

GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE ATTORNEY GENERAL



ATTORNEY GENERAL

[Privileged Attorney-Client Communication]

MEMORANDUM

TO: Robert Bobb
City Administrator

FROM: Robert J. Spagnoletti *Robert J. Spagnoletti*
Attorney General

DATE: March 4, 2005

SUBJECT: CareFirst -- evaluation of DC Appleseed's contentions regarding
GHMSI's charitable obligation

This memorandum responds to your request for an evaluation of the DC Appleseed Center for Law and Justice's ("DC Appleseed") legal contentions regarding the "charitable obligation" of Group Hospitalization and Medical Services, Inc. ("GHMSI"), the congressionally-chartered, District of Columbia ("District") affiliate of CareFirst Blue Cross and Blue Shield ("CareFirst"). DC Appleseed's legal contentions are set forth in Section 2 of its December 2004 report on "CareFirst: Meeting Its Charitable Obligation to Citizens of the National Capital Area" (hereinafter "Appleseed Report"). Section 2 was prepared by the law firm of Covington & Burling and is entitled "GHMSI's Legal Obligation to Pursue a Charitable, Public Health Mission."

DC Appleseed is correct in concluding that GHMSI, which was chartered by Congress as a "charitable and benevolent institution," has an obligation to pursue a public health mission and that this obligation is not inconsistent with GHMSI's obligation, also under its charter, to operate for the benefit of its subscribers. DC Appleseed also correctly concludes that GHMSI's responsibilities with respect to its public health mission are subject to (1) regulatory oversight by the Department of Insurance, Securities and Banking and (2) the Attorney General's enforcement authority under common law.

As DC Appleseed notes, the D.C. Council has recognized in a statutory finding that the Attorney General "is entrusted by common law to bring actions on behalf of the public in the event of a breach of the charitable trust of a healthcare entity." D.C. Code § 44-601(5). Because GHMSI is domiciled in the District, operates in the District, and is licensed and regulated by the District government, the Attorney General for the District of Columbia is the official who would represent the interest of the community in a court proceeding to determine whether GHMSI has acted contrary to its charter obligations. See Restatement (Second) Trusts § 391 comment *a*.

DC Appleaseed's analysis of GHMSI's operations has properly focused on whether the company has been using its financial resources consistently with its charitable mission. However, in characterizing GHMSI as "not yet devoting [its] considerable assets to charitable activities" (Appleaseed Report at I-4), DC Appleaseed uses the term "charitable" in a very narrow sense and fails to recognize that GHMSI can be faithful to its "charitable and benevolent" designation by operating its non-profit health plans for the purpose of promoting better public health. Indeed, by providing or improving non-profit health plan benefits for as many subscribers as possible, GHMSI can do much to promote better health in its service area. GHMSI may even choose to fulfill its "charitable" mission by devoting *all* of its resources – including profits and excess surplus – to maximizing the quality, benefits, affordability, and accessibility of its health plans, while maintaining fiscal soundness. Alternatively, GHMSI may choose to allocate some of its resources to providing health-related services at no charge or to funding other organizations or entities that are working to promote public health.

GHMSI must operate as a charitable and benevolent institution, consistent with operating for the benefit of its present and future subscribers. It cannot fulfill this mission simply by allocating a specified percentage of premiums or earnings to distinctly "charitable" activities. Rather, GHMSI is to devote its entire operation to serving, directly or indirectly, the purposes for which it was chartered. It is largely up to GHMSI's board to decide how GHMSI will serve these purposes, including the extent, if any, to which profits or surplus are to be devoted to public-health-related activities other than the operation of non-profit health plans for paying subscribers.

This memorandum focuses on the legal standards that should guide District of Columbia Government ("District") officials in determining how GHMSI may fulfill its corporate purpose as a "charitable and benevolent" institution. It does not address whether GHMSI has in fact been operating consistently with its charter.

1. GHMSI may fulfill its obligation to act as a "charitable and benevolent institution" by providing non-profit health plan services to paying subscribers.

GHMSI may meet its obligations under its charter through the operation of non-profit health plans, even if the only direct beneficiaries are the plans' past, current, and future paying subscribers. To the extent that GHMSI's health plans are being operated for "charitable and benevolent" purposes, the profits they generate need not be diverted to other activities. Instead, GHMSI may seek to promote better public health by using its profits exclusively to enhance the quality, benefits, affordability, or accessibility of its health plans.

In the District of Columbia, a charitable corporation like GHMSI is ordinarily subject to the principles and rules that apply to charitable trusts, as described by the Restatement (Second) Trusts (1959). *Bd. of Dirs. of the Washington City Orphan Asylum v. Bd. of Trs. of the Washington City Orphan Asylum*, 798 A.2d 1068, 1075-76 & nn. 5-6 (D.C. 2002); see *Hooker v. Edes Home*, 579 A.2d 608, 611 n.8 (D.C. 1990) (applying Restatement to

charitable corporation chartered by Act of Congress). Under these common law principles, charitable purposes are those that "are of a character sufficiently beneficial to the community to justify permitting property to be devoted forever to their accomplishment." Restatement (Second) Trusts § 374. A long-recognized charitable purpose is "the promotion of health." *Id.* §§ 368(d), 372. Therefore, GHMSI may act as a "charitable and benevolent" institution by making the promotion of health the bottom-line purpose of its health plan operations.

An institution that promotes health may be "charitable" even if, like GHMSI, it requires subscribers to "pay fees or otherwise contribute to the expense of maintaining the institution," so long as "the income so derived is to be used only to maintain the institution or for some other charitable purpose." *Id.* § 376 comment *c*. If the fees generate profits, the profits may "be used for the purposes of the undertaking producing the profits or for other charitable purposes." *Id.* § 376 comment *d* (emphasis supplied). In other words, as long as the institution is devoted to charitable purposes and the generation of profits is at most a means to those ends, the institution is under no obligation to devote its profits to an activity that is independent of the charitable activities that produced the profits.

Assuming that its purpose is to promote health, a non-profit health plan may qualify as charitable if "the persons who are to benefit are . . . of a sufficiently large or indefinite class so that the community is interested in the enforcement" of the obligation to serve. *Id.* § 375. The test is whether the benefit can be said to extend beyond the direct beneficiaries to the community itself:

A trust for the promotion of health is charitable whether it extends to all persons, or is limited to those residing in a particular district, or those of a particular class, provided that the class is not so small that the relief of the class is not of benefit to the community. Thus, a trust to establish or maintain a hospital for the employees of a particular railroad is charitable.

Id. § 372 comment *a*.

More important to the analysis than the actual number of beneficiaries is the size of the group from which they are drawn:

A trust may be a charitable trust although the number of persons who receive a benefit from it is small, provided that the class from which they are to be selected is sufficiently large. Thus, a trust to apply the principal for the benefit of a small number of poor persons, or a trust to apply the principal in defraying the expenses of the education of one poor boy, or a trust to apply the principal as a prize for the best work of art produced within five years after the settlor's death, is a charitable trust. In each case the class of persons from whom the recipients of the benefit are to be drawn is sufficiently wide to make the trust charitable, although the number of persons to receive the benefit is strictly limited.

Id. § 375 comment *j*. According to the most current authority, one looks beyond the actual number of direct beneficiaries to consider whether the beneficiaries are “drawn from an indefinite group” or “from a group so narrowly defined (e.g., the settlor’s descendants or relatives) as to make the trust a private trust.” Restatement (Third) Trusts § 28 comment *a(1)*.

With hundreds of thousands of paying subscribers and the potential to enroll hundreds of thousands more, GHMSI can have a broad and positive impact on the public health if it conducts itself for the benefit of its subscribers, as its charter requires. Moreover, the fact that the group of GHMSI subscribers is ever-changing and drawn from a broad segment of the region’s population increases the potential for the community as a whole to benefit from these activities.

DC Appleaseed argues that, because GHMSI’s assets are held for the benefit of the public, GHMSI has an obligation to benefit the public in some way that is independent of the benefits being conferred on current subscribers. It is true that, under both District and common law, GHMSI’s assets belong to the public. As a result, GHMSI may neither liquidate its assets and distribute the proceeds to its current subscribers, nor engage in the functional equivalent of an asset liquidation by providing an extraordinarily high level of benefits to current subscribers without regard for the corporation’s ability to survive over the long run. But as long as GHMSI does not sacrifice its ability to serve future subscribers, its service to current subscribers may satisfy, at least for now, its obligation to serve the public: “While the human beings who are to obtain advantages from charitable trusts may be referred to as beneficiaries, the real beneficiary is the public and the human beings involved are merely the instrumentalities from whom the benefits flow.” Restatement (Third) Trusts § 28, Reporters Notes on comment *a*, quoting *In re Estate of Freshour*, 345 P.2d 689, 695 (Kan. 1959).

In further support of its argument that GHMSI has a “current, charitable” obligation to “use its assets for the benefit of the public beyond its current policyholders,” DC Appleaseed notes that GHMSI has a statutory obligation, as a condition to its issuing subscriber contracts in D.C., to “provide health-related educational support for residents of the corporation’s service area.” D.C. Code § 31-3514(i). But the statute’s imposition of an educational support obligation, as a condition of GHMSI’s operating in D.C., does not serve to define or expand GHMSI’s charitable *purposes*, which are determined by its congressional charter. The statutory obligation is just one more regulatory constraint under which GHMSI must operate. Moreover, unlike a for-profit company, GHMSI *exists* to serve the public. It does not “satisfy” its obligation to the public simply by meeting a statute’s minimum threshold for good corporate citizenship.

Seeking “to derive a community benefit test that relies on a variety of concrete indicia to serve as a standard for assessing whether GHMSI is meeting its obligations as a charitable institution” (Appleaseed Report at II-27), DC Appleaseed cites to various federal and state court decisions that considered whether particular institutions qualified for the tax exemptions or public asset protections normally accorded to charitable organizations. But

these decisions provide little guidance for determining whether an *admittedly* charitable institution is acting consistently with or contrary to its own corporate purposes.

The cited cases stand for the general proposition that a non-profit organization whose only service is the provision of health insurance for paying subscribers is not *necessarily* "charitable" enough to be recognized as a charity, or at least not for all purposes. *E.g., Blue Cross and Blue Shield of Kansas City, Inc. v. Nixon*, 26 S.W.3d 218 (Mo. Ct. App. 2000) (non-profit corporation that had "increasingly articulated . . . a purpose to serve the public in a benevolent and charitable capacity" held to be "public benefit corporation"); *Supervisor of Assessments v. Group Health Ass'n, Inc.*, 517 A.2d 1076 (Md. 1986) (non-profit HMO not "charitable organization" for purposes of property tax exemption); *Harvard Community Health Plan, Inc. v. Board of Assessors*, 427 N.E.2d 1159 (Mass. 1981) (health plan that provided "lower than average cost" services to "a large number of persons . . . in the greater Boston area" deemed "charitable"); *Illinois Hospital & Health Service, Inc. v. Aurand*, 373 N.E.2d 1021 (Ill. App. Ct. 1978) (Illinois Constitution did not allow "charitable" tax exemption to be applied to property of non-profit health service corporation).

Contrary to the thrust of DC Appleseed's argument, the fact that organizations similar to GHMSI have often failed to qualify for various tax exemptions does not mean that these organizations – or GHMSI – have an *obligation* to conduct themselves in a manner that would qualify for such tax exemptions. In *Illinois Hospital & Health Service*, the court held that though a health services plan was declared by statute to be "a charitable and benevolent corporation," its property was "not used for charitable purposes within the meaning of . . . the Illinois Constitution and is therefore not entitled to exemption from tax." 373 N.E.2d at 1022-23, 1026. The court's conclusion was that the corporation, "laudable and desirable as it may be, is for the benefit of those members who make their payments," and that the corporation had not met "the burden of proving the right to [a tax] exemption." *Id.* at 1025. However, the court never suggested that this corporation had acted in any way contrary to its obligations under "the applicable statute relating to its organization." *Id.*

The apparent inconsistency between what are deemed to be charitable purposes under the common law and what are deemed to be charitable purposes under the tax laws reflects a reluctance by the courts to award tax exempt status to organizations unless they have clearly demonstrated that they "provide sufficient benefit to the community to justify exemption from . . . taxes." *Supervisor of Assessments v. Group Health Ass'n, Inc.*, 517 A.2d at 1081. In tax cases, the question before the court is not simply whether the health plan benefits the community, but whether benefit to the community is the "primary purpose" rather than "incidental to [the] function of providing health care services to its members." *Id.* at 1080. But a health plan does not have to satisfy the relatively stringent tests applied in tax cases in order to be "charitable" in the common law sense of benefiting the community *through* its service to its subscribers. *Cf. Restatement (Third) Trusts* § 28, Reporters Notes on comment *a*, quoting C.E. Rounds, Jr. & E.P. Hayes, *Loring: A Trustee's Handbook* (1997 ed.) § 9.4.1 ("A trust may not be exempt for income tax purposes, but may still be a common law charitable trust, and a trust may be exempt from income tax but not qualify as a charitable trust.").

Significantly, none of the court decisions cited by DC Appleseed considered the *obligations* of an admittedly "charitable and benevolent" organization, like GHMSI. For example, in *Blue Cross and Blue Shield of Kansas City*, the Missouri appellate court held that a non-profit corporation that was *not* designated by statute as a "public benefit corporation" could nevertheless be deemed to be one based on its having "articulated and carried out a purpose to serve a more far-reaching constituency than just its subscribers." 26 S.W.3d at 232. The court had no need to consider, and did not consider, whether a non-profit health insurer that *has* been designated by statute as existing for the benefit of the public, such as a corporation declared to be a "charitable and benevolent institution," has any obligation to serve the public other than through the provision of services to its subscribers.

The obligations of a charitable health insurer were also not addressed in *Abbott v. Blue Cross and Blue Shield of Texas, Inc.*, 113 S.W.3d 753 (Tex. App. 2003), another case cited by DC Appleseed. *Abbott* stands for the proposition that, at least in Texas, a non-profit health insurer whose original articles of incorporation provide that "the corporation will be one of charity and benevolence," *id.* at 762, is not necessarily a "public charity" whose assets must be preserved for charitable purposes. Having found that the health insurer had "never had a public charitable purpose," *id.* at 766, the *Abbott* court did not consider the obligations placed on a health insurer that *does* have a charitable purpose.

None of the cases cited by DC Appleseed undermine the conclusions, derived from general charitable trust principles, that GHMSI may fulfill its obligations as a "charitable and benevolent institution" through the provision of health plan services to paying subscribers, and that GHMSI has no obligation to divert the profits generated by its health plan services to other charitable activities.

2. GHMSI's board has responsibility for determining how the corporation will fulfill its obligation to act as a "charitable and benevolent institution."

As a "charitable and benevolent institution" whose operations are to be "conducted for the benefit of" its subscribers, GHMSI's bottom-line corporate purpose is to promote health in the community through service to its subscribers. In other words, the generation of operating profits or the enhancement of company value is at most a *means*, not an end. GHMSI has an obligation to conduct itself so as to serve the needs of subscribers in a manner that is consistent with its public health purpose. While the Attorney General has common law authority to seek judicial relief if GHMSI has neglected or acted contrary to this obligation, it is normally the responsibility of a non-profit corporation's board to determine how the corporation can best fulfill its "charitable and benevolent" mission.

Although the "business judgment rule protects the fair and honest business judgments" of GHMSI's directors as to how best to fulfill the corporation's charitable purposes, the rule does not provide any protection from judicial or regulatory interference to corporate decisions that are "contrary to those statutory purposes." *Blue Cross and Blue Shield of Missouri v. Angoff*, 1998 Mo. App. LEXIS 1490, at 51-52 (Mo. Ct. App. 1998) (state

attorney general challenge to reorganization of non-profit health insurer). Thus, a state attorney general was able to challenge a Blue Cross organization's "decision to reorganize and its subsequent operations where the reorganization and subsequent operations effectively resulted in an abandonment of its nonprofit purposes." *Id.* at 52.

The following are examples of conduct that would appear to contravene GHMSI's charitable purposes by (1) placing profit generation or executive compensation *ahead of* GHMSI's obligation to serve its subscribers, or (2) benefiting subscribers in a manner that is inconsistent with GHMSI's obligation to promote public health:

- Seeking to increase GHMSI's profits or asset value without due regard for the effect on the quality, benefits, affordability, or accessibility of GHMSI's health plans.
- Paying GHMSI executives substantially higher compensation than is generally paid to executives at comparable non-profit institutions.
- Providing shares of GHMSI to subscribers or making a public offering of GHMSI stock.
- Using subscribers' fees to obtain substantial benefits for them, like discounts on rental cars or complimentary "frequent flyer" miles, that are unrelated to the corporation's public health mission.
- Liquidating substantial corporate assets in order to generate funds for distribution to subscribers.

Within the constraints imposed by GHMSI's charter, the decision as to how GHMSI will use its profits and excess surplus to serve the needs of its subscribers or the public is largely up to its board. The board may choose to devote the additional resources to one or more of the following goals, among others:

- Improving the overall quality or benefits of its health plans for subscribers without increasing rates.
- Increasing the overall affordability of its health plans in order to increase the number of GHMSI subscribers.
- Increasing the accessibility of its health plans for new and existing subscribers by providing discounts for subscribers with limited income.
- Providing or supporting health-related education for subscribers or the general public in GHMSI's service area.
- Engaging in cooperative efforts with private or governmental

institutions to promote health in GHMSI's service area.

- Supporting the efforts of other charitable organizations to promote health in GHMSI's service area.

In pursuing any of these goals, the board should keep in mind that even the "non-profit" goal of maximizing benefits for GHMSI's subscribers should be pursued in a manner that is consistent with the larger "charitable" purpose of promoting better health in GHMSI's service area. For example, by reducing its rates and thereby making its health plans more affordable, GHMSI can help to reduce the number of people in its service area who lack health insurance.

Through regular consultations with public health officials, including District officials, GHMSI and other charitable health care institutions can help to ensure that their initiatives to promote better public health represent a coordinated effort to address unmet health care needs in the GHMSI's service area.

Conclusion

As a "charitable and benevolent institution" that seeks to serve a public health mission, GHMSI has an obligation to use its profits and excess surplus to serve the purpose of promoting health in its service area. GHMSI's board may choose to fulfill this obligation in various ways, such as devoting surplus resources to (1) improving the quality, benefits, affordability, or accessibility of its non-profit health plans, (2) providing health plan benefits or other services to the poor at no charge, and/or (3) funding health-related activities that are conducted by other charitable organizations. But GHMSI does not have an obligation – derived either from common law principles or tax decisions – to satisfy any minimum threshold for providing services at no charge or for making contributions to other organizations.

The District, through its Attorney General, has common law authority to enforce GHMSI's obligation to operate consistently with its "charitable and benevolent" purpose. However, District officials cannot use this authority to compel GHMSI to divert funds from its own operations on behalf of its paying health plan subscribers.

District officials can actively assist efforts by GHMSI's board to ensure that the corporation is operated consistently with its charter. By helping to identify unmet health care needs in D.C., District officials can encourage GHMSI to develop initiatives that, in coordination with the efforts of other private and governmental institutions, are effective in promoting better public health in GHMSI's service area.