

Nonprofit Health Care Conversions

When a nonprofit hospital or health plan is sold to or merged with a for-profit company, the charitable assets at stake have a special status in law—the assets must remain in the public trust and be used to meet the health care needs of the community.

Nonprofit to for-profit hospital and health plan conversions represent the transfer of hundreds of millions, if not billions, of charitable dollars out of the public domain and into the hands of big corporations and their investors. These “conversions” have transformed the Texas health care landscape from a community-focused system to a more corporate-controlled system.

Some Texas insurance companies/HMOs and most Texas hospitals were originally founded as charitable nonprofit organizations in order to take advantage of generous federal grants, loans, federal and state tax-exempt status and the ability to receive tax-exempt donations from people in their community who supported their charitable mission.

When such a nonprofit is formed, it agrees to irrevocably dedicate its assets to charitable purposes that serve the public. In essence, the public becomes the shareholder of the nonprofit corporation, the owner of its assets.

In Short

The Texas Attorney General is responsible for protecting charitable trusts, gifts and entities. However, there is no duty for nonprofits to notify the AG when they are considering a sale, merger or joint venture with a for-profit company. And Texas has not standards for these transactions.

When the nonprofit corporation becomes for-profit, it is obligated under common law to turn over its assets to a charitable organization dedicated to similar purposes.

Without careful monitoring, the for-profit corporation may seek instead to hold on to these public assets and devote them to multi-million dollar compensation packages for corporate executives and profit-making enterprises that are accountable only to their individual stockholders.

When public attention is focused on these transactions, the charitable assets held by converting nonprofit health care corporations can be preserved to meet critical health care needs of Texans. Without intense public scrutiny, the funds may be lost forever, going instead to the new for-profit company.

The Texas Attorney General (AG) is responsible for protecting charitable trusts, gifts, and entities in Texas. However, nonprofits are not obliged to notify the AG when they are considering a sale, merger, or other transaction with a for-profit or mutual company. Furthermore, Texas law provides insufficient standards and direction to guide these conversions.

While the flurry of nonprofit to for-profit conversion activity in Texas in the 1980s and 1990s has slowed, the threat to charitable health assets continues today. Nonprofit hospitals are constantly stressed by factors such as high rates of uninsured Texans and cuts in reimbursements from commercial, Medicaid, and Medicare managed care organizations. The possibility of future conversions is likely. The state should be proactive in preventing any further loss of Texas charitable dollars. See back for a brief summary of some important Texas

nonprofit hospital and health plan conversions from the past decade.

Recommendations

The legislature should establish minimum standards for transactions between nonprofit and for-profit or mutual corporations that address the following issues:

- **Notification to the AG.** The nonprofit should notify the AG regarding its intent to convert (including sales, mergers, and joint partnerships) as soon as an offer is under consideration or a bidding process planned. Basic information given to the AG about the transaction should be made public.

- **Public involvement in the process.** Nonprofit conversions should be public transactions with public disclosure and oversight. Ironically, while for-profit directors are required to notify the public of the sale of their corporation, nonprofit directors have no such responsibility. These transactions are considered “private.” Notice in local newspapers, public comment, and public hearings should be required.

- **Set aside assets for the community’s health care needs.** The full and fair market value of the assets of nonprofit health care organizations should continue to serve the mission for which they were dedicated, either in an existing foundation or a new grant-making foundation under IRS code 501(c)(3).

- **Independent foundation boards.** To avoid conflicts of interest, foundation boards receiving nonprofit health care assets should be independent from the organization involved in the transaction and reflect the diversity of the community.

Case Studies of Texas Conversions

Health Plan Conversions

Blue Cross Blue Shield of Texas (BCBSTX). The biggest Texas conversion transaction was in 1998, when BCBSTX, a charitable nonprofit, got the go-ahead from the Texas Department of Insurance to merge with Blue Cross Blue Shield of Illinois (BCBSIL), a mutual insurance company. While the merger was consummated, the Texas AG pursued preserving BCBSTX's charitable assets through a suit which is currently awaiting an appellate court decision. If the AG's appeal fails, these assets—which belong to the people of Texas—will transfer to an Illinois mutual insurance company whose duties and interests extend to its members and not to the citizens of Texas. If the AG succeeds, at least \$350 million will be placed in a foundation to serve the health care needs of the people of Texas. As part of an agreement with the AG to let the merger move forward, BCBSIL has donated \$6 million to help insure low-income Texas children.

Harris Methodist Health Plan in Fort Worth. In 1996, HMHP converted to a for-profit plan, but remained under control of its nonprofit parent, Harris Methodist Health Care System. After losing more than \$300 million, the once largest health plan in North Texas sold in 2000 to PacifiCare, a California for-profit company, in what the local paper called a “distress sale.” While the proceeds of that sale went to the health plan's nonprofit parent, Texas Health Resources (formed in 1997 by a merger of the Harris Methodist system and Dallas Presbyterian hospitals), they were significantly diminished, leaving fewer charitable dollars for the citizens of Fort Worth.

Hospital Conversions

In a marketplace rife with all variations of mergers, sales, and closures, many ask why Consumers Union focuses on “conversions” involving nonprofit to for-profit transactions. No matter what the transaction involves, changes in ownership can eventually lead to significant changes in available services in the area, including elimination of services altogether by closing.

Consumers Union believes hospitals have a responsibility to the communities they serve and should ask for input when such changes are considered. Unfortunately, most see these transactions as merely a business deal, and the community rarely has an opportunity to voice concerns. However, when the transaction involves a charitable nonprofit entity and a non-charitable entity, the assets at stake have a special designation through long-standing *law* to remain in the public trust. Hence our focus on these transactions and the compelling reason for the state to protect these funds for the charity's community.

Gilmer Hospital in rural East Texas. A nonprofit hospital, built by a local doctor but transferred to Baylor University in 1982, sold to the for-profit HealthTrust hospital chain 11 years later. No charitable assets were left to the community. In 1995, Columbia/HCA bought HealthTrust, scaled back Gilmer services and, six months later, shut the hospital down. Gilmer residents had to travel at least 25 miles for hospital and emergency services. With each transaction the local community found itself further removed from the decision-making process. They tried to keep the hospital open through negotiations, town meetings and protests. Eventually, Columbia agreed to sell the building to the community, which turned it into a free-standing 24-hour emergency care center.

Providence Hospital in El Paso. Tenet Healthcare Corporation purchased the last nonprofit hospital in El Paso in 1995 for \$130 million. These charitable assets were set aside in the Paso del Norte Health Foundation, which funds health education and prevention programs. The foundation board decision to move away from direct services was controversial in this community with a high poverty rate and strained public health care system. While most of the foundation's grants focus on prevention issues of critical importance to El Paso, some are only indirectly health related (e.g. \$378,000 for bike paths). Tenet abandoned plans for a much-needed new clinic and scaled back plans to expand

specialty pediatric services.

St. David's Hospital in Austin & Southwest Texas Methodist Hospital in San Antonio. Each of these nonprofit hospital systems formed a joint partnership with for-profit Columbia/HCA. In both ventures, the nonprofit and for-profit partners contributed equal amounts of assets (including property) to the venture. Columbia/HCA is the managing partner, all the hospitals in the “venture” systems are now run as for-profit hospitals, and the nonprofit partner holds half of the seats on the governing board. St. David's was valued at \$160 million and Southwest at \$268 million. As part of the Southwest transaction, Methodist Healthcare Ministries in San Antonio received \$42 million, which it uses to fund health-related projects, and secured an agreement that the for-profit hospital system will do a specified amount of charity care. The St. David's Foundation received no assets. Both nonprofit partners share 50% of system profits with Columbia/HCA.

Angelo Community Hospital. Columbia/HCA bought this 165-bed nonprofit hospital in 1995 for \$75 million. Angelo Community Health Foundation was created, governed by the old hospital board. The Foundation decided to use \$50 million (\$25 million paid off bond debt) to support general charitable projects not limited to health-related projects. While all grants are given to charities, a significant portion of them went to non-health related causes (such as a local art museum), thus diverting charitable *health* dollars to other purposes.

Northwest Texas Hospital in Amarillo. This tax-supported hospital was sold to Universal Health, a for-profit hospital chain, following competitive bidding that improved the ultimate sale price. A \$121 million trust fund was established to serve community health care needs. When open government laws required this *public* hospital to involve the community - which included a nonbinding referendum, debate in the local media, and public forums - citizen pressure led to an improved indigent care agreement. Under a 25-year agreement, the cost of indigent care is shared between the for-profit and the trust fund.