Banner Health Systems v. Long: A case study in the ability of state Attorneys General to apply charitable trust principles in order to regulate the activities of nonprofit corporations

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The Role of the State Attorney General

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Contents

I. Banner Health System v. Long ................................................................. 3
   a. Facts and Procedure ........................................................................ 4
   b. Outcomes ....................................................................................... 8
   c. Settlement ....................................................................................... 10

II. Background to Banner ........................................................................... 11
   a. The structure of nonprofit healthcare corporations ...................... 11
   b. The Parens Patriae Role of the State Attorney General .................. 12
   c. The Charitable Trust ...................................................................... 14
   d. Do nonprofit healthcare corporations warrant the distinction of charitable corporations? .......... 16
   e. The relationship between charitable trust law and nonprofit corporations ........................................... 19

III. Analysis .................................................................................................. 20
   a. How far should an attorney general go to keep assets in local communities and devoted to their original purposes? ............................................................................. 20
      i. In Banner ..................................................................................... 20
      ii. Public policy for all nonprofits ..................................................... 23
      iii. Movement of other courts away from the application of charitable trust principles to nonprofit corporations ........................................................................................................... 24

IV. Banner principles extended to similar present-day situations ................. 25
   a. The Ford Foundation ........................................................................ 25

V. Conclusion ................................................................................................ 27
Nonprofit corporations continue to face increased pressure from rising costs and from their for-profit counterparts. Some of these nonprofits have responded by making increasingly controversial business decisions, which have provoked public outcry and, in some cases, calls for increased government regulation and intervention. In some of these cases, state Attorneys General have chosen to intervene to protect the interests of the public and to protect the funds of the donors to the institution. One of these cases, *Banner Health Systems v. Long*, presents a case study of one recent approach toward regulation and litigation by an Attorney General’s office. In *Banner*, the Attorney General attempted to protect the assets of various nonprofits for their communities, though, as is increasingly common (particularly in the health care field), smaller nonprofits had been conglomerated to increase efficiency at the expense of the needs of their original communities.

I. *Banner Health System v. Long*

Facing financial pressure, Banner Health Systems, one of the largest non-profit healthcare providers in the United States, initiated the sale of seven healthcare facilities in the state of South Dakota.\(^1\) The non-profit healthcare conglomerate intended to divert the profits of these sales out of state, which was met with the disapproval of the South Dakota Attorney General, who alleged that all proceeds were subject to an implied charitable trust under South Dakota law, that diverting the proceeds out of state amounted to unjust enrichment, and that

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charitable trust common law requires that all proceeds from this sale must remain in the state of South Dakota.  

a. Facts and Procedure

Banner Health System, an Arizona-based, non-profit corporation, owned and operated seven hospitals and nursing homes in five South Dakota communities. Before being purchased by Banner Health System, each of these facilities was its own independent non-profit corporation.

For example, the Dorsett Nursing Home, in Spearfish, South Dakota, was created as a result of a 1974 bequest of $60,000 in the will of Olive Dorsett. The stated purpose of this donation was to build “a home for aged and indigent person in the city of Spearfish for the benefit of residents of Meade, Butte and Lawrence Counties.” The Lookout Memorial Hospital, also located in Spearfish, was established through $110,000 in donations given to the Lookout Memorial Hospital Corporation, whose purpose was to construct and maintain a hospital in Spearfish. The corporate charter specified that in the case of dissolution, the remaining assets were to be transferred to any nonprofit corporation willing and capable of operating a hospital in Spearfish. Sturgis Hospital, in Sturgis, South Dakota, was built by the Community Memorial Hospital association, a nonprofit whose corporate purpose was to establish and maintain hospitals and nursing homes within and outside of the city of Sturgis and to “participate in any

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2 Id. at 243.
3 Id. at 224-6.
4 Id at 245.
5 Id.
6 Id.
7 Id.

Frisbee 4
activity designed to promote the general heath of the community." The corporate charter indicated that in the case of dissolution, assets were to be distributed within the communities in which they were located.

Each of these facilities provided a significant proportion of its revenue through local personal and corporate contributions. However, due to mounting financial pressures, each of the corporations began to seek new solutions, including conglomeration, to continue operations. Between 1993 and 1997, each of the corporations amended their articles of incorporation to allow the out-of-state transfer of assets, and eventually each of the seven South Dakota-based corporations sold or transferred their assets to Lutheran Health Systems, a North Dakota-based non-profit. In 1999, Lutheran Heath Systems completed a merger with a Phoenix-based non-profit, and Banner Health Systems was formed.

In 2001, Banner Heath Systems began discussions about its departure from South Dakota in order to concentrate its assets in its facilities in Arizona and Colorado. Internal Banner Heath documents suggest that Banner Health directors felt that the corporation had expanded beyond a point where it would be financially sustainable, and that it would be in the best interest of the corporation to contract back into the more profitable Arizona and Colorado markets. Banner then began to initiate the sale of its seven South Dakota facilities.

8 Id. at 246.
9 Id.
10 See Defendant's Brief at 15, Banner, 2003 S.D. 60, 663, N.W.2d 242.
11 See Barbara Gorham, Banner's End Run Must End: Company Plays Chess With Assets it Inherited While Communities Pay the Price, MODERN HEALTHCARE (March 3, 2003)
12 Id at 21.
13 See Gorham, supra note 11 (“Banner announced it was selling 10 of its 29 hospitals and 17 long-term-care facilities in seven states as it concentrated its efforts in higher-growth markets in Arizona and Colorado.)
15 See Banner, 663 N.W.2d 242, supra note 1.
A private attorney, Rick Johnson, of Gregory, South Dakota contacted the South Dakota Attorney General’s office with concerns about this proposed sale.\textsuperscript{16} Two of the facilities owned by Banner were located in Gregory, and Johnson had concerns about the potential buyers for these facilities. Accordingly, the South Dakota Attorney General’s office, led by then-Attorney General Mark Barnett, investigated the Gregory sales, and discovered that Banner was selling all of its South Dakota facilities.

The Attorney General’s office initially wrote to Banner to put them on notice that the Attorney General “had concerns about the sale.” Current Attorney General Larry Long (the Chief Deputy Attorney General under Attorney General Mark Barnett) writes that “we specifically determined not to try to stop the sale, but we made clear to Banner that we believe the sale proceeds might be subject to a claim on behalf of the communities where the facilities being sold were located.”

Banner made the first litigation move. They sued in the United States District Court of South Dakota, alleging that the letter from the South Dakota Attorney General interfered with Banner’s due process rights and unconstitutionally impacted their sale.\textsuperscript{17} The Attorney General responded by defending the federal suit and instigating two state court proceedings seeking declaration that the proceeds of these sales should be held under a constructive trust for the benefit of the communities in which the facilities were located.\textsuperscript{18}

Then-Attorney General of South Dakota, Mark Barnett, acting in his role as parens patriae, publically advised that he “believed the facilities were restricted by constructive

\textsuperscript{16} Email from Larry Long, Attorney General, South Dakota, to Allison Frisbee (Mar. 11, 2008, 6:22PM EST) (on file with the author).

\textsuperscript{17} See Banner, 663 N.W.2d 242 \textit{supra} note 1, at 1, 243.

\textsuperscript{18} See Long email, \textit{supra} note 16.
charitable trusts and therefore the proceeds could not be removed from the communities in which
the facilities were located.” Attorney General Barnett argued that because Banner Health had
“never paid a nickel” for the seven hospitals and nursing homes (acquired through the 1999
merger), Banner had no right to the millions of dollars in charitable assets from the sales.  

Out of the public eye, the Attorney General’s office began to develop their litigation
strategy. Current Attorney General Larry Long states that “our position became this: The
transfers from the local non-profits to the professional managers were without consideration and
thus were subject to the same conditions as the original non-profits; that is, to operate the trust
asset for the benefit of the community citizens.” The AG’s position was that by assuming
control of the nonprofit facilities, Banner had not made a fee simple purchase; rather, Banner
assumed a role as the trustee of the non-profits’ assets. Therefore, Banner could not sell the
assets it was supposed to keep in trust and keep the proceeds. Banner could divest itself of its
South Dakota assets, but only by transferring the assets to another trustee who could abide by the
conditions of the trust. 

In its federal court reply brief, the Attorney General made this argument formally. The
AG argued that both South Dakota statutes and the common law of trusts placed certain
restrictions on the assets of non-profits donated “to a charitable nonprofit corporation such that
the corporation may not sell those assets and remove the sale proceeds for use in another
community.” Essentially, the Attorney General argued that the assets of a nonprofit hospital,
including the proceeds from a sale, can only be used to further the charitable purposes of that

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19 See Banner, 663 N.W.2d, supra note 1 at 24, 246.
20 Gorham, supra note 13 at 21.
21 Long email, supra note 16.
22 Id.
23 Defendant’s Brief, supra note 10 at 19.

Frisbee 7
particular community, not moved into a fund for the benefit of other hospitals in other communities.  

The U.S. District Court of South Dakota held that the resolution of this dispute regarded an issue of South Dakota law. The court therefore issued a certified question to the South Dakota Supreme Court: “Whether the laws of South Dakota recognize any legal theory that would subject any of the assets of a nonprofit corporation or proceeds from the sale of those assets to an implied or constructive charitable trust in the absence of an express trust agreement.”

This certified question was argued by the parties on March 24, 2003 at the University of South Dakota School of Law.

b. Outcomes

The South Dakota Supreme Court opinion in *Banner Health Systems v. Long* answered the certified question posed by the district court in the affirmative, holding that “South Dakota law does recognize legal theories that would subject Banner’s assets to an implied charitable trust assuming certain alleged and disputed facts are established.” Essentially, the court held that to the extent a charitable trust was imposed against a predecessor organization (in *Banner*, the original hospitals), the purchaser (or other assumer) of that organization took over those assets subject to the trust and agreed to be bound by that trust. In other words, the court held that South Dakota law required any transferee of the assets of a nonprofit organization to

24 Id.
25 *Banner*, 663 N.W.2d at 243.
27 *Banner*, 663 N.W.2d at 243.
28 Id.
continue to honor any restrictions or obligations already imposed upon the assets before the transfer.\textsuperscript{29}

The court ruled that South Dakota statute allows trusts to be either express or implied.\textsuperscript{30} Applying South Dakota state, the court analyzed several instances where implied should be recognized, including the situation in \textit{S.D.C.L.} 55-1-11 which states that the criteria for imposing an implied trust:

\textit{does not exclude or prevent the arising of an implied trust in other cases nor prevent a court of equity from establishing and declaring an implied, resulting, or constructive trust in other cases and instances pursuant to the custom and practice of such courts.}\textsuperscript{31}

In \textit{Banner}, the Supreme Court recognized a broad grant of power by the state legislature for a court of equity to prevent the unjust enrichment of a nonprofit, especially in cases where a nonprofit was unjustly enriched by “the sale of the assets and removal of the proceeds from the local communities at the expense of those communities.”\textsuperscript{32}

Additionally, the court found that a nonprofit corporation could potentially be held liable for breach of fiduciary duty by failing to honor these implied charitable trusts created by the original donations.\textsuperscript{33} The court cites to letters written by the President and CEO of Banner stating that the sales “are in the best interests of Banner,” rather than advocating that the interests of the particular facilities should be maintained.\textsuperscript{34}

\textsuperscript{29} Id.
\textsuperscript{30} Id. at 246.; \textit{S.D.CODIFIED LAWS} § 55-1-2.
\textsuperscript{31} \textit{Banner}, 663 N.W.2d at 246.
\textsuperscript{32} Id. at 248.
\textsuperscript{33} Id. at 249.
\textsuperscript{34} Id.
c. Settlement

After this certified question was decided by the South Dakota Supreme Court, the case continued in United States District Court litigation. However, the South Dakota Attorney General's office ultimately settled this litigation with Banner for approximately three million dollars, a fraction of the total sales proceeds, citing “the expense, time, and unpredictability associated with the lawsuits.”

This settlement allowed payouts to each of the affected facilities of amounts between $100,000 and $220,000, as well as debt forgiveness to certain facilities. Banner also agreed to pay $1.825 million to the state of South Dakota. The South Dakota Community Foundation assumed responsibility for the management of these funds. The Attorney General developed a plan whereby these funds were distributed in amounts ranging from $100,000 to $625,000 to the various facilities affected by the sales.

Jeff Hallem, a South Dakota Assistant Attorney General who was involved in the settlement negotiations, contends that the AG’s office sought settlement from the beginning. He states that “settlement negotiations continued on and off from the initial letter sent from [the AG’s] office and concluding with the execution of the final settlement agreement.” Hallem states that until the South Dakota Supreme Court decision, however, Banner did not have a strong enough incentive to settle. He writes that “settlement was desirable from the state’s

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36 Email from Jeff Hallem, South Dakota Assistant Attorney General, to Allison Frisbee (Mar. 24, 2008 at 3:25pm EST) (on file with author).
37 Id.
38 Id.
39 Id.
40 Id.
standpoint because of the difficulty in determining what portion of the sale proceeds should remain with the community.\textsuperscript{41} Particularly problematic was developing a defendable asset valuation for each facility prior to trial, as the different facilities were in various states of financial disarray at the time of their transfer to Banner. Therefore, the AG’s office felt that the potential recovery varied greatly based on the asset valuations accepted by the court, and ultimately decided that settlement was a better option to guarantee some recovery for the affected communities.\textsuperscript{42}

\textit{II. Background to Banner}

\textbf{a. The structure of nonprofit healthcare corporations}

Not all nonprofit organizations are incorporated; rather, many exist simply as free-standing charitable trusts. Nonprofit organizations that chose to incorporate must do so under the applicable state law of the state in which they reside or do business, similar to for-profit corporations.\textsuperscript{43} Like for-profit corporations, all non-profits must provide Articles of Incorporation (or Corporate Charters), which signify whether the corporation intends to be a charitable institution.\textsuperscript{44} Though traditionally nonprofit corporations have been distinguished from their for-profit counterparts by a prohibition on distributing profits – nonprofits must instead retain profits for the purposes for which the organization was formed – this is balanced

\textsuperscript{41} Id.\textsuperscript{42} Id.\textsuperscript{43} Henry Hansmann, \textit{Reforming Nonprofit Corporation Law}, 129 U. PA. L. REV. 497, 500 (1981).\textsuperscript{44} Brian F. Havel, \textit{Introduction to Corporations and Trusts}, SE61 ALI-ABA 89, 94 (2000). Most healthcare providers claim to be charitable institutions.
by a grant of tax-exempt status from the IRS. Nonprofit corporations are granted a number of privileges under federal and state statute, including exemption from state and federal income taxes, reduced postal rates, exemption from the Securities and Exchange Commission registration requirements, and exemption from property and sales taxes. All nonprofit corporations wishing to be exempt from federal income taxes must file Form 990, which provides basic information about the financial health of an organization to the public.

Some courts, however, as well as various legal commentators, have argued that there is no longer a functional difference between non-profit healthcare organizations and their for-profit counterparts. Nonprofit healthcare corporations retain an approximate additional $15 billion per year over their for-profit counterparts due to tax exemptions. The government’s purpose in allowing tax-related benefits to nonprofit hospitals is to enable the hospital to provide public health services that it could not otherwise afford and that for-profit hospitals would not find profitable. Yet nonprofits provide only a small percent more care than for-profits; in the year 2000, the national average spent by all hospitals on uncompensated care was 1.6 percent of hospitals’ gross revenue. In 2002, Banner spent 2.4 percent of its gross on uncompensated care.

b. The Parens Patriae Role of the State Attorney General

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45 Id. at 94.
46 Id. at 119.
47 Id.
50 Utah County v. Intermountain Health Care, Inc. 709 P.2d265 (Utah 1985).
State attorneys general are granted the near exclusive authority to supervise and oversee nonprofit corporations and charitable trusts.\(^{52}\) Charitable trust law derives the right and authority of the attorney general to monitor charitable trusts under parens patriae, which is derived from English common law.\(^{53}\) Parens patriae is a legal concept underlying all affirmative litigation by an attorney general, which implies that the attorney general is acting on behalf of all citizens of a state, rather than acting in a capacity of counselor to a particular state agency or authority.\(^{54}\) In these cases, essentially the state is suing another entity on behalf of its people.\(^{55}\)

The attorney general is entrusted with protecting the assets of a charitable trust and protecting the wishes of donors, and can bring actions to protect these in courts of equity.\(^{56}\) As donors do not have standing to bring these actions, state attorneys general have exclusive authority to police charitable trusts.\(^{57}\)

The New Mexico and North Dakota state attorneys general have also used parens patriae authority to police other transactions conducted by Banner.\(^{58}\) The New Mexico attorney general challenged the attempt of Banner to remove $38 million in sales proceeds from a facility that Banner had purchased for one dollar.\(^{59}\) The New Mexico case settled in May 2002 for $14 million.\(^{60}\) The North Dakota case involved another sale where Banner may have removed charitable trust proceeds and diverted them to Arizona.\(^{61}\) The North Dakota Attorney General, Wayne Stenehjem, filed court actions suggesting that Banner had violated charitable trust

\(^{52}\) See Havel, *supra* note 44 at 98.

\(^{53}\) BLACK'S LAW DICTIONARY (7th Ed. 1999)

\(^{54}\) Id.

\(^{55}\) Id.


\(^{57}\) Id.

\(^{58}\) See Banner Health System v. Stenehjem, Civ. No. A3-02-121 (D. N.D.)

\(^{59}\) Id.

\(^{60}\) Id.

\(^{61}\) Id.
principles and its tax-exempt status in these actions. However, this North Dakota action was dismissed in August 2003. The North Dakota court ruled that Attorney General Stenehjem “failed to prove the existence of an implied charitable trust between Banner and the state.” In the South Dakota case, Assistant AG Jeff Hallem states that there was no coordinated multi-state component; however, Assistant AGs from the three states exchanged a good deal of information regarding the sale of various facilities, and regarding legal theories and analysis.

c. The Charitable Trust

Some nonprofit entities choose not to incorporate and instead function as traditional charitable trusts. These charitable trusts, however, like nonprofit corporations, are not permitted to distribute profits but instead must reinvest them to meet their stated purposes. Charitable trusts, like nonprofit corporations, are governed under state law. A charitable trust is a legal obligation to preserve the intent of the donor – a fiduciary relationship – rather than a legal person like a corporation. Charitable trusts have one major significant difference from traditional trusts: while the trustee of a traditional trust owes a fiduciary duty to its beneficiary,

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62 Id.
63 Patrick Reilly, Court Dismisses Banner Case, MODERN HEALTHCARE, August 18, 2003 at 9.
64 Id.
65 Hallem email, supra note 36.
66 See Coffey, et. al., supra note 14 at 270. “Nonprofit hospitals were traditionally treated as tax exempt charitable institutions ... [and their] income was derived largely or entirely from voluntary charitable donations, not government subsidies, taxes or patient fees.” (citing Paul Starr, The Social Transformation of American Medicine 180 (1982)).
67 Id.
68 Id.
69 See RESTATEMENT (SECOND) OF TRUSTS §348 (1959).
the trustee of a charitable trust owes a duty to a public class of beneficiaries, usually to the local community.70

Charitable trusts tend to have more flexible internal structures than nonprofit corporations, especially as charitable trusts tend to be private creations and not incorporated under the laws of the state.71 Perhaps the most advantageous feature of the charitable trust for attorneys general is that a charitable trust provides “a device whereby assets could be devoted to a particular purpose in perpetuity.”72

Charitable trusts are often created by implication.73 Property given to a nonprofit charitable corporation with express restrictions on the manner of its usage creates a charitable trust governing this property.74 However, property given to a charitable corporation without any restrictions still creates an implied charitable trust providing that the charitable corporation will use the property to further the purposes for which the corporation is organized.75 According to the Restatement of Trusts, “no particular form of words or conduct is necessary for the manifestation of intention to create a charitable trust,” which is highly favorable to potential actions by attorneys general.76 California state courts, for instance, have enforced perpetual restrictions on gifts to nonprofit corporations under the theory that these gifts create perpetual trusts.77

70 See Samuel W. Braver, et al., Parens Patriae, the Business Judgment Rule and Not-For-Profit Corporations, 15 NO. 1 HEALTH LAW 40 at 40. 
71 See Hansmann, supra note 43 at 502. 
72 Restatement, supra note 69 at § 348 cmt. f (1959). 
73 Id. 
74 Id. 
75 Id. 
76 Id at cmt. d. 
In *Banner*, had the litigation proceeded, the South Dakota courts would have ultimately had to decide whether it was the intent of the donors at issue to create a charitable trust.\(^{78}\) In some cases, as in *Banner*, an original charitable purpose can become impracticable; for instance, in *Banner*, the corporation wished to divest itself of South Dakota assets, making the fulfillment of the original intent of those assets impossible. In these cases, courts may devise or approve alternate methods of asset distribution under the doctrine of *cy pres*.\(^{79}\) *Cy pres* requires courts to hold as close to the donor’s intent as possible.\(^{80}\) Using *cy pres*, a South Dakota court of equity could potentially force Banner to leave the proceeds of the sales with the communities to which it was intended to aid.

The South Dakota Supreme Court has held that charitable trusts are recognized in South Dakota and that these trusts may be express or implied.\(^{81}\) South Dakota courts have also held that charitable trusts can come in the form of constructive trusts, which are a remedial device by which courts can prevent unjust enrichment.\(^{82}\) Constructive trusts are imposed not because of the intentions of the parties (like in an implied or express trust) but rather as a remedial device at equity for the restoration of the status quo. This arises when a person owning title to property is under an equitable duty to convey it to another because the person would be unjustly enriched by retaining it.\(^{83}\)

d. Do nonprofit healthcare corporations warrant the distinction of charitable corporations?

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\(^{78}\) See Havel, *supra* note 44 at 100.
\(^{79}\) Id.
\(^{80}\) BLACK’S LAW DICTIONARY (7th Ed. 1999).
\(^{81}\) *In re Geppert's Estate*, 59 N.W.2d 727, 731 (S.D. 1953).
\(^{82}\) Hansmann, *supra* note 43 at 556.
\(^{83}\) Id.
Historically, hospitals were created to serve indigent populations who would not otherwise be able to afford access to medical care; those with greater resources instead paid for and were provided with in-home care by more skilled physicians.84 The vast majority of early hospital’s funding was provided by charitable donations.85 As the quality of hospital care increased and greater portions of the public grew to depend on hospital care for a part of their medical services, an increasing portion of hospitals charged fees for services and moved away from relying on donations for their survival.86 At the present, roughly ninety percent of hospital revenues come from public and private insurance payments.87

Under nonprofit corporation and charitable trust law, any funds solicited by a charitable organization must be devoted entirely to the charitable purposes outlined in the organization’s Articles of Incorporation or mission statement.88 However, these restrictions are limited to corporations and organizations that are recognized as charitable under state law.89 If all healthcare corporations were instead organized as for-profit, non-charitable corporations, there would be no question of the applicability of charitable trust law; however, to enjoy the tax breaks (and other benefits) inherent in charitable corporation status, Banner and many others have incorporated in this fashion. If Banner wishes to argue that the restraints of charitable trust doctrine should no longer apply to modern nonprofit healthcare corporations, then it may follow that they should no longer enjoy tax-exempt status.

85 Id.
86 Id.
87 Id.
88 Id.
89 See Hansmann, supra note 43 at 585.
The Restatement of Trusts states that “charitable purposes include (a) the relief of poverty; (b) the advancement of education; (c) the advancement of religion; (d) the promotion of health; (e) governmental or municipal purposes; (f) other purposes, the accomplishment of which is beneficial to the community.”90 Some commentators argue that “the promotion of health” in this section was not intended to include modern healthcare corporations.91

In Banner, one of the issues was whether the seven South Dakota hospitals sold by Banner were created as charitable institutions at their inception, thus deeming any early donations as assets held in charitable trust for the declared corporate purpose in the original articles of incorporation.92 One of the Attorney General's challenges in the case was to link the two points in history to show that all of the assets of the nonprofit are subject to the same charitable trust that was created when the institutions were first conceived, despite subsequent legal modifications to the corporate purposes of each institution, which may have drifted away from the original charitable trust principles.93 Even if the founders of these seven institutions clearly intended for the hospitals to operate as charitable organizations, Banner had a colorable argument that the later changes to the organizations' articles of incorporation had nullified this original intent.94 South Dakota law permits nonprofit corporations to amend their articles of incorporation.95

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90 Restatement (Second) of Trusts § 368 (1959).
91 See Hyman, supra note 84.
92 See Banner, 663 N.W.2d 242. In an amicus brief supporting the attorney general submitted to the South Dakota Supreme Court by a San Francisco-based non-profit corporation (the publisher of Consumer Reports magazine) argued that a nonprofit organization cannot “own the proceeds of a hospital sale. Instead, those assets belong to the people of the communities the organization serves.” Id.
93 See Hansmann, supra note 43 at 557.
94 Id.
95 S.D.Codified Laws § 47-22-14 (2003) (“A corporation may amend its articles of incorporation, from time to time, in any and as many respects as may be desired, so long as its articles of incorporation as amended contain only such provisions as are lawful under chapters 47-22 to 47-28, inclusive.”)
e. The relationship between charitable trust law and nonprofit corporations

The interpretation of nonprofit corporation statutes by judges has been “strongly influenced by the law of charitable trusts.”96 The common law trust principles long predate modern nonprofit corporation law, and prior to the arrival of the statutes governing nonprofit corporations, nonprofits, including hospitals, were formed under the common law of charitable trusts.97

Under California law, all assets of a charitable corporation are deemed to be part of a charitable trust.98 This is because California law considers the act of donation a declaration by the giver that he or she wishes to support the organization's stated corporate purpose.99 Essentially, in California, the donor does not have to expressly declare how the money should be spent because the corporation has already limited its actions to a specific corporate purpose in its articles of incorporation.100

However, other state courts have disagreed on this principle. For instance, Delaware state courts have held that if property is given to a charitable corporation without restriction, the corporation is only under a duty not to divert the property to anything other than one or more of the charitable purposes for which the corporation is organized. In Delaware, the act of donation does not create a charitable trust unless express restrictions are placed on the use of the property. Management of a nonprofit corporation in Delaware is judged under only corporate principles,

96 Hansmann, supra note 43 at 581.
97 Id.
99 “Even a simple gift of ten dollars given to a person who asserts that the gift will be used for some charitable purpose establishes or impresses a 'constructive' charitable trust on the ten dollars for the intended purpose.”
100 Id.
and not using any of the common law from charitable trust common law unless it is directly applicable (i.e. a charitable trust is deemed to exist).\textsuperscript{101}

In some areas on nonprofit corporation law, there is a clear preference in judicial rulings for the statutory principles of corporate law over the more amorphous common law principles of charitable trust law.\textsuperscript{102} For instance, in most jurisdictions, officers and directors of nonprofit corporations are governed by normal corporate principles despite the charitable or public purpose of their corporation.\textsuperscript{103}

\textit{III. Analysis}

\textbf{a. How far should an attorney general go to keep assets in local communities and devoted to their original purposes?}

\textit{i. In Banner}

In \textit{Banner}, one of Banner's primary arguments was that the enforcement of charitable trusts against healthcare corporations would lead to huge decreases in the efficiency of healthcare management.\textsuperscript{104} Banner argued that the imposition of charitable trusts in these cases would “increas[e] regulatory oversight and interference, [raise] borrowing costs, and an overall loss of autonomy in deciding how to fulfill their nonprofit healthcare mission.”\textsuperscript{105}

Perhaps the greatest problem with this argument is that it ignores the stake society may have in the governance of charitable nonprofits, particularly hospitals. Nonprofits receive benefits from state and local government not available to other corporations or persons precisely

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\textsuperscript{101} Denckla v. Independence Found., 193 A.2d 538 (Del. 1963) \\
\textsuperscript{103} Id. \\
\textsuperscript{104} See Patrick Coffey, et. al., \textit{The “Charitable Trust” Controversy Confronting Banner Health and Other Nonprofit Healthcare Systems}. 16 HEATH LAWYER 1 (November 2003). Coffey was a member of the Banner Health System litigation team. \\
\textsuperscript{105} Id.
\end{flushleft}
because they perform societal services the government has deemed beneficial. In some sense, these tax breaks and other benefits constitute a donation by every tax paying citizen to charitable nonprofit corporations. Perhaps these benefits given by taxpayers should afford the public or government some voice in the management of the expenditures of nonprofit corporations. Though nonprofit hospitals function in a manner different from most other nonprofits, they nonetheless receive substantial government assistance and benefits, and perhaps should be somewhat constrained thereby.

Banner refutes this argument, explicitly contending that the conferral of public benefits to a nonprofit institution “do not transform it into a public institution.”\textsuperscript{106} Some state courts have held that the conferral of benefits by the government changes nothing about the operation of nonprofits as private corporations.\textsuperscript{107} Banner argues that state legislatures have clearly laid out the requirements for corporations who wish to become tax-exempt organizations, and qualification and continued compliance with these regulations should be the only standards applied to nonprofits.\textsuperscript{108} Essentially, interventions such as \textit{Banner} constitute ex post facto interventions into corporate decisions, and “seek to change the rules upon which nonprofit corporations have relied for years.”\textsuperscript{109}

Lawyers for Banner argue that if charitable trust law is applied to nonprofit corporations, particularly in the field of healthcare, four large issues would arise:

1. \textit{Restriction of multistate nonprofit corporations}

\begin{footnotes}
\footnote{106}{Id.}
\footnote{107}{See, e.g. Levin v. Sinai Hosp. Of Baltimore City, Inc. 46 A.2d 298 (Md. 1946); Hughes v. Good Samaritan Hosp., 158 S.W.2d 159 (Ky. 1942).}
\footnote{108}{See Coffey, supra note 104 at 6.}
\footnote{109}{Id.}
\end{footnotes}
In *Banner*, the plaintiffs argue that the imposition of charitable trust principles would prevent corporations such as Banner from organizing a corporation that operates several facilities across state lines, or at least pooling the proceeds from these organizations so that proceeds from one facility could potentially be used by a facility in another community.\textsuperscript{110} Banner Systems is concerned that proceeds from each facility could only be used in that particular community.\textsuperscript{111}

Potentially, this could create a problem for nonprofit hospitals in less profitable communities, though the plaintiffs do not argue this. If large nonprofit healthcare systems cannot use the proceeds from one more profitable hospital to subsidize the operation of a less profitable hospital, these healthcare systems may be less likely to buy or invest in hospitals in more marginal communities with higher rates of uncompensated care.

2. *Restriction of sources of financing*

Most multistate, nonprofit healthcare corporations are able to finance their operations with low interest rate loans due to “master indenture financing,” which allows both joint and several liability for each healthcare facility in the system.\textsuperscript{112} Therefore, small rural hospitals can get low-interest financing that they would not otherwise be able to obtain using the liability of their larger brethren in the system.\textsuperscript{113} However, if all assets were required to remain in-state, this would similarly undercut the ability of hospitals in rural states to rely on the assets of larger hospitals across state lines in order to secure these loans.

3. *The transformation of nonprofit board members to trustees*

\textsuperscript{110} Id.
\textsuperscript{111} Id.
\textsuperscript{112} Id.
\textsuperscript{113} Id.
Banner argues that the application of a charitable trust to certain assets of nonprofit corporations would create obligations for board members to act as trustees. Banner argues that this would put directors “in conflict with their fiduciary duty to manage the corporation’s resources in furtherance of the system’s mission as a whole, and would place the various components of a multistate, nonprofit hospital in an inherent legal conflict with one another.”

Banner argues that this could prevent nonprofit corporations from, for example, funding out-of-state scholarships or research.

4. **Stricter liability would apply to nonprofit boards and officers**

Banner argues that enforcement of charitable trust doctrine would impose greater liability to boards of trustees and officers of nonprofit corporations. Currently, the decisions of these officers and trustees are governed by corporate law, which grants substantial deference to the business judgment of these parties. For instance, Banner argues that under charitable trust doctrine, officers might be held liable for “waste of charitable assets,” which would hold these officers to a higher standard than their for-profit counterparts. Additionally, nonprofits might face increased insurance costs due to this increased liability, and might have more difficulty attracting qualified members to serve on the board.

**ii. Public policy for all nonprofits**

An argument can be made for generally keeping charitable trust principles out of nonprofit corporation law. If all, or most, donations to nonprofit corporations are held to be subject to charitable trusts, all assets could potentially be tied to one purpose in perpetuity. As

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114 Id.
115 Id.
116 Id.
corporations evolve to respond to changing needs of communities, this could create a crisis where nonprofits no longer have the assets to provide contemporary services and instead must continue to use these assets for outdated demands.

In healthcare specifically, as costs continue to increase, nonprofits must be able to provide economically efficient healthcare delivery systems in order to be able to remain competitive with their for-profit counterparts. By preventing the interstate (or even potentially the inter-community) transfer of assets by national nonprofit healthcare organizations, the prospects of maintaining these organizations may ultimately diminish. As one commentator writes, unless nonprofit healthcare corporations are given significant latitude in transferring their assets, the “sector is likely to be hampered in its ability to attract needed capital, and may frequently be unable to keep pace with growth or shifts in demand.”

iii. Movement of other courts away from the application of charitable trust principles to nonprofit corporations

Both before and after Banner, many courts have declined to follow the precedent set by the South Dakota Supreme Court in applying charitable trust principles to nonprofit corporations, suggesting Banner may be something of an outlier and may not show a trend in nonprofit corporate jurisprudence. For example, City of Paterson v. Paterson General Hospital, a predecessor to Banner with some similarities, shows reticence in this area. In this case, the city of Paterson, individual residents and taxpayers argued that charitable trust principles should apply to an individual nonprofit hospital that wished to relocate to a nearby town. In Paterson, plaintiffs asked the court to hold that the original donors to the hospital intended for

117 See Hansman, supra note 43 at 520.
118 City of Paterson v. Paterson General Hospital 235 A.2d 487 (Ch. Div. 1967).
their donations to “forever be physically located within the prescribed municipal boundaries,” and to determine that as a matter of law the hospital and its assets could never leave those boundaries.\textsuperscript{119} The Superior Court of New Jersey rejected this argument, citing the enormous restrictions it would put on all nonprofits to adapt to changing community needs in order to survive and remain relevant.\textsuperscript{120}

In a contemporary case to \textit{Banner} from the District Court of Appeals for Florida, Fifth District, the court similarly refused to apply charitable trust principles to nonprofit corporations.\textsuperscript{121} There, the court held that “making a gift to a charity for a specific project or purpose does not create a charitable trust. For this court to suggest it does would create havoc for charitable institutions.”\textsuperscript{122}

\textbf{IV. \textit{Banner} principles extended to similar present-day situations}

\textbf{a. The Ford Foundation}

The principles established by the South Dakota Supreme court in \textit{Banner} could potentially have immediate resonance for other nonprofits nationwide.

For instance, Michigan Attorney General Mike Cox is currently conducting an ongoing investigation of the Ford Foundation, which is a Michigan nonprofit corporation.\textsuperscript{123} The Ford Foundation was begun by Edsel Ford, the son of Henry Ford, founder of Ford Motors, and

\begin{flushleft}
\begin{itemize}
  \item 119 Id. at 489.
  \item 120 Id.
  \item 121 Persan v. Life Concepts, Inc. 738 So.2d 1008 (Fla. Dist. Ct. App. 1999)
  \item 122 Id. at 1010.
\end{itemize}
\end{flushleft}
originally concentrated its focus on community initiatives specific to Michigan.\textsuperscript{124} When the Foundation was established in 1936, its focus was primarily on institutions connected with the Ford family, including the Henry Ford Museum in Dearborn, Michigan, and the Henry Ford Hospital, in Detroit.\textsuperscript{125} However, in 1950, the foundation decided to expand its mission to include such initiatives as fighting global poverty, supporting world peace, and promoting democracy.\textsuperscript{126} Additionally, the foundation ended its direct ties with the Ford family, and no family member has subsequently served on the foundation’s board.\textsuperscript{127}

The Attorney General and many Michigan residents have argued that though the foundations efforts have been broadened and expanded beyond Michigan’s borders, the foundation nonetheless owes a greater responsibility to Michigan (particularly the Southeastern communities of the state) because the corporations assets were generated by the Ford automobile dynasty.\textsuperscript{128} At the very least, many Michigan citizens believe that the Ford Foundation should resume providing funding to other nonprofit organizations bearing the Ford name, such as the Ford Museum or the Ford Hospital.\textsuperscript{129}

However, debate remains within the Michigan nonprofit community about whether the Attorney General investigation is appropriate or beneficial for nonprofits in general.\textsuperscript{130} Some have suggested that nonprofit funding priorities should be the sole provenance of the nonprofit’s board of trustees, and that the Attorney General is exercising too much control these priorities.\textsuperscript{131}

\textsuperscript{124} The Ford Foundation Website, \url{http://www.fordfound.org/}. (last visited Jan 1, 2008).
\textsuperscript{125} Wilhelm, supra note 123.
\textsuperscript{126} Id.
\textsuperscript{127} Id.
\textsuperscript{128} Id.
\textsuperscript{129} Id.
\textsuperscript{130} Id.
\textsuperscript{131} Id.
If the principles established in *Banner* were applied here, and the original contributions of Edsel Ford to the foundation were held to be governed by charitable trust principles, the Ford Foundation may have to seriously reexamine its spending priorities. The Ford Foundation assets, which were donated in a time where the foundation’s activities and mission were limited essentially to funding the Ford-named institutions, would probably be limited to expenditures primarily in these areas. Subsequent gifts made after the organization's change in mission in 1950 might be able to be used for those expanded purposes.

**V. Conclusion**

The *Banner* decision was undoubtedly a win for the Attorney General of South Dakota, and for the citizens of the communities where the seven nonprofit healthcare facilities were located. Furthermore, it was a win for all who disagree with the growing movement of consolidation of nonprofit healthcare facilities into giant multistate healthcare systems, which may increase the efficiency of nonprofit healthcare operation at the expense of the furtherance of the original community objectives of these facilities. If *Banner* was permitted to keep all the proceeds from the sale of the nonprofit hospitals, the citizens of the communities using the hospital’s services would likely be the bearers of these costs through increased costs of services at these facilities.

However, the needs of citizens in these communities must be balanced against the necessities to preserve corporate health and the ability of these corporations to adapt to change. The objectives of the Attorney General in *Banner* are admirable, and perhaps should be advanced through a different methodology, but the legal strategy used to achieve these objectives may cause more harm than good in meeting the goals of nonprofit corporations in the long term.