preceding the resolution.²¹⁶ The purpose of the resolution was to attract the attention of state legislators and focus the attention on protecting charitable assets in conversion transactions,²¹⁷ as well as, to encourage legislators to grant their states' Attorney General the authority to review these transactions.²¹⁸

The NAAG drafted the Model Act for Nonprofit Healthcare Conversion Transactions, which adhered to preceding provisions and released this document on March 31, 1998. The Model Act applies only to nonprofit healthcare conversions²¹⁹ and requires all nonprofit healthcare entities to notify the Attorney General and obtain his/her approval prior to entering a nonprofit healthcare conversion transaction.²²⁰ The Attorney General has 90 days from the written notification to make his/her decision to approve or disapprove the transaction²²¹ and must conduct at least one public meeting held in the county where the nonprofit healthcare entity's assets are located.²²²

The Model Act also outlines the elements that the Attorney General should consider in reviewing and making the decision to approve or disapprove the transaction. The Attorney General must determine whether the nonprofit hospital received "full and fair market value for its charitable and social welfare assets"²²³ and whether value of the hospital's assets have been manipulated to decrease its fair market value.²²⁴ Also, the Attorney General must consider whether the intended use of the proceeds from the proposed transaction is "consistent with the trust under which the assets [were] held by the nonprofit healthcare entity."²²⁵ Under the Model Act, the Attorney General must determine whether any fiduciary duties, like conflicts of interests, have been violated by the members of the governing board,²²⁶ whether the board exercised due diligence in deciding to undergo the proposed transaction,²²⁷ and

whether the conversion would result in private inurement to any person.²²⁸ Last, the Model Act suggests that “any foundation established to hold the proceeds of the sale will be broadly based in the community and be representative of the affected community, taking into consideration the structure and governance of such foundation.”²²⁹ Therefore, if Kansas had adopted the Model Act for Nonprofit Healthcare Conversion Transactions before the Health Midwest conversion, Attorney General Kline would have had the explicit authority not only to review the transaction but also to ensure that the proceeds from the sale of Health Midwest remained in Kansas under the authority of a Kansas foundation. Instead, the Kansas foundation occurred as a result of a controversial judicial ruling.

Some other important provisions included in the Model Act are reimbursements from nonprofit healthcare entities for the expenses incurred in the review of these conversion transactions²³⁰ and the infliction of penalties and remedies on nonprofit healthcare entities for any violations of the notice, review, or approval requirements in the Model Act.²³¹ The Model Act also makes all documents submitted to the Attorney General for his/her review of the transaction public record.²³² The NAAG Model Act for Nonprofit Healthcare Conversion Transactions is a useful guideline for states to use in drafting a nonprofit hospital conversion law and legislators can amend the Model Act to tailor it to their state laws and preferences. The adoption of legislation similar to this act would have simplified the legal process accompanying the Health Midwest conversion and circumvented expensive and time-consuming litigation.

C. State-Specific Statutory Laws

In reaction to the increasing trend of hospital conversions, many states have enacted legislation to increase oversight and authority of governmental officials²³³ in order to protect community assets from leaving the hands of the state and its affected residents.²³⁴ However, state hospital conversion statutes most notably vary in the purview of the Attorney General’s review authority, in the types of transactions they cover, and in the involvement of other state agencies in the review process. More than 20 states, including the District of Columbia, have enacted hospital conversion statutes. California, Nebraska, and Rhode Island provide good examples that demonstrate the variation among state hospital conversion laws. For instance, Rhode Island has one of the most restrictive hospital conversion statutes in the nation.²³⁵ The hospital conversion statutes in California and Nebraska, on the other hand, require approval by the states’ review authorities and have reasonable restrictions. However, Nebraska provides specific penalties for failing to comply with the state’s hospital conversion laws and includes the health policy expertise of the state’s health department.

1. California

In California, nonprofit hospital conversions are governed under the California Corporations Code, which has a section devoted to the sale of assets for nonprofit public benefit corporations.²³⁶ Under CA. Corp. § 5914, any nonprofit corporation that controls or operates a health facility in California must notify and obtain the consent of the Attorney General prior to entering into an agreement or transaction that involves the sale, transfer, lease, or other disposal of a material amount of its assets to a for-profit or mutual benefit corporation.²³⁷ The Attorney General must notify the nonprofit healthcare corporation of his/her decision within 60 days of notification to the Attorney General's Office, which may be extended by an additional 45 day period in special circumstances.²³⁸ Before the Attorney General issues a decision, he or she must conduct one or more public meetings in the counties where the healthcare facilities are located.²³⁹ Section 5917 outlines the considerations the Attorney General should take in reviewing the transaction, which include the terms and conditions of the sale, the valuation of the healthcare corporation's assets, the proposed use of the sale proceeds, the effect on the community's healthcare services, private inurement, breaches of trust, and the public's best interests.²⁴⁰

2. Nebraska

In Nebraska, a nonprofit hospital corporation must notify and receive approval from the Attorney General and the Department of Health and Human Services Regulation and Licensure prior to "any purchase, merger, lease, gift, or otherwise, which results in a change of ownership or control of twenty percent or greater or which results in the acquiring person or persons holding a fifty percent or greater interest in the ownership or control of a hospital."²⁴¹ The Attorney General must determine whether to review the transaction within 20 days of notification from the nonprofit hospital corporation.²⁴² If the Attorney General decides to review the transaction, he/she has 60 days after the original notification from the nonprofit hospital corporation to approve or disapprove the transaction. Moreover, the Attorney General is required to hold a public hearing no later than 30 days after notification of the transaction from the nonprofit hospital corporation.²⁴³

Nebraska's Nonprofit Hospital Sale Act gives the Attorney General the power to deny a conversion if the Attorney General finds that the conversion is not in the public's interest. In determining whether the conversion is in the public interest, the Attorney General considers the following: (1) due diligence in deciding to sell the hospital by its governing board; (2) the use of expert assistance by the board in making its decision; (3) conflicts of interests; (4) fair market valuation of assets; (5) value of

management compensation packages; and (6) the proposed use of the sale proceeds.²⁴⁴ The Department of Health also has approval standards, which include community access to affordable healthcare and the commitment to provide healthcare services to the indigent.²⁴⁵ In order to ensure that the acquiring corporation is satisfying its commitment to the affected community's general health interests, the Department of Health has the authority to revoke the corporation's license to operate the hospital.²⁴⁶ Moreover, the Attorney General has the authority to ensure compliance with the commitments set in the conversion agreement.²⁴⁷

Nebraska's Nonprofit Hospital Sale Act is more comprehensive than California's hospital conversion laws because it grants the review authorities the right to ensure compliance and specifies legal penalties for noncompliance in conversion transactions. Not only does Nebraska's conversion statute grant the review authorities the power to ensure compliance with the terms of the conversion transaction but it also requires the state to refuse to issue or to revoke a license to operate a hospital if the conversion occurs without the approval of both the Attorney General and the Department of Health. California's statutes do not specify penalties for nonprofit hospitals that perform a conversion transaction without the consent of the state's review authority. The lack of statutory penalties leaves the power to decide the penalty for circumventing approval to the courts. Because legislators have access to policy experts and information, the court system is not the best governing body to issue penalties for noncompliance with state hospital conversion laws. Therefore, Nebraska's Nonprofit Hospital Sale Act better governs the nonprofit hospital conversions than California's laws.

3. Rhode Island

The Rhode Island Hospital Conversion Act shares all of the same basic elements of Nebraska's Nonprofit Hospital Sale Act in governing nonprofit hospital conversion transactions except that it is more comprehensive and restrictive. The Rhode Island statute requires approval for a nonprofit hospital conversion from both the Attorney General and the Department of Health, like the Nebraska law.²⁴⁸ However, the Rhode Island statute also governs conversions between nonprofit corporations²⁴⁹ and conversions involving a for-profit hospital as the acquiree and either a nonprofit or for-profit corporation as the acquiror.²⁵⁰ However, conversions involving a for-profit hospital as the acquiree are only reviewed by the Department of Health.²⁵¹ The Attorney General and the Department of Health consider the same basic principles in the Rhode Island statute as they do in Nebraska's Nonprofit Hospital Sale Act, but the Rhode Island statute provides detailed guidance of all

aspects of a hospital conversion, from an explanation of the hospital board's fiduciary duties to excessive compensation packages for executives.²⁵²

Rhode Island's statute may be too restrictive in that it bans, for at least three years after the initial conversion, approval of a second conversion by a for-profit buyer.²⁵³

The above restriction notwithstanding, the Rhode Island statute does have some beneficial provisions. First, it specifies penalties for violations of the statute,²⁵⁴ and second, it has a compliance provision for community needs standards and charitable care, which is monitored by the Department of Health.²⁵⁵ Moreover, the statute provides whistleblower protection for workers who provide information to the Director of the Department of Health or the Attorney General regarding a violation of the state's hospital conversion laws.²⁵⁶ The Rhode Island Hospital Conversion Act also ensures a fair review by the Attorney General and the Department of Health because it allows the parties involved in the conversion to seek judicial review.²⁵⁷ Last, and most importantly, the Rhode Island statute provides detailed guidelines for the establishment of a foundation from the proceeds from the conversion and the power and duties of the foundation's board.²⁵⁸

CONCLUSION

Because nonprofit hospital conversion transactions in Kansas lack explicit statutory governance, nonprofit hospital conversions place charitable and affordable healthcare services at substantial risk for Kansas residents. When Health Midwest sold its hospital assets to HCA for \$1.125 billion, no legal provision guaranteed that the percentage of these proceeds attributable to Health Midwest's Kansas hospital assets had to remain in the state. Fortunately for the residents of Kansas, the District Court applied the 20/80 split. However, the District Court believed it was not empowered to consider whether the compensation packages of Health Midwest's executives were excessive. This ruling allowed millions of dollars to fall into the pockets of a privileged few from funds dedicated toward a charitable purpose.

The need for a nonprofit hospital conversion statute in the state of Kansas is not only evident from the Health Midwest litigation, but such a statute would also safeguard Kansas's charitable healthcare assets from private inurement and from leaving the state. In order for the Kansas Legislature to draft the most effective hospital conversion statute, state legislators should use the NAAG Model Hospital Conversions Act, Nebraska's Nonprofit Hospital Sale Act, and Rhode Island's Hospital Conversion Act as guidelines for creating a Kansas statute.

The NAAG Model Act provides a complete overview of the purpose of such legislation, thus informing Kansas legislators of the general legal and policy aspects

that should be addressed in drafting a conversion statute. Although Rhode Island's Hospital Conversion Act may be more restrictive than is desired in Kansas, the statute contains detailed provisions that legislators could adopt for the provisions they wish to include in the legislation. Nebraska's Nonprofit Hospital Sale Act is less detailed than the Rhode Island statute but the purview of the legislation is more in tune with the needs of nonprofit hospital governance in the state of Kansas. In conclusion, nonprofit hospital conversion legislation that fits the legal and health policy needs of Kansas should use the background of the NAAG Model Hospital Conversions Act, the framework of the Nebraska conversion statute and the detail of comparable provisions of the Rhode Island Hospital Conversion Act. Until the Kansas Legislature enacts such legislation governing nonprofit hospital conversion transactions, affected community access to affordable and charitable healthcare services in Kansas will be endangered in the event of another nonprofit hospital conversion.

Notes

1. Phill Kline was elected as the 41st Attorney General of Kansas in November 2002. A native of Kansas City, Kansas, Kline graduated from Central Missouri State University and the University of Kansas School of Law. He served in the Kansas Legislature for eight years, during which time he chaired the taxation and appropriations committees. Kline is an active member of the National Association of Attorneys General and was recently elected to serve as the Chairman of the Republican Attorneys General Association.
2. Robert T. Stephan served as Kansas Attorney General from 1979 until 1995. He served as District Court Judge of Sedgwick County for 13 years prior to being elected as Attorney General. Stephan is a past President of the National Association of Attorneys General. He served as President of the Overland Park Rotary Club during 2002-2003. Stephan was appointed as a Special Assistant Attorney General representing the State of Kansas in the review of the sale of Health Midwest to HCA, Inc.
3. Reid Holbrook received his AB in Economics from the University of Kansas and his Juris Doctor from the University of Kansas School of Law. He is admitted to practice in Kansas, Missouri and the District of Columbia. He is a Past President of the Kansas City Society of Hospital Attorneys, the Kansas Association of Hospital Attorneys and a former Chairman of the Medicine and Law Committee of the American Bar Association. He is a member of the Bench/Bar Committee of the Kansas Bar Association and a partner in the firm of Holbrook & Osborn, P.A. located in Kansas City and Overland Park, Kansas. He served as Special Assistant Attorney General representing the State of Kansas in the review of the sale of Health Midwest to HCA, Inc.
4. The authors wish to gratefully acknowledge the significant contribution to this article from Frankie J. Forbes, Holbrook & Osborn, P.A., JD, MBA, University of Kansas, 2001 and Christopher A. Williams, B.S. in Economics, A.B. in Public Policy Studies, Duke University.
5. *See generally* DUKE UNIVERSITY, CENTER FOR HEALTH POLICY, LAW AND MANAGEMENT, A GUIDE FOR COMMUNITIES CONSIDERING HOSPITAL CONVERSION IN THE CAROLINAS (May 1998), *available*

- at <http://www.hpolicy.duke.edu/cyberexchange/conversion/gchap1.html#3bak> [hereinafter DUKE GUIDE].
6. *Id.* at 1.
 7. *Id.*
 8. *See generally* VOLUNTEER TRUSTEES, THE SALE AND CONVERSION OF NOT-FOR-PROFIT HOSPITALS: A STATE-BY-STATE ANALYSIS OF NEW LEGISLATION, *available at* <http://www.volunteertrustees.org/hospitals/intro.html> (last visited Mar. 2004) [hereinafter VOLUNTEER TRUSTEES ANALYSIS].
 9. *See generally* DAVID SHACTMAN & ANDREA FISHMAN, COUNCIL ON THE ECONOMIC IMPACT OF HEALTH SYSTEM CHANGE, STATE REGULATION OF HEALTH INDUSTRY CONVERSIONS FROM NOT-FOR-PROFIT TO FOR-PROFIT STATUS (1996), *available at* <http://www.sihp.brandeis.edu/council/pubs/statereg.pdf>. In order to understand the magnitude of the Health Midwest/HCA conversion, the total value of all hospital assets that were sold or joint ventured with investor-owned health systems in the U.S. in 1996 was \$1.6 billion dollars. JILL R. HORWITZ, HARVARD UNIVERSITY, STATE OVERSIGHT OF HOSPITAL CONVERSIONS: PRESERVING TRUST OR PROTECTING HEALTH? 5 (The Hauser Center for Nonprofit Organizations, Working Paper No. 10, 1998), *available at* http://www.ksghauser.harvard.edu/active_backup/PDF_XLS/workingpaper_10.pdf (last visited March 2004).
 10. *See* VOLUNTEER TRUSTEES ANALYSIS, *supra* note 8. This purpose is vested in the concept of *parens patriae* authority for Attorneys General.
 11. Investor-owned hospitals may threaten charitable care in various ways: through higher prices, failing to provide care for the indigent, and by reducing the quality of care for those less able to afford healthcare.
 12. *See* VOLUNTEER TRUSTEES ANALYSIS, *supra* note 8.
 13. In 1997, the Kansas Senate attempted and failed to pass Senate Bill No. 372 and the Kansas House of Representatives attempted and failed to pass House Bill No. 2628. In 2003, the Kansas State Senate passed Senate Bill No. 44, which was found to be unconstitutional by the trial court in *Health Midwest v. Kline*, Case No. 02-CV-08043, in Johnson County, Kansas, District Court.
 14. An integrated healthcare delivery system implies that Health Midwest is the parent organization of a hierarchical corporate system composed of subsidiary organizations that manage medical-service oriented activities. Health Midwest consisted of five nonprofit organizations (Health Midwest Central Region, Health Midwest Johnson County, Health Midwest Eastern Region, Health Midwest Development Group, and Health Midwest Partners for Change) and one investor-owned organization (Health Midwest Ventures Group). Health Midwest Central Region, Development Group, Johnson County, Eastern Region, and Ventures Group owned and operated hospitals or centers that provided medical-related services. Health Midwest Partners for Change concentrated on economic redevelopment in its central operating regions.
 15. *See* HORWITZ, *supra* note 9, at 7.
 16. KAN. STAT. ANN. § 79-201b (2002).
 17. Department of Justice, "Largest Health Care Fraud Case in U.S. History Settled HCA Investigations Nets Record Total for \$1.7 Billion" (June 26, 2003), *available at* http://www.usdoj.gov/opa/pr/2003/June/03_civ_386.htm.
 18. Allen County Hospital (Iola), Menorah Medical Center (Overland Park), and Overland Park Regional Medical Center (Overland Park) belonged to Health Midwest before the conversion to

- HCA. Trinity Lutheran Manor (a 120 bed nursing home in Merriam) was also part of the conversion. Surgicare of Wichita, and Wesley Medical Center (Wichita) were owned by HCA prior to the conversion.
19. Journal Entry of Judgment: Findings of Fact at ¶ 69(a), *Health Midwest v. Kline*, No. 02 CV 08043 (D. Kan. Feb. 7, 2003).
 20. *Id.* at ¶ 69(b).
 21. *Id.* at ¶¶ 69-73.
 22. *Id.* at ¶¶ 58-63, 68.
 23. *Id.* at ¶¶ 73, 74.
 24. *Id.* at ¶ 82.
 25. *Id.* at ¶ 89.
 26. Carla J. Stovall was serving as Attorney General in Kansas at the beginning of the suit. Phill Kline succeeded her on Jan. 13, 2003. Jeremiah Nixon was the Attorney General of Missouri throughout the litigation in Missouri.
 27. The MOU between Health Midwest and the Missouri Attorney General established a nineteen-member board to which the Missouri Attorney General made all the appointments. The new foundation's board would consist of 15 Missouri residents and four Kansas residents. See Memorandum of Understanding, *Health Midwest v. Kline*, No. 02 CV 08043 (D. Kan. Feb. 7, 2003) (on file with authors).
 28. DUKE GUIDE *supra* note 5, at 17.
 29. *See id.*
 30. *Id.* at 16.
 31. See Elaine M. Silverman et al., *The Association Between For-Profit Hospital Ownership and Increased Medicare Spending*, 341 NEW ENG. J. MED. 420 (1999). See also Press Release, Physicians for a National Health Program, New England Journal of Medicine Editorial Says Evidence Against For-Profit Hospitals Now Conclusive (Aug. 4, 1999), available at http://www.pnhp.org/news/1999/august/new_england_journal_.php (last visited March 2004) [hereinafter Physicians Press Release] (discussing a study of the effects of for-profit hospital ownership).
 32. PUBLIC SECTOR CONSULTANTS, INC., MICHIGAN IN BRIEF, HOSPITAL HEALTH PLAN CONVERSIONS (1998), available at <http://www.michiganinbrief.org/edition06/text/issues/issue-34.htm>.
 33. *Id.*
 34. See DUKE GUIDE, *supra* note 5, at 16. A 1995 Kaiser Family Foundation poll found that 70 percent of Americans prefer local control to a national chain (regardless of ownership type). *Id.*
 35. See DUKE GUIDE, *supra* note 5.
 36. With the exception of Allen County Hospital.
 37. DUKE GUIDE, *supra* note 5, at 7.
 38. *Id.*
 39. States (including D.C.) that have enacted hospital conversion legislation include: Arizona, California, Colorado, Connecticut, the District of Columbia, Georgia, Hawaii, Idaho, Louisiana, Maine, Maryland, Massachusetts, Nebraska, New Hampshire, New Jersey, Ohio, Oregon, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin.
 40. Gary Claxton et al., *Public Policy Issues In Nonprofit Conversions: An Overview*, 16 HEALTH AFF. 9, 15-17 (1997). Community benefits that nonprofit hospitals historically provide include charity care, relieving people of bad debt, losses from serving public programs enrollees and subsidizing

- community services, lower prices, research and education, and community needs assessment, education, and service programs. *Id.*
41. *See* Silverman, *supra* note 31. *See also* Physicians Press Release, *supra* note 31 (discussing a study of the effects of for-profit hospital ownership).
 42. Physicians Press Release, *supra* note 31.
 43. *Id.*
 44. *Id.* A study has concluded that for-profit hospitals in 1995 cost Medicare \$5.2 billion, which was an additional \$732 per enrollee. *See* Silverman, *supra* note 31.
 45. Physicians Press Release, *supra* note 31. *See* Silverman, *supra* note 31.
 46. After settling lawsuits with Tenet Healthcare Corp., regarding their billing and collection practices toward uninsured patients, Consejo de Latinos Unidos is turning their focus to HCA. *After Tenet Settlement, Civic Group Takes Aim at HCA* NASHVILLE BUS. J., Jan. 28, 2003, at <http://nashville.bizjournals.com/nashville/stories/2003/01/27/daily18.html>.
 47. *See* Karin Miller, *Hispanic Advocacy Group Investigating HCA's Treatment of Uninsured Patients*, NAPLES DAILY NEWS, Feb. 22, 2003.
 48. Marsha Austin, *Uninsured Pay Higher Price: Hospital Collection Agents Demand Full Cost of Care*, DENVER POST, Jan. 28, 2003, available at <http://www.cohealthinitiative.org/Uninsuredpayhigherprice.htm>.
 49. *See* Miller, *supra* note 47.
 50. Austin, *supra* note 48.
 51. States (including D.C.) that have enacted hospital conversion legislation include: Arizona, California, Colorado, Connecticut, the District of Columbia, Georgia, Hawaii, Idaho, Louisiana, Maine, Maryland, Massachusetts, Nebraska, New Hampshire, New Jersey, Ohio, Oregon, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin.
 52. VOLUNTEER TRUSTEES ANALYSIS, *supra* note 8.
 53. *Id.* Part I, available at <http://www.volunteertrustees.org/hospitals/pt1.html> (last visited Mar. 2004).
 54. *See* HORWITZ, *supra* note 9, at 14-15.
 55. *See generally* Kan. East Conference of the United Methodist Church, Inc. v. Bethany Med. Ctr., 969 P.2d 859 (Kan. 1998).
 56. *See* HORWITZ, *supra* note 9, at 14.
 57. *See generally* RESTATEMENT (SECOND) OF TRUSTS; Common law *cy pres* doctrine.
 58. RESTATEMENT (SECOND) OF TRUSTS § 348(1959).
 59. *Id.* at cmt. f.
 60. *Id.*
 61. *See id.*
 62. *Id.*
 63. *See generally* RESTATEMENT (SECOND) OF TRUSTS § 372 (1959) (stating “[a] trust for the promotion of health is charitable.”); RESTATEMENT (SECOND) OF TRUSTS § 376 (1959) (stating “[a] trust is not a charitable trust if the property or the income therefrom is to be devoted to a private use.”).
 64. *See* RESTATEMENT (SECOND) OF TRUSTS § 372 (1959). The comment to § 372 states: “a trust to establish or maintain a hospital . . . is charitable.” *Id.* at cmt. a.
 65. RESTATEMENT (SECOND) OF TRUSTS § 376 (1959).
 66. Funds donated by a restricted trust are governed by charitable trust law and are charitable in purpose and so are unrestricted donations. *See generally* Attorney Gen. v. Hahnemann Hosp., 494 N.E.2d 1011 (Mass. 1986).

67. See HORWITZ, *supra* note 9, at 15.
68. See Rachel B. Rubin, *Nonprofit Hospital Conversions in Kansas: The Kansas Attorney General Should Regulate All Nonprofit Hospital Sales*, 47 KAN. L. REV. 521, 534 (1999).
69. See KAN. STAT. ANN. § 59-22a01 (2002). The applicable portions of the statute reads:
“If a trust for charity is or becomes illegal or impossible or impracticable of fulfillment or if a devise or bequest for charity, at the time it was intended to become effective is illegal or impossible or impracticable of fulfillment, and if the settlor or testator, manifested a general intention to devote the property to charity, any judge, on application of any trustee, executor, administrator, any interested party or the attorney general, may order an administration of the trust, devise or bequest as nearly as possible to fulfill the manifested general charitable intention of the settler or testator. In every such proceeding, the attorney general, as representative of the public interest, shall be notified and given an opportunity to be heard.” *Id.*
70. ROBERT A. BOISTURE & DOUGLAS N. VARLEY, VOLUNTEER TRUSTEES, STATE ATTORNEY’S GENERAL’S LEGAL AUTHORITY TO POLICE THE SALES OF NONPROFIT HOSPITALS AND HMOs (1995) available at <http://www.volunteertrustees.org/legal.html> (last visited March 2004) [hereinafter BOISTURE].
71. *Id.*
72. See generally RESTATEMENT (SECOND) OF TRUSTS (1959). Furthermore, nonprofit hospitals are exempt from federal taxes under § 501(c)(3) because the Internal Revenue Service generally considers healthcare to qualify as a charitable purpose.
73. See BOISTURE, *supra* note 70.
74. *Queen of Angels Hosp. v. Younger*, 136 Cal. Rptr. 36 (Cal. Ct. App. 1977).
75. *Attorney Gen. v. Hahnemann Hosp.*, 494 N.E.2d 1011 (Mass. 1986).
76. Daniel W. Coyne & Kathleen Russell Kas, *The Not-For-Profit Hospital as a Charitable Trust: To Whom Does Its Value Belong?*, 24 J. HEALTH L. 48 (1991) [hereinafter Coyne].
77. HORWITZ, *supra* note 9, at 19.
78. See Rubin, *supra* note 68, at 540.
79. See generally Coyne, *supra* note 76, at 50 (citing *Queen of Angels Hosp. v. Younger*, 136 Cal. Rptr. 36 (Cal. Ct. App. 1977)).
80. See *id.* W.D.C. Services, Inc. was a proprietary organization, or for-profit entity. *Id.*
81. *Id.*
82. *Id.*
83. *Queen of Angels Hosp. v. Younger*, 136 Cal. Rptr. 36, 38 (Cal. Ct. App. 1977). See also Rubin, *supra* note 68, at 541.
84. See Coyne, *supra* note 76, at 50.
85. Rubin, *supra* note 68, at 541.
86. Coyne, *supra* note 76, at 50. See also *Queen of Angels*, 136 Cal. Rptr. at 41.
87. Rubin, *supra* note 68, at 544. See also *Attorney Gen. v. Hahnemann Hosp.*, 494 N.E.2d 1011 (Mass. 1986)
88. See Coyne, *supra* note 76, at 51.
89. Rubin, *supra* note 68, at 544-45.
90. Coyne, *supra* note 76, at 51. The amendment to Hahnemann’s articles of incorporation broadened its corporate purposes to include: “Participating in any activity that promotes the health of the general public, including making distributions to organizations that qualify as exempt organizations

- under section 501(c)(3) of the Internal Revenue Code.” The original bylaws of the corporation included a provision that the A[bylaws shall never be so amended as to be inconsistent therewith provisions of the Converse Trust.” *Attorney Gen. v. Hahnemann Hosp.*, 494 N.E.2d at 1015.
91. *See* Coyne, *supra* note 76, at 55. The five major issues in *Attorney General v. Hahnemann Hospital* were “1) whether Hahnemann Hospital’s board was legally authorized to sell the hospital’s assets; 2) whether the board violated its fiduciary duty by amending the articles of organization to authorize the sale of the hospital’s assets; 3) whether the board violated its fiduciary duty by selling all the hospital’s assets; 4) whether the sale of the hospital’s assets constituted a closing of the affairs of a charitable corporation for which the board would violate its fiduciary duty if they did not file a petition for dissolution; and 5) whether the hospital board would violate its fiduciary duty by using any proceeds from the sale of the hospital’s assets for new purposes.” *Id.*
92. *Id.* at 51.
93. *See* Rubin, *supra* note 68, at 546.
94. Coyne, *supra* note 76, at 51.
95. *Id.*
96. *Id.*
97. *See* HORWITZ, *supra* note 9, at 147.
98. *See* KAN. STAT. ANN. § 17-1701 (2002).
99. *See* Rubin, *supra* note 68, at 547.
100. *Id.*
101. *Id.*
102. *See* Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985). The Kansas Corporate Code is based on the Delaware Corporate Code so Delaware case law is an instructive authority.
103. Gray v. Manhattan Med. Ctr., 18 P.3d 291, 297 (Kan. Ct. App. 2001).
104. MICHAEL W. PEREGRINE, COALITION FOR NONPROFIT HEALTHCARE, OVERVIEW OF STATE LAW CHALLENGES TO NONPROFITS 3 (2001) [hereinafter PEREGRINE].
105. *Id.*
106. *See* Rubin, *supra* note 68, at 549 (ascertaining the value of the hospitals assets requires A an independent appraisal from an expert in the field”).
107. “A lower bid may be accepted if the choice was based on the belief that the bidder would provide a higher level of care and service to the community.” *Id.*
108. *See id.*
109. PEREGRINE, *supra* note 104, at 3.
110. *Id.*
111. YWCA, THE LEGAL RESPONSIBILITIES OF THE NOT-FOR-PROFIT BOARD, at http://www.geocities.com/ywca_berkeley/BYL/mod2sec4.html.
112. Cros v. Tanner, 229 P.2d 1008, 1013 (Kan. 1951).
113. *See id.*
114. *See* N.Y. NOT-FOR-PROFIT CORP. LAW §§ 510-511 (2003).
115. The nonprofit/charitable corporation codes in Kansas statutory law fail to address lack of accountability of nonprofit directors in corporate decision-making.
116. *See generally* Kan. East Conference of the United Methodist Church, Inc. v. Bethany Med. Ctr., 969 P.2d 859 (Kan. 1998).

117. The 1892 charter of Bethany declares that its medical purpose is “to nurse and furnish medical treatment for the sick and wounded . . . and for that purpose to rent, build and maintain, in or near Kansas City, Wyandotte County, Kansas, a hospital in which indigent patients may be treated and nursed, under such rules and conditions as the Board of Directors may prescribe; but pay may be accepted from such persons as may be able and willing to render the same, and all receipts from that source shall be expended for the use and benefit of the hospital” *Id.* at 861.
118. “Bethany was not created for the benefit of the Methodist Church, but was one of its missions.” *Id.*
119. *Id.*
120. This was in response to the outcome of litigation in 1979 that held the California Conference of the Methodist Church accountable for the activities of a Methodist-related retirement facility. *See id.*
121. *See id.* at 861-62.
122. *See id.* at 861.
123. *See id.*
124. Bethany’s articles of incorporation also permitted its Board to amend the articles without restrictions. *Id.* at 862.
125. *See id.*
126. *See id.* at 863.
127. *See id.* at 862-63.
128. The Kansas Supreme Court did not rule on whether corporate law governed conversions as a whole. *See generally id.*
129. *Manhattan Eye, Ear & Throat Hosp. v. Spitzer*, 715 N.Y.S.2d 575, 577 (N.Y. Sup. Ct. 1999). MEETH’s certificate of incorporation states that its corporate purposes are “to establish, provide, conduct, operate and maintain a hospital in the City, County and State of New York for the general treatment of persons suffering from acute short-term illnesses; performing general plastic surgery; treating persons suffering from diseases of the eye, ear, nose or throat; and maintaining a school for post graduate instruction in the treatment of such illnesses, performing such surgery, and the treatment of such diseases, and conduction associated and basic research.” *Id.*
130. *See id.* at 576-77.
131. *See id.* at 579.
132. *See id.* at 583.
133. *See id.* at 584.
134. *See id.* at 591-92; *see also* N.Y. NOT-FOR-PROFIT CORP. LAW §§ 510– 511 (1997).
135. N.Y. NOT-FOR-PROFIT CORP. LAW § 511(d) (1997).
136. *See* 715 N.Y.S.2d 575 at 597.
137. *Id.*
138. *Id.* at 592.
139. *See id.* (citing *V. Bjorkland et al.*, *New York Nonprofit Law and Practice: With Tax Analysis*, § 8-2[a] p. 238).
140. *See id.*
141. KAN. STAT. ANN. §§ 17-1762(k), 17-1762(n) (2002).
142. Press Release, State of Kansas Office of the Attorney General, *Stovall Files Counter-Suit against Health Midwest*. (Dec. 11, 2002) (on file with authors) [hereinafter *Stovall Press Release*].
143. *See* KAN. STAT. ANN. § 17-1768(a) (2002).
144. *See* § 17-1769(g) (2002).

145. *See* § 17-1769(h).
146. *See* § 17-1769(i).
147. *See* KAN. STAT. ANN. §§ 58-3601–58-3610 (2002).
148. § 58-3606.
149. *See* § 58-3607.
150. Stovall Press Release, *supra* note 143.
151. *See id.*
152. *See* Health Midwest v. Kline, No. 02-CV-08043 (D. Kan. Filed Dec. 18, 2003) (on file with authors).
153. Health Midwest was a Missouri nonprofit corporation and the general issue concentrated on the scope of the Attorney General as to the merger of Kansas nonprofit corporations into an out-of-state nonprofit corporation.
154. *See* Health Midwest v. Kline, No. 02-CV-08043 (D. Kan. Filed Dec. 18, 2003) (on file with authors).
155. *See id.*
156. *See* KAN. STAT. ANN. § 1700 *et seq.* (2002).
157. The Kansas nonprofit corporations involved in the merger included: Health Midwest, Johnson County, Inc.; Menorah Medical Center, Inc., Overland Park Regional Medical Center, Inc., and Trinity Lutheran Manor, Inc.
158. *See* Health Midwest v. Kline, No. 02-CV-08043 (D. Kan. Filed Dec. 18, 2003) (on file with authors).
159. *Id.*
160. *See id.*
161. *See id.*
162. *See id.*
163. *Id.*
164. *See id.*
165. *See id.*
166. *See generally* RESTATEMENT (SECOND) OF TRUSTS § (1959) (stating that under the common law, attorney generals are the protectors of the trusts, especially charitable trusts).
167. *See* KAN. STAT. ANN. § 59-22a01 (1994); *see also* §§ 17-1759 to 58-1776 (COSA); §§ 58-3601 to 58-3610 (UMIFA).
168. BLACKS LAW DICTIONARY 1003 (5th ed. 1979) (“State attorneys general have *parens patriæ* authority to bring actions on behalf of state residents for anti-trust offenses and to recover on their behalf”).
169. *See* KAN. STAT. ANN. § 59-22a01 (1994); COSA, *See* K.S.A. §§ 17-1759 to 58-1776; and UMIFA, *See* K.S.A. §§ 58-3601 to 58-3610.
170. *See generally* Kan. East Conference of the United Methodist Church, Inc. v. Bethany Med. Ctr., 969 P.2d 859 (Kan. 1998) (applying corporate law but also recognizing that Bethany’s assets are held in trust for the beneficiaries of its charitable purpose).
171. *See* discussion *infra* Part III.C.
172. *See* 715 N.Y.S.2d 575 (1999).
173. *See* Health Midwest v. Kline, No. 02-CV-08043 *Answer, Counterclaim and Cross Claim of Defendant*, 67-73 (D. Kan. Filed Dec. 18, 2003) (on file with authors). Health Midwest’s C.E.O.’s “golden parachute” consisted of: (1) an \$875,000 retention bonus; (2) a continued salary for three

- years in excess of \$3.3 million; (3) a leased automobile estimated at \$18,000; (4) forgiveness of a \$125,000 loan from Health Midwest; (4) outplacement assistance valued at \$165,000; and (5) a supplemental executive retirement plan (SERP) worth at least \$2,455,457.
174. *See* Health Midwest v. Kline, No. 02-CV-08043 (D. Kan. Filed Dec. 18, 2003) (on file with authors).
175. During the pendency of the litigation, the Health Midwest Board of Directors approved what they characterized as a “retention bonus”. The bonus rewarded 13 executives with a one-time lump sum payment of an amount equal to 150 percent of their annual salary for senior executives and 100 percent of the annual salary of nine other vice presidents. In addition, these same executives and vice-presidents were also guaranteed either continued employment with HCA or a full year’s salary as a severance package.
176. *See* Health Midwest v. Kline, No. 02-CV-08043 (D. Kan. Filed Dec. 18, 2003) (on file with authors).
177. *See id.*
178. *See id.* at ¶¶ 2, 4.
179. *See id.* at ¶ 4. (contradicting the ruling in Attorney General v. Hahnemann Hospital, 494 N.E.2d 1011 (Mass. 1986) in which the court ruled that all unrestricted contributions made prior to amendment of the corporation’s articles were subject to the same restrictions as the contributions from the original trust.)
180. *See* Health Midwest v. Kline, No. 02-CV-08043 (D. Kan. Filed Dec. 18, 2003) (on file with authors).
181. *See id.*
182. *See id.*
183. *Id.*
184. *See id.*
185. *See id.*
186. *See* Health Midwest v. Kline, No. 02-CV-08043 (D. Kan. Filed Dec. 18, 2003) (on file with authors).
187. *See id.*
188. *See* 715 N.Y.S.2d 575 at 592 (1999).
189. *See id.*
190. BLACKS LAW DICTIONARY 1003 (5th ed. 1979) (defining *parens patriæ* as: “the role of state as sovereign and guardian of persons under legal disability. It is a concept of standing utilized to protect those quasi-sovereign interests such as health, comfort and welfare of the people, interstate water rights, general economy of the state, etc.” In the United States the *parens patriæ* function belongs in the states and is vested in state attorneys general).
191. In most states where the attorney general has the authority to review a hospital conversion, this authority is given in hospital conversions statutes; however, attorneys general in some states are given the authority to review a hospital conversion through other statutes. For example, in New York this authority is given in the state’s Not-For-Profit Corporations Code.
192. DUKE GUIDE, *supra* note 5 at 57.
193. More specifically this refers to states without statutes giving the attorney general or another equally qualified public official the authority to review a transaction that resembles a nonprofit hospital conversion.

194. The rulings in *Queen of Angels Hosp. v. Younger*, 136 Cal. Rptr. 36 (Cal. Ct. App. 1977), and *Attorney General v. Hahnemann Hosp.* 494 N.E.2d 1011 (Mass. 1986) were based on the principles of charitable trust law while the ruling in *Health Midwest v. Kline* was based on corporate law principles.
195. *See* *Manhattan Eye, Ear and Throat Hosp. v. Spitzer*, 715 N.Y.S.2d 575 at 592.
196. *See* JAMES R. SCHWARTZ AND H. CHESTER HORN, JR., *HEALTH CARE ALLIANCES AND CONVERSIONS: A HANDBOOK FOR NONPROFIT TRUSTEES* 80-81 (Jossey-Bass Publishers, 1998).
197. *WEBSTER'S II NEW RIVERSIDE UNIVERSITY DICTIONARY* 538 (1988) (defining a golden parachute as a lucrative termination agreement with an executive who is fired or demoted following a corporate takeover).
198. *See Memorandum of Understanding*, *Health Midwest v. Kline*, No. 02 CV 08043 (D. KS Feb. 7, 2003) (on file with authors).
199. *See* Chris Brown, *Kansas AG Approves Foundation to Receive Assets from Menninger's Location Change*, *BNA'S HEALTH LAW REPORTER*, May 22, 2003, at 815. Both the Baylor College of Medicine and The Methodist Hospital are nonprofit organizations.
200. *See id.*
201. The new foundation received: (1) \$3.5 million in real property from Menninger's; (2) full interest in 123 acres of land located near and owned by Menninger's, which is valued at \$600,000; and (3) 50 percent ownership interest in remaining property owned by Menninger's, which is valued between \$18 million and \$25 million.
202. *BICKERS AND WILLIAMS, PUBLIC POLICY ANALYSIS: A POLITICAL ECONOMY APPROACH* 108-09 (Houghton Mifflin Co. 2001).
203. Paul Wenske, *Kline in January Rejected Health Midwest Deal Similar to February Pact*, *KANSAS CITY STAR*, Apr. 3, 2003 (It is estimated that Health Midwest spent \$900,000 on litigation costs. This money could have been used for activities benefiting community healthcare in the greater Kansas City area).
204. ²⁰⁴ States (including D.C.) that have enacted hospital conversion legislation include: Arizona, California, Colorado, Connecticut, the District of Columbia, Georgia, Hawaii, Idaho, Louisiana, Maine, Maryland, Massachusetts, Nebraska, New Hampshire, New Jersey, Ohio, Oregon, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin.
205. Gary Claxton et al., *Public Policy Issues In Nonprofit Conversions: An Overview*, 16 *HEALTH AFF.* 9, 19 (1997).
206. *See id.*
207. *See id.* at 26.
208. *VOLUNTEER TRUSTEES ANALYSIS*, *supra* note 8.
209. *See id.*
210. *See id.*
211. *See id.*
212. *See id.* (maintaining that "the purpose of this review is to ensure that the transaction is fair, meaning that community interests [are maintained], that the assets have not been manipulated so as to decrease their value, that the assets are not placed at unreasonable risk if financed in part by the seller, and that management contracts are fair").
213. *VOLUNTEER TRUSTEES ANALYSIS*, *supra* note 8.
214. *See id.*
215. *See id.*

216. *See id.* (citing National Association of Attorneys General (NAAG) Resolution: Conversion of Nonprofit Health Care Entities to For-Profit Status, (1998) available at: http://www.naag.org/naag/resolutions/res-sum98-healthcare_conv.pdf) (Last visited March 2004).
217. DUKE GUIDE, *supra* note 5 at 64.
218. *See id.* (citing NAAG Resolution: Conversion of Nonprofit Health Care Entities to For-Profit Status, (1998) available at: http://www.naag.org/naag/resolutions/res-sum98-healthcare_conv.pdf) (Last visited March 2004).
219. *See* NAAG Resolution: Conversion of Nonprofit Health Care Entities to For-Profit Status, § 1.02 (1998) available at: http://www.naag.org/naag/resolutions/res-sum98-healthcare_conv.pdf) (Last visited March 2004) (According to the NAAG a nonprofit hospital conversion is: (1) the sale, transfer, lease, exchange, optioning, conveyance, or other disposition of a material amount of the assets or operations of a licensed nonprofit hospital, nonprofit health maintenance organization or nonprofit healthcare insurer, including a mutual corporation holding assets in charitable trust, to an entity or person other than a charity; and (2) the transfer of control or governance of a material amount of the assets or operations of a licensed hospital, nonprofit health maintenance organization or nonprofit healthcare insurer, including a mutual corporation holding assets in charitable trust, to an entity or person other than a charity).
220. *See id.* at § 2.01.
221. *See id.* at § 3.01.
222. *See id.* at § 4.01.
223. *Id.* at § 5.01(1).
224. *See id.* at § 5.01(2).
225. *Id.* at § 5.01(3).
226. *Id.* at § 5.01(4). Also, the Model Act § 5.01(7) suggests that the opportunity for healthcare providers to invest or own interest in the acquiring entity or a related party constitute a conflict of interest.
227. *See id.* at § 5.01(5).
228. *See id.* at § 5.01(6); *see also* § 5.01(8) (suggesting that the Aterms of any management or services contract negotiated in conjunction with the proposed nonprofit healthcare conversion transaction [be] reasonable.” More or less, excessive executive compensation packages are a form of private inurement).
229. *Id.* at § 5.01(9).
230. *See id.* at §§ 7.01–7.04.
231. *See id.* at §§ 9.01–9.02
232. *See id.* at § 8.01.
233. The state’s Attorney General is usually granted authority in the review of hospital conversions; however, some states give statutory authority to other state governmental officials or agencies as well (usually agencies or officials that oversee health issues).
234. Leigh Walton, Emerging Trends in Non-Profit and For-Profit Hospital Mergers, Acquisitions and Joint Ventures. Corporate and Securities: State Law Issues (Aug. 3, 1998) (available at <http://www.bassberry.com/resources/corp/030098/4.html>) (Last visited March 2004).
235. *See* Rubin, *supra* note 68, at 534.
236. *See generally* CAL. CORP. CODE §§ 5910 to 5925 (2003).

237. *See id.* at § 5914; *see also* § 5913 (requiring the consent of the Attorney General for “any transaction involving a nonprofit charitable health facility when a material amount of the charitable assets are transferred to a for-profit or mutual benefit entity”).
238. CAL. CORP. CODE § 5915.
239. *See id.* at § 5916.
240. *See id.* at § 5917.
241. NEB. REV. ST. §§ 71-20,103 and 71-20,104 (2003).
242. *See id.* at § 71-20,105(2).
243. *See id.* at § 71-20,106.
244. *See id.* at § 71-20,108.
245. *See id.* at § 71-20,109.
246. *See id.* at § 71-20,110.
247. *See id.* at § 71-20,111.
248. R. I. GEN LAWS § 23-17.14-5 (2003).
249. *See id.* at §§ 23-17.14-9–11.
250. *See id.* at § 23-17.14-12.
251. *Id.*
252. *See id.* at § 23-17.14-6, 7, and 10.
253. *See id.* at § 23-17.14-19.
254. *See id.* at § 23-17.14-30.
255. *See id.* at § 23-17.14-15.
256. *See id.* at § 23-17.14-29.
257. *See id.* at § 23-17.14-34.
258. *See id.* at § 23-17.14-22 to 27.