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Mr. Gary Chumrau
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RE: September 2, 2015 Proposal for Distribution of Charitable Assets from the Sale of Community Medical Center's Assets

Dear Mr. Chumrau:

On January 12, 2015, the Montana Attorney General's Office (AGO) approved the sale of substantially all of the assets of the former nonprofit Community Medical Center (CMC). At that time, the AGO expressly indicated its review did not include approval of CMC's then proposal for the distribution of charitable assets. The AGO sought and received additional time for public input and review of the proposed distribution.

Also on January 12, 2015, the AGO and CMC entered into a Stipulation extending the period to review the asset distribution proposal. This Stipulation also included substantive provisions concerning the distribution of charitable assets. CMC agreed to engage a public process to select board members for a new foundation to be called the Missoula Community Hospital Legacy Foundation (Legacy Foundation); limit to three, the number of former CMC Board members that may serve on the Legacy Foundation Board; strike the provision in a prior proposal that would have allowed the former CMC board members to select other Legacy Foundation Board members for nine years; allow an individual appointed by the Attorney General to attend Legacy Foundation Board meetings; and, agreed that the Legacy Foundation's governing documents may not be amended without AGO approval. The AGO posted the January 12, 2015 Stipulation on the AGO's website.

Further on January 12, 2015 after negotiations with the AGO, counsel for RCHP Billings-Missoula LLC (CMC's buyer) clarified a non-compete clause in the Asset Purchase Agreement. That agreement contained a very broad non-compete clause that prevented the Legacy Foundation from donating to a host of healthcare service providers in Missoula and the surrounding region. The Attorney General narrowed the application of the non-compete language to allow the Legacy Foundation to make grants to nonprofit organizations, including nonprofit hospitals in the CMC service area, under specified conditions. *See* January 12, 2015 letter from counsel for the buyer, RCHP Billings-Missoula LLC, to AGO. The AGO also posted this letter on the AGO's website.

On January 16, 2015, the sale transaction closed and the sales proceeds were distributed to CMC Missoula Inc. (CMC Missoula), successor-in-interest to CMC.

That same month, the AGO received a revised proposal entitled "CMC's Proposal for Use of Net Closing Proceeds."

On March 18, 2015, CMC Missoula withdrew its January 2015 Proposal for Use of the Net Closing Proceeds and requested an extension of up to six months to reassess and refine its proposal.

On March 19, 2015, the AGO granted an extension to September 20, 2015. On September 2, 2015, CMC Missoula submitted a proposal (September 2 Proposal) to create a new foundation, the Legacy Foundation. CMC Missoula also submitted proposed Articles of Incorporation (proposed Articles) and proposed Bylaws (proposed Bylaws) for the Legacy Foundation.

The AGO published the September 2 Proposal, including the proposed Articles and the proposed Bylaws, on the AGO's website. Additionally, the AGO issued a press release notifying the public of the placement of these materials on the AGO website and seeking public comment.

The AGO received and reviewed over 70 public comments regarding the disposition of CMC's charitable assets. We summarize the most-repeated comments later in this letter.

The Attorney General conducted a thorough review of CMC's and CMC Missoula's proposals for the use of charitable assets. We made several specific requests for information and documents. We reviewed hundreds of pages of documents received in response and met several times with representatives of the CMC Missoula Board. In addition to receiving information from CMC Missoula, the AGO conducted its own independent research and interviewed several individuals with knowledge of the process used in developing the asset distribution proposals. After an extensive review, we now approve the September 2 Proposal subject to two conditions set forth later in this letter.

SUMMARY OF SEPTEMBER 2, 2015 PROPOSAL

Unlike CMC's January 2015 proposal that would have distributed $10,500,000 to the University of Montana Foundation, the September 2 Proposal would distribute all of the net proceeds of the sale of the charitable assets to the Legacy Foundation. This new foundation would be organized for the purpose of promoting health and healthcare services to that portion of western Montana which comprised CMC's service area at the time of the sale of CMC's assets. *See* Article VIII of proposed Articles. Other significant provisions of the proposed Articles include:

- The Legacy Foundation cannot change its purpose or mission without the express, written approval of the Montana Attorney General (AG). *See* Article VIII of proposed Articles.
- After engaging in a public process, CMC Missoula would appoint the initial Board of Trustees of nine members. At no time would there be more than three trustees who served as members of the CMC board prior to January 16, 2015. *See* Article VI of proposed Articles.
- Trustees could serve a maximum of three, full three-year terms. Subject to this term limit, the Board of Trustees could reelect existing trustees or elect new trustees. *See* Article VI of proposed Articles.
- All trustees must have an interest in and concern for the Legacy Foundation and its nonprofit health and healthcare mission, be objective and impartial, and have a willingness and ability to commit time to the Legacy Foundation's affairs, and must be committed to the purpose of the Legacy Foundation as a whole and not to any other special interest. *See* Article VI of proposed Articles.
- Trustees would serve without compensation. *See* Article VI of proposed Articles.
- Subject to the exception that follows, all trustees must reside in CMC's service area. However, if it is necessary to populate the Board with the individuals who have experience or expertise in the areas outlined in Article VI of the proposed Articles, the Board could elect up to two trustees who reside outside CMC's service area.
- The Legacy Foundation would be operated and managed on a permanent endowment basis. *See* Article VIII of proposed Articles.

The proposed Bylaws provide that the Board shall approve a conflict of interest policy for the Legacy Foundation that is consistent with, and at least as protective as, the applicable conflict of interest provisions of the Montana Nonprofit Corporation Act. *See* Article VIII of the proposed Bylaws. Other significant provisions of the proposed Bylaws include:

- The Board may create committees, which shall be advisory in nature. *See* section 5.1 of the proposed Bylaws.
- Non-trustees may serve on committees. *See* section 5.2 of the proposed Bylaws.
- The Board must ensure that the Legacy Foundation undergoes an annual audit by an independent auditor. *See* section 9.5 of the proposed Bylaws.
- The AG, or a representative of the AG, shall be entitled to attend all meetings of the Board of Trustees in a non-voting capacity. *See* section 3.6 of the proposed Bylaws.
- Prior to making any amendment to the proposed Bylaws, notice must be given to the AG. If the AG objects to the proposed amendment within twenty days, the Board may not adopt the proposed amendment. *See* section 13.1 of the proposed Bylaws.

APPLICABLE LAW

Similar to the legal analysis performed for the underlying sale, the AGO reviewed the transaction pursuant to *parens patriae* authority, as well as authority granted by the Montana Nonprofit Corporation Act, MCA §§ 35-2-113 et seq. This legal framework authorizes the Attorney General to protect charitable assets and serve the public's interest by assuring that charitable organizations serve the purposes for which they were created. Our inquiry focused on two primary legal questions:

1) Whether the Board of CMC Missoula satisfied its fiduciary duties in forming its proposal for the disposition of its charitable assets, including whether CMC's officers and directors fulfilled their duty of care and good faith and their duty of loyalty to the corporation; and

2) Whether the proposed use of the assets complies with the principles of the *cy pres* doctrine, which means the assets must be given to another charitable organization with a mission that closely matches that of the former nonprofit hospital and that the assets must be used to serve the same geographic area.

ANALYSIS

The duty of care requires directors of a nonprofit organization to act in a reasonable, diligent, and informed manner. They must discharge their duties in good faith, with the care an ordinarily prudent person in a similar position would exercise under similar circumstances, and in a manner the director reasonably believes to be in the best interests of the organization.

Directors are expected to make informed decisions, which requires the director to take reasonable steps to obtain the information relevant to the matters that come before the Board. They may rely on information and recommendations provided by others, including consultants and advisors. The directors must reasonably believe that the people providing the information are competent and reliable. A director does not act in good faith if the director knows information that makes reliance unreasonable.

In fulfilling the duty of care and good faith, the Board should engage a fair and thorough process designed to identify various options available to the Board, weigh the consequences of each option, and arrive at an informed and well developed conclusion. The process should be memorialized in meeting minutes or other documents showing what information and advice the Board considered in reaching its conclusion.

Our investigation reveals that from March 18, 2015 to September 2, 2015, Board members engaged in the process of examining options concerning the disposition of the net charitable proceeds. The Board engaged The Giving Practice (TGP), a foundation consultant, to identify potential foundations for affiliation and to analyze the advantages of affiliation and the advantages of creating a new foundation, as well as the disadvantages. TGP did identify two foundations for potential affiliation and undertook discussions with the staff of one of those foundations, which TGP described as the "most likely partner." TGP identified savings of approximately $100,000 for reoccurring salary costs of an extra CEO and CFO. In our view, TGP underestimated the cost savings achievable by affiliation. In addition to eliminating the reoccurring salary costs of an extra CEO and CFO, which are likely to be greater than $100,000, an affiliation could achieve savings of other annual operating costs, such as:

- audit costs;
- tax document preparation expenses;
- costs associated with memberships in key industry associations and networks;
- possibly lower total general liability insurance costs, including directors and officers insurance; and,
- investment management cost savings associated with a larger sum of assets under management.

Although our view is that there are greater potential cost savings than those estimated by TGP, the Board could rely on TGP's recommendations. The Board could reasonably conclude that TGP is competent and reliable. Further, as indicated in the Board minutes, the Board devoted substantial time considering TGP's recommendations. Ultimately, the Board decided that the perceived benefits associated with its plan of local control for a new foundation outweighed the cost savings achievable through affiliation with an existing foundation. The AGO declines to substitute its preference for that of the Board, so long as the Board satisfies its fiduciary obligation. In short, the AGO concludes the Board fulfilled its duty of care and good faith.

In addition, we conclude that the Board fulfilled its duty of loyalty. The duty of loyalty obligates officers and directors to act in the best interests of the corporation and not in their own self-interest. A conflict of interest transaction is one in which a director or officer has a direct or indirect personal interest in a transaction. None of the board members had any personal interest in selecting the recipient of the charitable funds.

CY PRES **DOCTRINE**

The AGO must also determine if CMC's proposed use of the sale of CMC's assets (the charitable assets) meets the requirements of *cy pres*. *Cy pres* is an abbreviated form of "*cy pres comme possible*," a French phrase meaning "as near as possible." *Cy pres* requires that the proceeds of assets of the former nonprofit entity be devoted to a charitable purpose that reasonably approximates the designated original purpose. The AGO is charged to see that donors' charitable intent is honored, even though CMC no longer operates as a nonprofit entity. The proceeds of the sale of its assets must be devoted to charitable purposes that are as near as possible to the charitable mission of the former CMC and must serve the same geographic area as the former CMC.

CMC described its mission as: "Your Health – our commitment to you, from day one." CMC provided its health services to Missoula County residents and to residents in nearby counties located in Western Montana (CMC's service area). As applied to CMC, *cy pres* therefore requires (1) services that promote health and (2) services that are provided to residents within CMC's service area.

As noted, the Legacy Foundation would be organized for the purpose of promoting health and healthcare services to that portion of western Montana which comprised CMC's service area at the time of the sale of CMC's assets. *See* Article VIII of proposed Articles. We conclude that the Board's proposal satisfies the *cy pres* requirement.

PUBLIC COMMENT

The AGO received public comment on a variety of matters.

One. Legacy Board Composition. Some objected to the service of any individual who had been a member of the CMC board. Others objected to CMC Missoula making appointments to the Legacy Foundation board and suggested that Missoula City Commissioners and the Missoula County Commissioners make board appointments. Although these objections and suggestions reflect legitimate policy opinions, the proposal put forth by CMC Missoula satisfies the requirements of Montana law. The AGO recognizes the importance of an independent Board of Directors for the Legacy Foundation and encourages CMC Missoula to select highly-qualified, independent individuals to serve on the board. Additionally, the CMC Missoula board must be mindful of potential conflicts of interest, particularly with regard to the now for-profit CMC hospital, in selecting individuals to serve on the Legacy Foundation Board.

Also, the AGO received a number of comments about permitting the appointment of up to two trustees from outside CMC's service area under certain circumstances. CMC responded that it might be useful to find a person needed in investment, asset management, public health, or nonprofit administration/grant making in the healthcare field. Again, the AGO concludes that including such a provision does not constitute a breach of fiduciary obligations. However, we do request that CMC consider a modification of the proposed Articles and proposed Bylaws in light of the provisions that require only three trustees. As currently drafted, it is conceivable that two of three trustees could reside outside CMC's service area. We request that CMC consider a further restriction that would permit the appointment of up to two trustees from outside CMC's service area only so long as at least nine trustees are serving.

Additionally, the AGO received specific suggestions to modify other provisions of the proposed Articles and proposed Bylaws relating to the board's composition.

Two. <u>Advisory Board</u>. Some criticized the proposed Articles and the proposed Bylaws because they do not require the creation of an advisory board. Section 5.1 of the proposed Bylaws permits the creation of advisory committees. Section 5.2 of the proposed Bylaws permits non-trustees to serve on committees. The AGO strongly recommends that the Legacy Foundation create an advisory committee and seek broad community input.

Three. <u>Specific Uses of the Assets</u>. A number of members of the public observed that the health and healthcare purposes of the Legacy Foundation do not identify the specific programs and uses of the charitable assets. CMC Missoula responded that since the health and healthcare needs will change over time, the Legacy Foundation must have the flexibility, within the scope of its mission, to meet these varying needs. The AGO again concludes that CMC Missoula has not violated any of its fiduciary obligations in this regard. In fact, the broad purposes are very consistent with the Legacy Foundation's permanent endowment model. That said, this inquiry underlines the need for public involvement. In addition to recommending the use of an advisory board, the AGO recommends that the Legacy Foundation actively seek citizen input. Public confidence is critical to the Legacy Foundation's success.

The AGO relayed public comment on the above three matters as well as other questions and concerns and asked CMC Missoula to respond. On October 14, 2015, CMC Missoula responded to the AGO's inquiries. That response was posted on the AGO website.

CONCLUSION

In light of this investigation, the Attorney General concludes that the CMC Missoula's Board of Directors did not breach its fiduciary duties in creating its September 2 Proposal and that the proposal satisfies the *cy pres* requirement. However, the Attorney General's approval is subject to two conditions.

First, within 90 days of receipt of a certificate of incorporation, and before the Legacy Foundation makes any distributions, the Legacy Foundation must adopt and enforce a strict and thorough conflict of interest policy, which must be approved by the AGO. We understand that Article VIII of the proposed Bylaws commits the Legacy Foundation to adopt a conflict of interest policy that meets the minimum state law requirements. We think it essential to the success of the Legacy Foundation and to public confidence that a strict and thorough policy be adopted.

Second, the Legacy Foundation must acquire a recent community health needs assessment that covers CMC's service area prior to making any distributions to grantees. We understand that Missoula County has already put forth a community health needs assessment and has adopted a health plan pursuant to the needs identified in the assessment. If that assessment does not provide sufficient detail for CMC's service area and no sufficient assessment is available from another source, the Legacy Foundation should fund a collaborative community health needs assessment prior to making grants. We anticipate that once the assessment and plan are completed, the Legacy Foundation will broadly publish requests for proposals that will address identified community needs and the health improvement plan. For instance, we expect that requests for proposals and grants awarded will be published on a website created and maintained by the Legacy Foundation.

Finally, we urge the Legacy Foundation to seek every opportunity to involve the public in the Legacy Foundation's operations. In addition to creating and utilizing an advisory committee, we recommend that the Legacy Foundation broadly publish its budgets, its requests for proposals, criteria for awarding grants, the names of its grantees, the purposes and dollar amounts of its grants, and its financial reports.

The Legacy Foundation has a significant opportunity to serve the health and healthcare needs of citizens who reside within CMC's service area. We wish the Legacy Foundation well.

Sincerely,

TIM FOX
Attorney General
State of Montana