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Nonprofits: The Internal Struggles of Officers and Directors

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NOT FOR PROFITS:
THE INTERNAL STRUGGLES OF OFFICERS AND DIRECTORS
A Panel Discussion

Presented By:

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THE NOT-FOR-PROFIT HEALTH CARE ENTITY-
INTERNAL STRUGGLES AND OPERATIONAL DILEMMAS

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I. Identifying the Problem—Current Issues Facing Not-for-Profit Health Care:

Health care facilities face numerous stressors in today's world and, so too, their officers and directors. From the ever increasing costs of compliance with applicable regulations to the labyrinth of controls levied upon them by state and federal agents, not-for-profit (and for that matter for-profit) health care facilities and their managers are faced with a daunting array of requirements while also facing the daily uncertainty of adequate payment for their efforts. The problem is not confined to any particular state or region or any specific segment. Nursing homes and hospitals alike face these problems. It is indeed endemic to the business. Although a complete survey of the fifty states is beyond the scope of this presentation, certain paradigms exist. Perhaps one old adage can sum it up—"As Maine goes, so goes the nation."

In Maine, a record number of nursing homes closed in 2018.[1, 2] Six closed in Maine in 2018 alone, three in 2014 and one in each of 2016 and 2017.[3] Forty such homes have closed since 1995.[4] Why?

a. Medicaid[5]

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[1] Brendan Williams (President & CEO of NH Health Care Association), *Column: N.H. Must Act Now on Crisis in Long-Term Care*, VALLEY NEWS (Dec. 25, 2018), https://www.vnews.com/Column-N-H-Must-Address-Long-Term-Care-Crisis-22299035 (hereinafter referred to as "December 2018 VN Art.").

[2] Jackie Farwell, *Record Number of Maine Nursing Homes Closed This Year, Displacing Hundreds*, BANGOR DAILY NEWS (Dec. 12, 2018), https://bangordailynews.com/2018/12/12/mainefocus/record-number-of-maine-nursing-homes-closed-this-year-displacing-hundreds/ (hereinafter referred to as "December 2018 BDN Art.").

[3] December 2018 BDN Art.

[4] *Id.*

[5] Medicaid is always the "payor of last resort." 42 C.F.R. § 433.139(b); *see* Joy Hicks, *What it Means that Medicaid is the Payer of Last Resort*, VERY WELL HEALTH (Oct. 13, 2018), https://www.verywellhealth.com/medicaid-payor-of-last-resort-2317386. As explained below, it is also the least desirable method of payment from the standpoint of facilities. Facilities that accept Medicaid are limited to payments pursuant to Medicaid for eligible patients. In other words, there is a general prohibition on supplemental billing.

One of the most vexing problems is Medicaid coverage. For example, MaineCare in Maine, a federal-state assistance program, has underfunded care for an extended period.[6] Sixty six percent of Mainers in nursing care are paid for by MaineCare.[7] "On average, a day in a nursing home costs roughly $250 . . . [but] MaineCare pays about $215. . . ."[8] The result is an ever worsening predicament which sometimes becomes a death spiral. "Some facilities stay afloat by shifting the burden to residents with more generous private long-term care insurance or Medicare . . . . But that is not always an option, particularly in rural areas where residents who can afford better insurance are few and far between."[9]

The underfunding issue also compounds another problem—staffing.[10] Finding qualified staff is already difficult in light of the fact that better paying jobs in retail or other industries are available.[11] Where the funds are not there to compete with those better paying jobs, the result is obvious—talented staff goes elsewhere.[12,13] Staffing levels also become a barrier to filling beds, since care facilities are forbidden from having more patients[14] than they can adequately care for based upon certain federally mandated (and closely monitored) criteria.[15,16]

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[6] December 2018 BDN Art.
[7] *Id.*
[8] *Id.*
[9] *Id.*
[10] *Id.*
[11] *Id.*
[12] *Id.*
[13] Maggie Flynn, *Non-Profit Texas SNFs Forced to Close Amid Low Medicaid Rates*, SKILLED NURSING NEWS (Feb. 4, 2018), https://skillednursingnews.com/2018/02/non-profit-texas-snfs-forced-close-amid-low-medicaid-rates/ (stating that without adequate reimbursement, facilities are unable to improve staffing levels and upgrade quality of care.).
[14] The term "patient" or "patients" is used generically to refer to patients in hospitals and residents in long-term care facilities.
[15] December 2018 VN Art.
[16] December 2018 BDN Art.

Although Maine is used as an example, it is one of many. Other states are experiencing the same type of problem to various degrees.[17] This includes New Hampshire.[18,19] It also includes Texas.[20] Indeed, it is reported to have been 25 years since Texas has reimbursed nursing homes for actual costs.[21] A recent study for the American Health Care Association reported that none of the 28 participating states provided adequate reimbursement of costs to facilities participating in the Medicaid program.[22] "According to the 4Q2017 NIC Skilled Nursing Report, Medicaid reimburses skilled nursing properties at an average national rate of $206 per day, less than half the rate paid by Medicare, $503."[23]

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[17] Maggie Flynn, *NY Times: Lower Census Causing Hundreds of Nursing Homes to Close Each Year*, SKILLED NURSING NEWS (Sept. 30, 2018), https://skillednursingnews.com/2018/09/ny-times-lower-census-causing-hundreds-nursing-homes-close-year/ (stating that researcher Nicholas Castle of University of Pittsburgh reports that 200 to 300 nursing homes close each year).

[18] Max Sullivan, *Sherman Wants NH to Increase Medicaid Reimbursement Rates*, FOSTERS.COM/SEACOAST ONLINE.COM (Nov. 18, 2018), https://www.fosters.com/news/20181118/sherman-wants-nh-to-increase-medicaid-reimbursement-rates (stating that NH has not seen a permanent increase in Medicaid reimbursement rates for mental health since 2006).

[19] Thomas Blonski, *NH's Long-Term Care System is in Crisis*, NH BUSINESS REVIEW (June 5, 2017), https://www.nhbr.com/nhs-long-term-care-system-is-in-crisis/ (President & CEO of New Hampshire Catholic Charities stating that "[c]aring for Medicaid recipients in the long-term care arena in New Hampshire is bringing with it losses that cannot be sustained, even for nonprofits with charitable missions, like Catholic Charities" and that "even if wages were the only costs we had, the state's payment rate, by itself, would fall short of covering them").

[20] Maggie Flynn, *Non-Profit Texas SNFs Forced to Close Amid Low Medicaid Rates*, SKILLED NURSING NEWS (Feb. 4, 2018), https://skillednursingnews.com/2018/02/non-profit-texas-snfs-forced-close-amid-low-medicaid-rates/ (stating that NFP Morningside Ministries is closing its care facility and that other NFP facilities are facing the same problems due in large part to low Medicaid reimbursement rates and increasing costs of care).

[21] *Id.*

[22] Hansen Hunter & Company, PC, *A Report on Shortfalls in Medicaid Funding for Nursing Center Care*, AMERICAN HEALTHCARE ASSOCIATION (Nov. 2018), https://www.ahcancal.org/facility_operations/medicaid/Documents/2017%20Shortfall%20Methodology%20Summary.pdf (and stating at page 5 that "[h]istorically, nursing centers have struggled with Medicaid rates insufficient to cover costs of delivering care to an increasingly frail and medically complex population."); *see also* Jacqueline LaPointe, *Federal Policies to Decrease Hospital Payments by $218B by 2028*, REVCYCLE INTELLIGENCE (June 19, 2018), revcycleintelligence.com/news/federal-policies-decrease-hospital-payments-by-218b-by-2028 (decrying low and ever decreasing rates of reimbursement for hospitals too); Jacqueline LaPointe, *Medicare, Medicaid Reimbursement $76.8B Under Hospital Costs*, REVCYCLE INTELLIGENCE (Jan. 7, 2019), revcycleintelligence.com/news/medicare-medicaid-reimbursement-76.8b-under-hospital-costs (same).

[23] Liz Liberman, *Medicaid Reimbursement Rates Draw Attention*, NATIONAL INVESTMENT CENTER FOR SENIORS HOUSING & CARE (Mar. 21, 2018), https://www.nic.org/blog/medicaid-reimbursement-rates-draw-attention/.

b. Medicare

Medicare is the federal health insurance program for: (1) people who are 65 or older, (2) certain younger people with disabilities, and (3) people with end-stage renal disease (permanent kidney failure requiring dialysis or a transplant).[24] Medicare Part A covers inpatient hospital stays, care in a skilled nursing facility, hospice care, and some home health care.[25] Although Medicare reimburses at a higher rate than Medicaid, it is still not enough; in 2017, about two-thirds of hospitals received Medicare reimbursement less than cost.[26] Its application is also more limited, because it does not cover custodial care (most nursing homes); rather, it will only cover care where skilled nursing care is medically necessary.[27]

i. Private Pay

Private pay patients generally offer the highest rate of reimbursement, easily outstripping Medicaid—sometimes by triple.[28] However, private pay has its own drawbacks. Some patients enter a facility on Medicare, but once the benefits end they must switch to private pay. Others enter on a private pay basis. Where private pay patients actually pay, this is a boon to facilities. Actual payment, however, is not assured.

Upon admission, most patients are required to execute an admission agreement which includes a commitment to pay the facility a private pay daily rate. Discussion, *infra*, Section IV(a)(i). Although contractual payment obligations can normally be enforced in court in other

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[24] *What's Medicare?*, MEDICARE.GOV (accessed Apr. 25, 2019), https://www.medicare.gov/what-medicare-covers/your-medicare-coverage-choices/whats-medicare.
[25] *Id.*
[26] Jacqueline LaPointe, *Medicare, Medicaid Reimbursement $76.8B Under Hospital Costs*, REVCYCLE INTELLIGENCE – REIMBURSEMENT NEWS (Jan. 7, 2019), https://revcycleintelligence.com/news/medicare-medicaid-reimbursement-76.8b-under-hospital-costs.
[27] *Nursing Home Care*, MEDICARE.GOV (accessed Apr. 25, 2019), https://www.medicare.gov/coverage/nursing-home-care.
[28] State of New Hampshire, Department of Health and Human Services, NH DHHS Release of Policy, 17-07 PR 7.1.17, July 26, 2017 (showing substantial differences in Medicaid reimbursement and private pay rates).

contexts, in the health care realm there are complications. Perhaps most significant is the prohibition on discharge unless the facility can issue a "safe discharge plan."[29] A safe discharge plan is what the name implies—a plan that ensures the care of the patient in another setting including her home as appropriate. Since a nonpaying patient will not be accepted by any other facility, a discharge plan in this context usually means a home setting. If a patient under threat of discharge cannot care for herself, or assistive programs in the state are insufficient supplements, a discharge to the home will be deemed "unsafe" and impermissible.[30] Under applicable regulations, where a facility attempts to discharge a patient under such a plan, the patient has a right of appeal before the state administrative agency assigned the task of overseeing care facilities.[31] Patients generally have an advantage in administrative hearings before such agencies. This has led to the obvious dilemma that once in a facility, nonpaying "private pay" patients often are "in for good." In light of the tremendous costs of daily care, this can easily jeopardize financial viability of any facility.[32]

A discussion of the drawbacks to private pay patients would be incomplete without an explanation of the common scenarios leading to nonpayment. Nonpayment sometimes results from a simple lack of attentiveness to financial matters by the patient or family. This can be the simplest scenario to remedy since courts can order a patient to pay or a facility can obtain a judgment and then collect from the patients account. Other times a more nefarious reason

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[29] *See e.g.* 42 U.S.C. § 1396r (relevant to nursing homes); 42 C.F.R. § 482.43 (for hospitals); *see also* NH He-P 802.16(b)(2)(h) (governing discharge from hospitals in NH); NH He-P 802.18(g) (same).
[30] *When is Hospital Discharge Unsafe*, RELIAS MEDIA (May 1, 2016).
[31] 42 U.S.C. 1396r; NH RSA 151:26; 42 C.F.R. § 482.43.
[32] As an example, in 2017, daily costs of private pay nursing care equaled about $321. According to a study by the Foundation for Health Communities in 2015, 516 people stayed a total of 10,277 patient days in an acute care (hospital) setting where average cost equaled $2,635 per day. *Barriers to People Receiving the Right to Care at the Right Time*, FOUNDATION FOR HEALTHY COMMUNITIES (June 11, 2015).

underlies the problem. Improper transfers of patient assets occur with some regularity.[33] Out of a desire to provide for family and in connection with estate planning, patients (or families on behalf of patients (or out of self-interest)) often divest the patient of her assets as the elder years approach. Such transfers can not only render patients unable to pay their care providers, they also can render patients ineligible for Medicaid.[34] Of course, if such transfers occur more than 5 years before a Medicaid application this does not present a problem for Medicaid eligibility. If sooner, there is a different answer.

If the transfers occur within 5 years of the Medicaid application, i.e., during the Medicaid "look-back" period, Medicaid eligibility is jeopardized.[35] The state entity evaluating Medicaid applications always examines an applicant's finances for transfers without receiving reasonable equivalent value within that 60 month timeframe.[36] In the event of such transfers, the state imposes an asset transfer disqualification period during which time the patient is ineligible for Medicaid benefits.[37] Although supposedly directed at the non-qualifying patient, because of difficulty in discharging a patient as explained above the penalty actually "punishes" the facility, resulting in forced retention of a nonpaying patient. In essence, the facility becomes a co-opted welfare arm of the state and federal governments.

ii. Non-cooperation in the Medicaid Applications Process

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[33] *See* NH RSA 151-E:19 (causes of action for liability for fiduciaries (usually family members) for failure to apply for Medicaid and for participation in improper transfers resulting in disqualification for Medicaid); *see also* NH RSA 151-I:1-2 (providing recourse for hospitals and nursing homes in situations where a patient and family have failed to apply for Medicaid).

[34] *Understand Medicaid's Look-Back Period; Penalties, Exceptions & State Variances*. MEDICAIDPLANNINGASSISTANCE.ORG (Jan. 21, 2019), https://www.medicaidplanningassistance.org/medicaid-look-back-period.

[35] *Id.*

[36] *Id.*

[37] *Id.*

Hospitals and nursing homes alike have also experienced another significant problem—the failure of patients and their families to complete and submit Medicaid applications in order to ensure payment to the facilities once a patient is "impoverished" and unable to pay.[38] For clarity, patients 65 or older with resources of less than $2,500 that demonstrate inadequacy vis-a-vis certain activities of daily living (bathing, eating, toileting) are eligible for long-term Medicaid coverage but only if there are no disqualifying transfers as discussed above.[39] However, eligibility is irrelevant if no one with authority (such as the patient, guardian or an agent under a power of attorney) is willing to complete and submit the Medicaid application. Although most rational people would assume that an eligible patient or his/her family member would not hesitate to cooperate if the result would be health care coverage for a loved one, sadly, that has proven to be an incorrect assumption.

Uncooperative patients and families are not common but nonetheless appear all too often, resulting in the enactment of certain first-in-the-nation legislation in New Hampshire sponsored and/or requested by the New Hampshire Hospital Association and the New Hampshire Health Care Association.[40] In light of the inability of facilities to discharge for nonpayment as mentioned above, and since nursing care can easily cost hundreds of dollars daily and average daily care costs in hospitals equal multiples of that amount, such uncooperative patients can financially hamstring and, indeed, bankrupt a facility, especially a smaller facility that does not

[38] *See* NH RSA 151-E:19 (recent legislation enacted to counter failures of fiduciaries to apply for Medicaid; NH RSA 151-I:1-2 (same).

[39] *New Hampshire Bureau of Family Assistance (BFA) Program Fact Sheet*, New Hampshire Department of Health and Human Services (Mar. 2019), https://www.dhhs.nh.gov/dfa/documents/fam-asst-fact-sheet.pdf; *New Hampshire Bureau of Family Assistance (BFA) Program Fact Sheet*, NEW HAMPSHIRE DEPARTMENT OF HEALTH AND HUMAN SERVICES (Oct. 2017).

[40] NH RSA 151-E:19 (recent legislation enacted to counter failures of fiduciaries to apply for Medicaid; NH RSA 151-I:1-2 (same).

have the financial wherewithal to weather such a financial storm.[41] Possible ways to address such situations are discussed further below.

iii. The Cost of Regulations[42]

Federally mandated oversight of care facilities represents yet another issue that further compounds the underpayment problem. Hospitals and long-term care facilities have been among the most highly regulated businesses. Yet in 2016, the Center for Medicare and Medicaid Services (CMS) released a vast revision to the federal regulations governing them, further increasing administrative and other costs.[43] Of course, the intent of the regulations generally and CMS's recent revisions is simply to ensure protection and quality of care for some of our most vulnerable citizens but the net financial result is increased costs to comply with the new requirements.[44][45]

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[41] *NH DHHS Release of Policy*, State of New Hampshire, Department of Health and Human Services, 17-07 PR 7.1.17 (July 26, 2017) (showing care rates in the hundreds of dollars); *Barriers to People Receiving the Right to Care at the Right Time*, FOUNDATION FOR HEALTHY COMMUNITIES (June 11, 2015) (stating that average daily costs for acute care in hospitals equaled $2,635 in 2015).

[42] Applicable federal law represents a floor, not a ceiling, in the health care arena. Many states create even higher standards under state law that applies to various activities of health care entities.

[43] David G. Stevenson, *The Future of Nursing Home Regulation: Time for a Conversation?*, HEALTH AFFAIRS BLOG (Aug. 23, 2018), https://www.healthaffairs.org/do/10.1377/hblog20180820.660365/full/ (stating policy makers have long focused on nursing home oversight but the most recent flare-up was caused by the "Reform of Requirements for Long-Term Care Facilities" [81 FR 68688] issued October 4, 2016, resulting in considerably expanded requirements in several key areas to facilitate person-centered care, care planning, infection control, and quality improvement activities); *see also* CMS.gov *Long-Term Care Facilities: Reform of Requirements Call*, CENTERS FOR MEDICARE & MEDICAID SERVICES (Oct. 27, 2016), https://www.cms.gov/Outreach-and-Education/Outreach/NPC/National-Provider-Calls-and-Events-Items/2016-10-27-LTC.html (discussing the expansion of federal regulations on nursing homes implemented in 3 stages over time and certain new requirements resulting in costs to facilities).

[44] A dramatic example of CMS changes to applicable regulations relates to the CMS clarification of ligature risk policy of December 8, 2017 prohibiting potential ligatures from psychiatric hospitals and hospitals. *See S&C Memo: 18-06-Hospitals, Clarification of Ligature Risk Policy*, CENTER FOR CLINICAL STANDARDS AND QUALITY/SURVEY & CERTIFICATION GROUP (Dec. 8, 2017), https://www.cms.gov/Medicare/Provider-Enrollment-and-Certification/SurveyCertificationGenInfo/Downloads/Survey-and-Cert-Letter-18-06.pdf (interpreting 42 CFR 482.13(c)(2) applicable to hospitals and defining a ligature risk as anything which could be used to attach a cord, rope, or other material for the purpose of hanging or strangulation and stating that "[l]igature points include shower rails, coat hooks, pipes, and radiators, bedsteads, window and door frames, ceiling fittings, handles, hinges and closures" and requiring a ligature "resistant" or ligature "free" environment in Psychiatric units/hospitals).

[45] Kamila Kudelska, *Rural Psychological Units, Facing Regulation Pressures, Choose to Close*, NATIONAL PUBLIC RADIO (Apr. 11, 2019) (reporting PineRidge Inpatient Behavioral Health Unit shut down because it

iv. Declining (and Declined) Census

Although seemingly counterintuitive in light of the coming grey wave (a/k/a silver tsunami), nursing homes are seeing decreasing numbers of residents. Federal data shows that the number of residents dropped from 1.48 million in 2000 to 1.36 million in 2015.[46] The top 31 metropolitan market have 13,586 fewer nursing home beds than in 2005.[47] In certain states, one third of beds were empty.[48] The emphasis is on community alternatives, not nursing home stays, and where nursing homes are used for care, the stays tend to be shorter as a cost savings measure.[49] Hospitals are also not immune, with inpatient surgeries on the decline in favor of outpatient.[50] Translated: revenues are down while costs of administration and compliance with regulations have increased and continue to do so.

For some (read: many) organizations, the issues discussed above have presented serious and sometimes insurmountable obstacles to survival as a going concern. Accordingly, an understanding of the foregoing problems and their scope is an important step for officers and directors of health care facilities and for restructuring officers charged with providing guidance out of financial extremis. It is also important for restructuring professionals to have an understanding of the growing criticism of the nonprofit form and oversight problems inherent in it as described in more detail below.

II. Directors' and Officers' Duties in Not-for-Profit Health care Facilities

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couldn't comply with new federal regulations aimed at patient safety and that "surveyors" are demanding high cost solutions in enforcing the CMS "ligature free" rule placing a more pressure on an already fragile situation resulting in closure of at least 4 inpatient psych units in Ohio, Missouri, California and Wyoming, including Pine Ridge facility in Wyoming).

[46] Maggie Flynn, *NY Times: Lower Census Causing Hundreds of Nursing Homes to Close Each Year*, SKILLED NURSING NEWS (Sept. 30, 2018), https://skillednursingnews.com/2018/09/ny-times-lower-census-causing-hundreds-nursing-homes-close-year/.

[47] *Id.*

[48] *Id.*

[49] *Id.*

[50] *Id.*

a. Defining the Duties

Against this difficult backdrop, officers and directors of not-for-profit health care institutions must execute their duties and successfully guide their institutions while remaining faithful to their mission statements. Systemic problems inherent to the health care field (as described above) are magnified by agency issues that are part and parcel of the nonprofit form. Similar to directors of for-profit companies, directors (or "trustees") of not-for-profits must adhere to the fiduciary duties of care and loyalty.[51] The duty of care requires directors to act with the diligence, care, and skill that an ordinarily prudent person would exercise under similar circumstances.[52] The duty of loyalty requires directors to put the organization's interests before their own or any private interests.[53] Not-for-profit directors are also subject to the additional "duty of obedience," which requires directors to further the charitable mission of the organization.[54] This additional duty derives from the fact that "[u]nlike business corporations, whose ultimate objective is to make money, nonprofit corporations are defined by their specific objectives: perpetuation of particular activities are central to the *raison d'etre* of the organization."[55] Even volunteer directors are subject to these duties and may be held personally liable for breaching them.[56]

The case of *Estate of Lemington for the Aged v. Baldwin (In re: Lemington Home for the Aged Official Comm. of Unsecured Creditors)*,[57] ("*Lemington*") is very instructive. Lemington

[51] 7 COLLIER BANKRUPTCY PRACTICE GUIDE ¶ 130.03 (Adam C. Rogoff; Richard Levin & Henry J. Sommer eds.) (PDF at 1).
[52] *Id.* (citation omitted).
[53] *Id.* at 3.
[54] *Id.*(citing *Manhattan Eye, Ear & Throat Hosp. v. Spitzer*, 715 N.Y.S.2d 575, 593 (Sup. Ct. 1999) (hereinafter "*MEETH*"))
[55] *MEETH*, 715 N.Y.S.2d at 593 (quotation and citation omitted).
[56] 7 COLLIER BANKRUPTCY PRACTICE GUIDE ¶ 130.03 (Adam C. Rogoff; Richard Levin & Henry J. Sommer eds.) (PDF at 2) (discussing *Estate of Lemington Home for the Aged v. Baldwin (In re Lemington Home for the Aged Official Comm. of Unsecured Creditors)*.
[57] 777 F.3d 620 (3d Cir. 2015).

Home for the Aged was the oldest, non-profit, unaffiliated nursing home in the United States dedicated to the care of African American seniors, established in 1883.[58] In the *Lemington* case, the Third Circuit affirmed a jury's findings that the Administrator/CEO of Lemington Home had breached her duty of care by failing to address significant problems identified by the Pennsylvania Department of Health (such as failing to keep proper documentation of residents' clinical records, her general lack of knowledge of applicable regulations, and her inability to direct staff as required), and because she was only working part-time, and not full-time as required by Pennsylvania law for nursing home Administrators.[59] In addition, she had breached her duty of loyalty because of her "self-interested decision to stay on as an administrator despite being unable to serve full-time as required under state law", and collecting her full salary while "not in fact fulfilling the duties of the role for which she was being compensated."[60]

The Court also upheld the jury's findings that the CFO had breached his duties of care and loyalty because he was unable to produce records such as financial statements, annual audits, Medicare and Medicaid cost reports, nursing home reports or census data, accounts receivable and accounts payable, and aging reports – ultimately admitting he was using an Excel spreadsheet – and had failed to bill for Medicare since 2004, forgoing collection of upwards of $500,000.[61] He also breached his duty of loyalty by sending a proposal to another entity (Mount Ararat Baptist Church, or "MARC") proposing a sale of Lemington Home, proposing that he (the Lemington CFO) would then be elevated to President and CEO of MARC.[62] After affirming the jury's findings, the Third Circuit also upheld the award of punitive damages against the

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[58] *Id.* at 624 (quotation and citation omitted).
[59] *Id.* at 627.
[60] *Id.*
[61] *Id.* at 628.
[62] *Id.*

Administrator/CEO and CFO of the nursing home for $1 million and $750,000 respectively because of their self-dealing.[63] With respect to the Board of Directors, the jury found they had breached their duty of care by "failing to take action to remove [the Administrator/CEO and CFO] once the results of their mismanagement became apparent."[64] The Court also predicted that Pennsylvania would recognize the tort of "deepening insolvency," described as "an injury to the Debtor's corporate property from the fraudulent expansion of corporate debt and prolongation of corporate life," and upheld the jury's verdict that the Board of Directors had deepened the Home's insolvency by concealing for over three months the Board's decision to close the Home and deplete the patient census.[65] The Third Circuit upheld the jury's damage award of $2.25 million against all of the defendants, but vacated the award of punitive damages against the Board of Director defendants primarily because they had *not* engaged self-dealing.[66] *Lemington* demonstrates the substantial duties owed by not-for-profit officers and directors. It also illustrates, as is more fully discussed below, the inadequacy of corporate governance among not-for-profit institutions is significant and prevalent.[67]

b. Noteworthy Lack of Oversight—Transparency *with No Effect*

Since charities are often publicly funded through government financial support in the form of tax subsidies, grants, and other federal and state benefits,[68] one would assume there would be more effective oversight of not-for-profit institutions' finances. However, outside of the bankruptcy context, "charitable officers and directors are subject to little or no external

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[63] *Id.* at 624, 635 ("[T]he Officer Defendants acted with the outrageous motive of pursuing self-enrichment at the expense of the non-profit nursing home to which they owed fiduciary duties.")
[64] *Id.* at 628.
[65] *Id.* at 630-1 (finding the same with respect to the Administrator/CEO and CFO for the same reasons it found breaches of their fiduciary duties).
[66] *Id.* at 634.
[67] *See also* Reid K. Weisbord, *Charitable Insolvency and Corporate Governance in Bankruptcy Reorganization* (hereinafter "Charitable Insolvency Art."), 10 BERKELEY BUS. L.J. 305 (2014).
[68] *Id.* at 310.

oversight."[69] Where for-profit corporations are subject to financial oversight by principals (shareholders) who have a financial incentive to monitor or remove underperforming fiduciaries, most not-for-profits are entirely governed by officers and directors who are tasked with regulating their own conduct.[70] In addition to lack of shareholder oversight, there are three weaknesses particular to not-for-profit entities that render them more susceptible to fiduciary misconduct:

> (1) bank monitoring and intervention, which play significant non-bankruptcy roles in constraining corporate governance in the for-profit sector, are absent or less common in the charitable nonprofit sector;
> (2) bankruptcy reorganization, which facilitates a transfer of ownership and control in the for-profit sector, does not generally lead to new ownership of a reorganized charity; and
> (3) involuntary bankruptcy proceedings, which allow creditors to force insolvent for-profit debtors into bankruptcy, do not apply to charitable nonprofit debtors.[71]

Therefore, the government "is often the sole party with authority or ability to regulate the conduct of charitable fiduciaries."[72] Long-standing common law, now often codified by statute, vests state attorneys general with power to represent the public interest in matters concerning charitable assets.[73] However, this authority is rarely invoked with respect to enforcement of fiduciary duties.[74] And, although the IRS is authorized to impose "intermediate sanctions" in the event of nonprofit self-dealing, it rarely investigates such conduct "and lacks statutory authority to pursue enforcement in cases of pure mismanagement."[75] As one commentator accurately

[69] *Id.* at 316.
[70] *Id.* at 322 n.67; *MEETH*, 715 N.Y.S. 2d at 592-93 (providing a detailed discussion of the duties and role of charitable boards and the drawbacks of oversight by the attorney general).
[71] Charitable Insolvency Art. at308.
[72] *Id.* at 318.
[73] *Id.* at 318-19 n.50.
[74] *Id.* at 319 n.52.
[75] *Id.* at 319-20 n.57.

points out, "heightened transparency alone is insufficient to constrain agency costs without a party to act as enforcer."[76]

III. Bankruptcy and the Zone of Insolvency

a. The Dilemma: Faithfulness to Mission or to Creditors

When an entity enters the "Zone of Insolvency," for-profit directors' and officers' duties expand to protect stockholder and creditor interests; directors and officers of not-for-profits, however, owe duties to both the creditors *and* the mission of the charity (as opposed to vindicating stakeholder's financial interest).[77] This is particularly apparent in the health care context, where "the unique nature of health care services and patient care prevent a unilateral and immediate cessation of services."[78] Unlike for-profit corporations which are more readily liquidated during bankruptcy, insolvent nonprofits must try to pursue continued operation of their mission, while still balancing the rights of their creditors.[79] Interestingly, not-for-profits are not subject to the Absolute Priority Rule, which requires for-profits in bankruptcy to pay unsecured creditors in full prior to recovery to equity holders.[80] This means a Board of Directors of a not-for-profit "may proceed with a proposed plan of reorganization that preserves the existing sponsorship of the debtor (the equivalent of a for-profit's equity ownership) and that does not provide for a full recovery for unsecured creditors. . . . This permits the organization to be restructured while preserving the core elements of the prebankruptcy mission."[81] Other effects of the inapplicability of the Absolute Priority Rule are discussed below. However,

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[76] *Id.* at 320-21.
[77] 7 COLLIER BANKRUPTCY PRACTICE GUIDE ¶ 130.03 (Adam C. Rogoff; Richard Levin & Henry J. Sommer eds.) (PDF at 4 and nn.28-29).
[78] *Id.* at 5.
[79] *Id.* at 7 n.41; *see also In re United Healthcare System, Inc.*, 1997 U.S. Dist. LEXIS 5090 (D.N.J. 1997) (discussed on same page).
[80] 7 COLLIER BANKRUPTCY PRACTICE GUIDE ¶ 130.03 (Adam C. Rogoff; Richard Levin & Henry J. Sommer eds.) (PDF at 10).
[81] *Id.* at 10 n.70.

irrespective of these effects, the challenge for directors of health care entities in adhering to their mission is that patients' needs must be taken into account when deciding whether, when, and how to deal with insolvency.[82]

b. Lack of Oversight Solved—Is the Result Transparency *with Effect*?

The filing of a bankruptcy petition brings to bear numerous constraints on a debtor health care entity and its officers and directors. Whereas officers and directors have immense leeway in the running of the pre-bankruptcy business due to agency issues, post-bankruptcy oversight increases as a necessary function of the Bankruptcy Code and process. Bankruptcy can bring new light to bear upon the root problems of the debtor's woes. In the best of circumstances, that illumination also results in resolutions and successful emergence of a viable going concern. In some circumstances, it reveals mismanagement and exposes officers and directors to scrutiny and potential liability for breaches of their duties. A case in point has already been discussed above. *See* discussion, *supra* (concerning *Lemington*). Some of the more useful aspects of bankruptcy that increase oversight of the not-for-profit form are as follows:

i. United States Trustee and the Patient Care Ombudsman

"The United States Trustee Program ("USTP") is the government agency charged with ensuring the integrity of the bankruptcy process."[83] As with any bankruptcy matter, the United States Trustee (the "UST") for the district oversees certain aspects of any health care bankruptcy.[84] In health care related bankruptcy matters, the UST has an additional obligation. Pursuant to 11

[82] *Id.* at 7 and n.41; *see also In re United Healthcare System, Inc.*, 1997 U.S. Dist. LEXIS 5090 (D.N.J. 1997) (discussed on same page).
[83] Roberta DeAngelis and Paul Bridenhagen, *The United States Trustee Program Administers BAPCA's Patient Care Ombudsman Requirements*, EXECUTIVE OFFICE FOR UNITED STATES TRUSTEES (2008) https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=2ahUKEwj-66zbuuvhAhVFi1kKHYyTBYsQFjAAegQIABAC&url=https%3A%2F%2Fwww.justice.gov%2Farchive%2Fust%2Farticles%2Fdocs%2F2008%2Fabi_200806.pdf&usg=AOvVaw2SfvJBV6fcTDzOC4eaa_4k (hereinafter "UST/PCO Art.").
[84] *Id.*

U.S.C.§ 333,[85] the UST is obligated to appoint a Patient Care Ombudsman ("PCO") "to ensure the safety and welfare of the most vulnerable group of persons affected by the bankruptcy process."[86] The Court must order the UST to appoint a PCO in case under chapters 7, 9, or 11 "unless the court finds that the appointment is not necessary under the specific facts of the case."[87]

Whereas the UST protects the integrity of the bankruptcy process, the role of the PCO is to represent the interests of the patients and to monitor patient care.[88] The PCO must file an initial report within 60 days with additional reports systematically filed thereafter.[89] If the PCO finds that quality of care is declining or is materially compromised, pursuant to Code section 333(b)(3),she must make an appropriate filing notifying the court and parties in interest.[90,91]

In the appointment process, the initial question is whether the appointment of the PCO is necessary.[92] The presumption is that a PCO must be appointed but it is a rebuttable presumption.[93] Of the factors expressly recited, the most relevant for the purposes of this discussion are arguably those that focus upon transparency and oversight related to management decisions by officers and directors. These include the relative financial status of the debtor, whether sufficient local, state and federal oversight is already present, whether there is a history of inadequate patient care, whether the facility is adequately maintained and the totality of factors surrounding the bankruptcy filing, i.e., the causes of insolvency.[94]

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[85] Fed. R. Bankr. P. 2007.2 (appointment) and 2015 (record keeping and reporting duties) are also applicable.
[86] UST/PCO Art. at 1.
[87] UST/PCO Art. at 1 (internal quotations omitted).
[88] UST/PCO Art. at 1.
[89] *Id.*
[90] 11 U.S.C. § 333(b)(3).
[91] UST/PCO Art. at 1.
[92] *Id.* at 3.
[93] *Id.* at 3-4 (referencing a nonexclusive list of factors important to proving that a PCO is not necessary under the circumstances of the case as mandated in Code section 303).
[94] *Id.* at 3-4.

ii. State Attorneys General

As already stated above, state attorneys general possess the authority to represent the public interest in all matters concerning charitable institutions.[95] The state attorney general for the local of the charitable debtor also has the right to intervene and be heard in any bankruptcy proceeding.[96] Accordingly, the attorney general continues the pre-bankruptcy role in the bankruptcy process.[97] That is a role, however, that has generally been seen to have little effect on the conduct of officers and directors of charitable institutions.[98]

iii. Creditor Pool

Whereas creditors play a substantial role in bankruptcy cases involving for-profit entities, creditor influence in not-for-profit cases is substantially neutered. In large part, this results from the inapplicability of the Absolute Priority Rule since not-for-profits do not have an ownership/shareholder structure.[99] Accordingly, where an incompetent management team or board exists pre-petition the bankruptcy process is less likely to "flush out" the problem than in a for-profit bankruptcy matter where prior ownership (who chooses and supports the board and, directly or indirectly, management) would be eliminated in the plan process. It also is worth noting that creditors cannot force a charitable organization into bankruptcy via an involuntary filing.[100] In short, the leverage afforded creditors in for-profit bankruptcies is largely eliminated in the not-for-profit context.

iv. Chapter 11 Trustees and Examiners

[95] Charitable Insolvency Art. at 318-19.
[96] *Id.* at 352 n.199.
[97] *Id.* (noting, however, that attorneys general have by and large proven "notoriously ineffective" in overseeing not-for-profits).
[98] *Id.* at 318-19, 352; *but see MEETH*, 715 N.Y.S.2d at 592-93 (attorney general of New York becoming involved in opposing the sale of charitable specialty hospital albeit late in the process).
[99] *See* Discussion, *supra* (The Dilemma: Faithfulness to Mission or to Creditors) (discussing the inapplicability of the Absolute Priority Rule).
[100] 11 U.S.C. § 303(a) (allowing involuntary filings against entities that are "moneyed.").

As in for-profit cases, where charitable bankruptcies are concerned, a chapter 11 trustee can be appointed "for cause."[101] Cause can include "fraud, dishonesty, incompetence, or gross mismanagement."[102] Arguably, appointment of a chapter 11 trustee to ensure elevated oversight of a bankrupt charitable organization could be beneficial in circumstances where there is cause to believe mismanagement or, worse yet, fraud, has been in issue.

There are likewise compelling arguments for the appointment of examiners in charitable health care bankruptcies.[103] Indeed, a compelling argument has been made for presumptive appointment of examiners in all large charitable bankruptcy proceedings as a preemptive strike against blameworthy incumbent fiduciaries and as a deterrent against further blameworthy conduct—in essence, to combat agency issues discussed earlier in this article.[104] Such examiners may currently be appointed, *inter alia*, upon request of a party-in-interest or the United States trustee where such appointment "is in the interest of the creditors, any equity security holders, and other interest of the estate."[105]

IV. The Going Concern--How do you right the ship?

a. Financial Hygiene-A Culture of Care, Not Collections

Hospitals and nursing homes are in the business of caring for people. That is their calling. In all fairness, it can probably be said that this statement applies doubly for not-for-profit health care entities. Their mission, above all others, is patient care irrespective of a patient's financial means. Anecdotally, such facilities have traditionally been less than diligent in pursuing outstanding balances for costs of care as an understandable consequence of their mission. That

[101] 11 U.S.C. § 1104(a).
[102] *Id.*
[103] *See generally* Charitable Insolvency Art.
[104] Charitable Insolvency Art. at 351-60.
[105] 11 U.S.C. § 1104(c).

said, a business, even a charitable one, cannot survive on good intentions alone—it must have cash flow sufficient to support operations. However, this valid, mission driven sentiment carries inertia that must be moderated once the entity enters the zone of insolvency or, worse yet, files a petition for bankruptcy relief. Only by doing so can a financially handicapped charitable institution survive and reorganize to fight the good (charitable) fight another day.

If the pun may be pardoned, the filing of a bankruptcy petition is not a panacea that cures all ills, or even all financial ills, of the debtor health care facility. It should go without saying that managerial deficiencies identified in the bankruptcy process must be remedied prior to emergence from bankruptcy or the debtor may not survive for long. Steps toward better financial hygiene include the following:

i. Private Pay Documentation, Contractual Claims and Third Party Guarantors

Proper documentation of admission is vital. Federal and state law mandates it for many reasons and in many respects, requiring notice to the patient and agents of the care that a patient is to receive as well as the rights possessed by each patient.[106] However, such documentation serves another important purpose--it establishes who is liable for payment and who has the responsibility for other tasks to ensure payment, such the responsibility of completing and submitting applications for Medicaid and for applicable insurance coverage. A properly drafted and executed admission agreement provides predictability for facilities and patients alike, and provides a basis upon which a court may enforce payment obligations when disputes arise. In the absence of such agreements, courts have exhibited a hesitancy to enforce obligations against

[106] *See e.g.* 42 C.F.R. § 483.10 (Resident Rights-Federal, as applicable to long-term care facilities); NH RSA 151:1 *et seq.* (NH Patient Bill of Rights, as applicable to long-term care facilities and hospitals); *see also* 42 C.F.R. § 482 *et seq.* (Patients' Rights, as applicable to hospitals).

third parties, even where strong evidence otherwise demonstrates that the patient or her agents have acted inequitably.

ii. Doctrine of Necessaries and Filial Responsibility

Contractual commitments are not always needed to impose liability on third parties for the costs of a patient's care. Under the doctrine of necessaries and related "filial responsibility" laws, spouses and other relatives can be liable, irrespective of whether they have signed a contact with the care facility. Many of these laws see scant use.[107] Others are recently enacted but hold great promise.

NH RSA 151-E:19 is one such statute. Whereas the statutes mentioned directly above are exercisable by the government, RSA 151-E:19 provides broad relief for long-term care. Enacted July 2, 2013, it imposes liability for failure to pay the patient liability amount under Medicaid, for negligent failure to promptly complete and submit a Medicaid application, and for participation in improper transfer[108] that result in disqualification for Medicaid coverage. Interestingly, anecdotal evidence suggests that it has been unnecessary to broadly apply this statute. Instead, because the statute itself requires notice to a fiduciary in the admission process (and in some instances) again prior to suit, the unambiguous duty contained in it has provided the necessary "push" to uncooperative fiduciaries to comply with their statutory obligations. In short, the threat of suit under the statute has been sufficient to compel cooperation in, for example, timely submitting Medicaid applications.

[107] *See* M.G.L. Ch. 273, Sec. 20 (requiring children to pay for care of a parent and imposing a $200 fine and imprisonment for up to one year for failure to do so but allowing enforcement by the Commonwealth); M.G.L. Ch. 209 § 1 (spousal liability for care debts); NH RSA 167:2 (imposing liability for care upon a broad spectrum of family members assertable by the state); NH RSA 546-A:2 (same).

[108] A facility also has recourse to the Uniform Fraudulent Transfers Act as well as 11 U.S.C. § 548. However, the burden of proof under RSA 151-E:19 is less, requiring only that a fiduciary have participated in transfers that resulted in disqualification for Medicaid.

A companion statute, RSA 151-I:1-2, also recently enacted, is becoming effective in 2019. That statute establishes the special Medicaid representative ("SMR") for use by hospitals and nursing homes. In situations where a patient or family has failed to timely complete a Medication application, the facility can request that the probate court appoint an SMR to compile any information needed to complete a Medicaid application and prosecute the application to approval. Although not establishing liability of any particular individual for care, it can serve as a shortcut to head-off a fight over liability of an agent by taking the responsibility of drafting the application out of the agents hands early in the process, before nonpayment becomes an insurmountable issue. Although a facility could, in the alternative, request appointment of a guardian, guardianship law is ineffective where a patient has capacity. SMRs, on the other hand, can be appointed irrespective of capacity of the patient and even over the patient's objection where the patient has not paid the facility and has not made out a Medicaid application.

b. Medicare Issues in Bankruptcy—Provider Agreements

One issue that frequently arises when health care providers file for bankruptcy is whether federal or state agencies may terminate Medicaid provider agreements without violating the automatic stay.[109] Courts have treated this issue variously. Some courts have resolved cases on jurisdictional or prudential grounds without reaching the automatic stay issue, while at least one court has found no violation of the automatic stay.[110] The courts that have declined to reach the issue have generally focused on the failure of health care debtors to pursue relief at the U.S. Department of Social Security before turning to the bankruptcy court. In *United States v.*

[109] *See* 11 U.S.C. § 362(a)(3), which states, "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate."

[110] For a more expansive collection of cases and commentary, *see* Mark G. Douglas, *Focus on Health Care Provider Bankruptcies*, JONES DAY (Sept./Oct. 2017), https://www.jonesday.com/focus-on-health-care-provider-bankruptcies-10-01-2017/#.

Nightingale Home Healthcare,[111] for example, the plaintiff health care providers claimed that discriminatory actions of federal agencies forced them into bankruptcy. The bankruptcy court issued an injunction preventing the defendants from terminating their contract with Medicare. On review, however, the U.S. District Court for the Southern District of Indiana determined that the plaintiffs had not exhausted administrative remedies. Consequently, the bankruptcy court lacked jurisdiction to issue the injunction, which was vacated.

Similarly, in *Florida Agency for Health Care Admin. v. Bayou Shores SNF, LLC (in re Bayou Shores SNF, LLC)*,[112] the health care debtor successfully sought a preliminary injunction in bankruptcy to prevent the state agencies from terminating Medicare provider agreements. As in the *Nightingale* case, the injunction was vacated on review by the U.S. District Court for the Middle District of Florida because the health care debtor had not exhausted all available administrative remedies. This order was affirmed by the U.S. Court of Appeals for the Eleventh Circuit, which held that the bankruptcy court is without jurisdiction to enjoin the termination of a provider agreement where the plaintiffs fail to exhaust administrative remedies.

The U.S. Court of Appeals for the Ninth Circuit has expressed a contrary view and ruled that a plaintiff need not exhaust administrative remedies to seek review of Medicare-related decisions in bankruptcy court (as opposed to federal district courts),[113] but has not opined on the ultimate issue of whether termination of a provider agreement violates the automatic stay.

At least one court that has reached the issue has found no violation of the automatic stay when state or federal agencies terminate Medicare provider agreements with health care debtors.

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[111] No. 1:16-cv-00317-LJM-TAB, 2016 U.S. Dist. LEXIS 127088 (S.D. Ind. Sept. 16, 2016); *see also Home Care Providers, Inc. v. Hemmelgarn*, 861 F.3d 615 (7th Cir. 2017) (declining, on mootness grounds, to consider propriety of bankruptcy court's preliminary injunction barring the federal government's termination of Nightingale Home Healthcare, Inc.'s Medicare provider agreement).
[112] 828 F.3d 1297 (11th Cir. 2016).
[113] *Do Sung Uhm v. Humana, Inc.*, 620 F.3d 1134, 1138 (9th Cir. 2010).

In *Parkview Adventist Medical Center. v. United States*,[114] the plaintiff Parkview notified the Centers for Medicare & Medicaid Services (CMS) that it intended to file for bankruptcy and would no longer participate in the Medicare program as an acute care provider, but would still provide outpatient services. In response, CMS provided notice that it would terminate the provider agreement. Shortly afterwards, Parkview filed for bankruptcy relief and sought to enjoin termination of the provider agreement. Parkview argued that the provider agreement was an executory contract that cannot properly be terminated post-petition.[115] The court disagreed. Under the Bankruptcy Code, an automatic stay does not apply to "an action or proceeding by a governmental unit . . . to enforce such governmental unit's . . . police and regulatory power."[116] For this exception to apply, the court explained, the government action must be designed to protect the public safety and welfare rather than to protect the government's pecuniary interest. The court concluded that CMS's termination enforced a generally applicable regulatory law that furthers a public policy interest, and was not designed to reap financial gain. Therefore, the termination of the provider agreement did not violate the automatic stay.

V. Reinventing the Business

a. Although a detailed discussion of the myriad options available in the health care sector is beyond the scope of this article, as a part of any reorganization, reinvention of the debtor's business must be a consideration. Most pertinently, some businesses have changed their focus to more profitable segments in light of the problems experienced in obtaining adequate payment for care. This is particularly the case in the nursing home business

[114] 842 F.3d 757 (1st. Cir. 2016).
[115] The bankruptcy code does not define executory contract, *see* 11 U.S.C. § 365(a), but courts have interpreted the term to embrace contracts on which performance remains due, to some extent, on both sides. *See NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 522 n.6 (1984).
[116] 11 U.S.C. § 362(b)(4).

where dismal Medicaid rates and other significant reimbursement problems have left facilities unable to recoup their costs. But where do these businesses focus their attention?

Kindred Healthcare, Inc. ("Kindred"), although a for-profit entity, is a noteworthy example that is useful to illustrate this point. Kindred has been reported to be a top-100 private employer in the United States, a FORTUNE 500 health care services company based in Louisville, Kentucky with annual revenues of approximately $6.1 billion.[117] In a preemptive reinvention of its business, Kindred sold its nursing facility business (over 80 facilities) recently, divesting itself of that sector to focus on "higher margin" health care segments.[118,119,120] It could be that Kindred's exit of the nursing care arena is a "canary in a coal mine" harbinger of things to come.

Obviously, Kindred bet on the hospice and acute care hospital sectors.[121] But there are others. Memory Care is yet another area that has received favor in recent years.[122] In fact, as of 2018 the number of units in this sector had seen a 55% increase since 2013.[123] The focus, however, in recent years has been away from single purpose memory care facilities to facilities

[117] *Press Release: Kindred Provides Update on Additional Transaction Closing for Its Skilled Nursing Facility Business Divesture* (Dec. 1, 2017), https://www.kindredhealthcare.com/news/2017/12/01/kindred-provides-update-additional-transaction-closings-its (hereinafter "Kindred Update").
[118] *Id.* (discussing the divesture by Kindred's nursing homes through a sale to BlueMountain Captial Management LLC of 80 skilled nursing and five assisted living facilities and the closing of other facilities and explaining that "[w]e continue to believe that the sale of our skilled nursing facility business will significantly enhance shareholder value, enable us to sharpen our focus on higher margin and faster growing businesses, and further advance our efforts to transform Kindred").
[119] Iris Dorbian, *Kindred Sells Nursing Facility Business to BlueMountain for $700 mln*, BUYOUT INSIDER – PE HUB NETWORK (Oct. 2, 2017), https://www.pehub.com/2017/10/kindred-sells-nursing-facility-business-to-bluemountain-for-700-mln/# (also reporting on the extensive transaction).
[120] Olivia Nguyen, *Kindred's Q2 Report: Exiting Nursing Facilities Slows Growth*, D CEO HEALTHCARE (Aug. 8, 2017), https://healthcare.dmagazine.com/2017/08/08/kindreds-q2-report-exiting-nursing-facility-business-proves-profitable/ (stating that Kindred will focus on the hospice industry and long-term, acute care hospitals).
[121] Kindred's Q2 Report.
[122] Jeff Shaw, *Investors Rethink Memory Care*, SENIORS HOUSING BUSINESS (June 4, 2018), https://seniorshousingbusiness.com/investors-rethink-memory-care/ (stating that the long-term prospects are encouraging for this specialty segment).
[123] *Id.*

with more care options such as combination assisted living and memory case.[124] The lesson seems to be that the decision to change focus must always be made on an *ad hoc* basis given current market indicators mixed with a modicum of precognition. This is much more difficult for not-for-profit health care facilities, where the duty of obedience to the charitable mission must be a consideration.[125]

b. 363(d)(1) Sales

Pursuant to 11 U.S.C. 363(d):

> The trustee may use, sell, or lease property under subsection (b) or (c) of this section-
> (1) in the case of a debtor that is a corporation or trust that is not a moneyed business, commercial corporation, or trust, only in accordance with nonbankruptcy law applicable to the transfer of property by a debtor that is such a corporation or trust; ….

This provision presents challenges for asset sales of not-for-profit health care facilities in bankruptcy. It "limits the right of trustees of certain non-profit entities to use, sell and convey the assets of the non-profit" and "was added in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 as was a companion provision, section 541(f)."[126] By doing so, Congress intended "to restrict the use, sale or lease of a non-profit entity's property except in accordance with applicable non-bankruptcy law, so that a non-profit entity cannot escape supervision by its state's Attorney General, who is given standing to appear and be heard on this

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[124] *Id.*
[125] *See generally* Meeth, 715 N.Y.S.2d 575 (Sup. Ct. 1999) (denying approval of a sale of the charitable entity for failure to adhere to the mission statement).
[126] *Ky. Emples. Ret. Sys. v. Seven Counties Servs. (In re Seven Counties Servs.)*, 511 B.R. 431, 471 (W.D. Kent. 2014).

issue."[127] The court noted that the statute is designed ensure that a trustee does not violate state law applicable to nonprofit entities.[128]

11 U.S.C 541(f), the companion provision referenced in *In re Seven Counties Servs.*, states that:

> Notwithstanding any other provision of this title, property that is held by a debtor that is a corporation described in section 501(c)(3) of the Internal Revenue Code of 1986 [26 USCS § 501(c)(3)] and exempt from tax under section 501(a) of such Code [26 USCS § 501(a)] may be transferred to an entity that is not such a corporation, but only under the same conditions as would apply if the debtor had not filed a case under this title.

Together, the provisions limit the ability of a debtor to sell or transfer the health care business except as permitted by applicable state law.

Although these provisions limit the debtor's ability to sell or transfer property, application is narrower than may originally appear. For example, consider the case of *In re Gardens Reg'l Hosp. & Med. Ctr., Inc.*, 567 B.R. 820 (CD Cal. 2017). Gardens Regional Hospital (the "Hospital") and Medical Center, Inc. filed for Chapter 11 relief on petition on June 6, 2016.[129] At that time, it operated a 137-bed acute care hospital.[130] In July 2016, the Court approved a sale of the hospital to a for-profit entity for consideration of about $19.5 million (rights under the sale agreement were subsequently assigned to KPC Global Management, LLC ("KPC").[131] Cal. Corp. Code § 5914(a) (West 2017), however, requires a non-profit entity

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[127] *Id.* (citing 3 Collier on Bankruptcy ¶ 363.04 (Alan N. Resnick & Henry J. Sommers eds., 16th ed); H. Rept. 109-31 (BAPCA 2005); 11 U.S.C. § 363(d)(1) and § 541(f)).
[128] *Id.* In that case, the statute was K.R.S. § 273.303, which states, *inter alia*, that "[a]ssets received and held by the corporation subject to limitations permitting their use only for charitable, religious, eleemosynary, benevolent, educational or similar purposes, but not held upon a condition requiring return, transfer or conveyance by reason of the dissolution, shall be transferred or conveyed to one or more domestic or foreign nonprofit corporations, societies, or organizations engaged in activities substantially similar to those of the dissolving corporation . . . ."
[129] 567 B.R. at 823
[130] *Id.*
[131] *Id.*

operating a health facility to obtain approval from California's Attorney General before consummating a sale to a for-profit entity.[132] Although the debtor subsequently sought such approval, for reasons unimportant here the attorney general ultimately did not consent to the terms agreed upon between the debtor and the interested for-profit.[133]

The debtor subsequently was unable to obtain debtor in possession financing.[134] It therefore ceased operations and transferred all of its patients to other facilities.[135] By January 20, 2017, the Court granted an emergency motion to close the Hospital.[136] Importantly, "[t]he Court found that in voting to close the Hospital, the Debtor's Board of Directors had acted in accordance with the Debtor's mission of sustaining public health and welfare, as health and welfare would be jeopardized if the Hospital continued to admit new patients when it lacked the funds to adequately sustain operations."[137] The Hospital discharged or relocated all patients by February 2, 2017, and the Hospital was completely closed.[138]

The debtor then moved once again to sell certain assets including its below market lease, furniture, inventory and other items.[139] The debtor argued that, at that point, it did not need to seek approval of the attorney general because it was no longer subject to Cal. Corp. Code § 5914(a) which provided in relevant part that:

> Any nonprofit corporation that ... operates or controls a health facility, as defined in Section 1250 of the Health and Safety Code, or operates or controls a facility that provides similar health care, shall be required to provide written notice to, and to obtain the written consent of, the Attorney General prior to entering into any agreement or transaction to ... [s]ell ... its assets to a for-profit corporation or entity ... when a material amount of the assets of the

[132] *Id.*
[133] *Id.*
[134] *Id.*
[135] *Id.* at 823-24.
[136] *Id.* at 824.
[137] *Id.*
[138] *Id.*
[139] *Id.*

> nonprofit corporation are involved in the agreement or transaction.[140]

The court held that the attorney general's right to disapprove a sale pursuant to 541(f) turned on whether, under state law, the limitation provisions applied in a circumstance where the facility was closed.[141] Based upon a plain meaning of the statute and giving significance to the verb tenses used by the legislature, the court determined that since the debtor had transferred all of its patients and was no longer currently operating the provision under state law giving the attorney general veto power over the transaction was no longer applicable.[142] In essence, then, the attorney general did not have standing to object to the sale.[143]

Petitioners have likewise attempted to extend the influence over a debtor provided under 363(d)(1) and 541(f) through application of other statutes such as 28 U.S.C. 959(b). *In re Seven Counties Servs.*, *supra*, is instructive in this regard. In *In re Seven Counties Servs.*, the petitioner relied upon 11 U.S.C. 363(d)(1) and 541(f) and sought a mandatory injunction to compel the debtor to continue post-petition "employer required" pension contributions pursuant to state law, arguing that they were obligations inextricably tied to state "health and safety" concerns.[144] The petitioner bolstered its argument by asserting that its request also implicated 28 U.S.C. 959(b).[145] 28 U.S.C. 959(b) provides that:

> ….[A] trustee, receiver or manager appointed in any case pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.

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[140] *Id.* at 826-27.
[141] *Id.*
[142] *Id.*
[143] *Id.*
[144] 511 B.R. at 471.
[145] *Id.*

In its decision, the court addressed the petitioner's argument, stating that:

> It has been stated that the power of the Debtor to reject an executory contract in bankruptcy pursuant to § 365(h) is complimentary to the provisions of 28 U.S.C. § 959(b) where "the debtor is permitted to reject private contracts under § 365(h), but is not relieved of public obligations—especially ones going to health and safety—under § 959(b)." Here, the Court is not faced with the Debtor using Chapter 11 and specifically 11 U.S.C. § 365(h) as a shield to avoid state laws regulating health and safety. What is at issue here is funding of a specific pension fund. This Court does not find this to be the equivalent of the public health and safety concerns addressed by the cases cited by KERS in support of application of § 959(b). Accordingly, the Court finds that 28 U.S.C. § 959(b) does not compel this Court to grant KERS's requested relief in Count III.[146]

The court therefore denied the petitioner's request.[147]

[146] 511 B.R. at 472-73 (quoting *Saravia v. 1736 18th Street, N.W., Ltd. Partnership*, 844 F.2d 823, 269 U.S. App. D.C. 205 (C.A. D.C. 1988).
[147] *Id.*

VI. Conclusion

The not-for-profit form has certain inherent deficiencies that lead to managerial problems-mainly through lack of meaningful oversight by a properly motivated party-in-interest. This issue, combined with the systematic difficulty experienced in the health care sector in obtaining adequate payment for care creates a circumstance that is rife with difficulty and pitfalls for not-for-profit officers and directors. The bankruptcy process has the potential to remedy these problems, but it is by no means a perfect cure for all facilities. Sometimes the facility becomes the patient and sometimes the patient cannot be rehabilitated. Nonetheless, the instruments of the Bankruptcy Code as described above are arguably the best treatment currently available for health care businesses in the Zone of Insolvency.

Higher Ed And Fiduciary Duties

The Risks To Not-For-Profit Officers and Trustees

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The Cause Of The Problem

Higher Ed Is Faced With A Dramatic Demographic Shift

» Between 2011 and 2016 the total number of enrolled college students nationwide fell every fall

- National Student Clearing House research center statistics indicate that post-secondary school enrollment has declined in each year since at least 2013
  - Fall 2013: -1.5%
  - Fall 2014: -1.3%
  - Fall 2015: -1.7%
  - Fall 2016 -1.3%
  - Fall 2017 -1%
  - Fall 2018 -1.7%
    - Total -10.5% over a 6 year period

» The trend is predicted to continue through the next decade

- Demographics and the Demand For Higher Education author Nathan Grawe of Carlton University projects a 10.5% decrease in college applicant aged people nationwide through 2029.
  - In the Northeast the projected decrease is greater than 15%.

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The Impact

- Five New England Colleges Have Ceased Operations Or Announced An Intention To Cease Operations Since March, 2018
  - Mount Ida College
    - Private tuition dependent not-for-profit college in Newton, Massachusetts
    - Enrollment of approximately 1400
    - Endowment in 2016 of $1.9 million
    - Closed May, 2018
  - Newbury College
    - Closing May, 2019
  - Green Mountain College
    - Private tuition dependent not-for-profit college in Poultney, Vermont
    - Enrollment of approximately 450
    - Endowment in 2017 of approximately $3.7 million
    - Closing May, 2019
  - Southern Vermont College
    - Private tuition dependent not-for-profit college in Bennington, Vermont
    - Enrollment of approximately 200
    - Endowment in 2016 of approximately $2.9 million
    - Closing May, 2019
  - College Of St. Joseph
    - Closing May, 2019

The Financials In The Public Record

- Mount Ida College Balance Sheet

	2016	2015
ASSETS		
Cash and Cash Equivalents	$ 4,001,764	$ 1,871,611
Accounts Receivable, Net of Allowance for Doubtful Accounts of $620,000 in 2016 and $386,420 in 2015	488,317	1,027,212
Contributions Receivable	51,148	72,879
Prepaid and Deferred Expenses	502,935	214,038
Investments	23,526,670	15,952,578
Property, Plant, and Equipment, Net of Accumulated Depreciation	54,006,033	55,793,878
Deferred Financing Costs, Net of Accumulated Amortization	658,573	523,094
Total Assets	$ 83,235,440	$ 75,455,290
LIABILITIES AND NET ASSETS		
LIABILITIES		
Note Payable - Bank	$ 5,500,000	$ 5,500,000
Accounts Payable	780,466	1,394,918
Accrued Payroll and Payroll Taxes	2,006,845	1,494,888
Accrued Expenses and Deposits	856,470	275,726
Deferred Revenues	5,265,449	6,532,773
Annuity Payment Liability	21,312	22,811
Deferred Compensation	528,744	764,275
Capital Leases Payable	223,351	329,338
Financing Obligation	241,773	399,761
Notes Payable	7,018,376	27,133
Bonds Payable	39,353,139	40,287,823
Accrued Pension Liability	5,006,629	4,122,176
Total Liabilities	66,802,554	61,151,622
NET ASSETS		
Unrestricted	14,527,692	12,870,527
Temporarily Restricted	628,349	519,296
Permanently Restricted	1,276,845	913,845
Total Net Assets	16,432,886	14,303,668
Total Liabilities and Net Assets	$ 83,235,440	$ 75,455,290

The Financials In The Public Record

» Mount Ida College Statement of Activities

	2016	2015
OPERATING ACTIVITIES		
Revenues:		
Tuition	$ 38,913,349	$ 35,260,994
Room and Board	10,105,379	8,951,444
Comprehensive Fee	1,522,083	1,183,067
Less Financial Aid	(18,645,121)	(14,886,112)
Net Tuition, Room and Board Revenues	31,895,690	30,509,393
Fees and Other	213,408	129,835
Government Contracts	80,222	580,101
Auxiliary Enterprises	911,207	1,410,552
Private Gifts and Grants	8,114,300	60,558
Investment Interest and Dividends	6,167	162,682
Net Realized and Unrealized Gains on Investments		
Used for Operations	452,000	594,000
Other Investment Income	-	35
Total Operating Revenues	41,672,994	33,447,156
NET ASSETS RELEASED FROM RESTRICTIONS		
Satisfaction of Program Restrictions	60,646	281,940
Satisfaction of Property and Equipment Acquisition Restrictions	9,160	17,908
Total Net Assets Released from Restrictions	69,806	299,848
Total Operating Revenues, Gains, and Other Support	41,742,800	33,747,004
Expenses:		
Instruction	12,636,220	11,442,047
Academic Support	3,925,256	3,437,024
Student Services	9,006,119	8,028,549
Institutional Support	9,170,306	7,374,456
Fundraising and Advancement	887,494	569,793
Auxiliary Enterprises	7,605,677	8,919,393
Total Expenses	43,231,072	39,771,262
CHANGE IN UNRESTRICTED NET ASSETS FROM OPERATING ACTIVITIES	(1,488,272)	(6,024,258)
NONOPERATING ACTIVITIES		
Net Gain on Disposal of Property, Plant, and Equipment	2,500	9,960
Net Realized Gains on Investments	3,273	126,223
Net Unrealized Gains on Investments	4,602,036	3,926,668
Lease Termination Payment	(300,000)	-
Used for Operations	(452,000)	(594,000)
Change in Accrued Pension Liability	(710,371)	(1,513,531)
CHANGE IN UNRESTRICTED NET ASSETS FROM NONOPERATING ACTIVITIES	3,145,437	1,955,320
CHANGE IN UNRESTRICTED NET ASSETS	$ 1,657,165	$ (4,068,938)

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The Litigation—Mount Ida Class Action

» Squeri et al. v. Mount Ida College et al.

- United States District Court for the District of Massachusetts
- Putative class action for and on behalf of the former students of Mount Ida College
- Causes of action include breach of fiduciary duty, fraud, fraud in the inducement, breach of contract as well as statutory and common law consumer projection theories
- Primary fiduciary duty assertion is that the failure of the college, its administration and its trustees to notify students and prospective students of the college's financial condition when known breached a fiduciary duty to students
- Motion to dismiss with prejudice as to all counts granted
  - Trustees' fiduciary duties owed to the college itself, not to the students
    - "To the extent that a fiduciary duty was imposed on defendants, it was owed to Mount Ida as a corporate entity."
  - College has no fiduciary duty to students.
    - "Massachusetts courts have consistently held that no fiduciary relationship exists between a student and his or her college."

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The Litigation—Mount Ida Civil Investigative Demand

- In re Mount Ida College
  - Massachusetts Superior Court
  - A proceeding filed by the Massachusetts Attorney General in accordance with M.G.L. c. 12, § 8H
  - The basis for the requested issuance was that "review of the requested information is necessary to determine whether charitable funds have been applied to charitable purposes or if breaches of trust have been committed in the administration of" Mount Ida
  - The CID was opposed, primarily on the basis that "the Attorney General lacks the predicate belief that charitable funds have been misappropriated or that breaches of trust were committed."
  - The parties suspended the CID proceeding and agreed to a consensual production of documents and information.
  - The CID was terminated without the commencement of civil or criminal proceedings.

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The Litigation—Green Mountain College Receivership Action

- Poses v. The Corporation of Southern Vermont College, Inc.
  - Vermont Superior Court
  - Poses, a second lien lender, sought recovery of a $2 million claim secured by the main campus assets of the college.
  - In connection with the action, he sought prejudgment attachments and appointment of a receiver
  - The causes of action alleged include breach of contract, avoidance of fraudulent transfers and breach of fiduciary duty
  - The fiduciary duty count asserts that SVC, because insolvent, owes fiduciary duties to creditors including the plaintiff and that those fiduciary duties were breached when SVC received a working capital loan from members of the board of trustees and secured its obligations under that loan with liens on substantially all of SVC's assets.
  - The College has opposed the prejudgment relief sought. A hearing has been scheduled.

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The Law—Fiduciary Duties In Nonprofit Entities Generally

- Statutory
  - A director, officer or incorporator of a corporation shall perform his duties as such, including, in the case of a director, his duties as a member of a committee of the board upon which he may serve, in good faith and in a manner he reasonably believes to be in the best interests of the corporation, and with such care as an ordinarily prudent person in a like position with respect to a similar corporation organized under this chapter would use under similar circumstances. In performing his duties, a director, officer or incorporator shall be entitled to rely on information, opinions, reports or records, including financial statements, books of account and other financial records, in each case presented by or prepared by or under the supervision of (1) one or more officers or employees of the corporation whom the director, officer or incorporator reasonably believes to be reliable and competent in the matters presented, or (2) counsel, public accountants or other persons as to matters which the director, officer or incorporator reasonably believes to be within such person's professional or expert competence, or (3) in the case of a director, a duly constituted committee of the board upon which he does not serve, as to matters within its delegated authority, which committee the director reasonably believes to merit confidence, but he shall not be considered to be acting in good faith if he has knowledge concerning the matter in question that would cause such reliance to be unwarranted. A director, officer or incorporator of a corporation shall not be liable for the performance of his duties if he acts in compliance with this section. M.G.L. c. 180, § 6C
- Decisional Law
  - "Directors of a corporation stand in a fiduciary relationship **to that corporation** and have a duty to protect its interests '**above every other obligation**.'" *Estate of Moulton v. Puopolo*,467 Mass. 478, 492-93 (2014) (emphasis added) (quoting *American Discount Corp. v. Katz*, 348 Mass. 706, 711 (1965)). The codification of this long-standing common law precept imposes upon a trustee of a not-for-profit entity the obligation to act in "good faith and in a manner [she] reasonably believes to be in **the best interest of the corporation**." M.G.L. ch. 180, § 6C. (emphasis added).

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The Law—The Fiduciary Duties

- **Fiduciary Duties Of Not-For-Profit Officers/Trustees and Directors**
  - **The duty of due care**
    - **The duties of a not-for-profit corporation's board members are measured by a standard that is virtually indistinguishable from the SJC's definition of the private business judgment rule. *Rockwell v. Trustees of Berkshire Museum*, No. 1776-cv-00253, 2017 WL 6940932 (Mass. Sup. Ct. Nov. 7, 2017).**
  - **The duty of loyalty**
    - **The duty of loyalty obligates directors to act in good faith, in the best interests of the corporation and to refrain from self-dealing or other acts that would confer an improper personal benefit from the directors' relationship with the corporation. *Trenwick America Litigation Trust v. Ernst & Young LLP*, 906 A.2d 168 (Del. 2011).**
    - **Duty of loyalty claims are tested on an "entire fairness" standard.**
      - **Fair process**
      - **Fair price**
      - ***Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983)**
  - **The duty to mission/of obedience**
    - **Not for profit officers and directors have an additional duty—the duty of obedience. Hazen and Hazenns, <u>Duties of Nonprofit Corporate Directors—Emphasizing Oversight Responsibilities</u>, 90 NCLR 1845 (Sept. 2012).**
    - **This duty requires that the board cause the corporation to adhere to the mission stated in its governing documents.**
    - **This duty has been described as a remnant from another time when for-profit directors were also considered to have a duty of obedience.**

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The Law—Who Is Owed The Duties And Who Enforces Them

» **"Directors of a corporation stand in a fiduciary relationship to that corporation, and have a duty to protect its interests 'above every other obligation."** ***Estate of Moulton v. Puopolo*, 467 Mass. 478 (2014).**

- The duty, therefore, is owed to the college itself, and not to any particular constituency of the college.
- There is no separate duty owed to students—the "student-college relationship is essentially contractual in nature." *Mangala v. Brown University*, 135 F. 3d 80 (1st Cir. 1998).

- **"[I]t is the exclusive function of the Attorney General to correct abuses in the administration of a public charity by the institution of proper proceedings."** ***Lopez v. Medford Cmty. Ctr., Inc.*, 384 Mass 163 (1981).**
  - M.G.L. 12, § 8. The attorney general shall enforce the due application of funds given or appropriated to public charities within the commonwealth and prevent breaches of trust in the administration thereof.
  - "The law has provided a suitable officer to represent those entitle to the beneficial interest in a public charity. It has not left it to individuals to assume this duty, or even to the court to select a person for its performance." *Weaver v. Wood*, 425 Mass. 270 (1997)

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The Law—Protections Afforded Board Members

» The Federal Volunteer Protection Act—42 U.S.C. § 14501 *et seq*.

- "[N]o volunteer of a nonprofit organization … shall be liable for harm caused by an act or omission of the volunteer on behalf of the organization or entity if … the volunteer was acting within the scope of the volunteer's responsibilities in the nonprofit organization or governmental entity at the time of the act or omission …."
- Expressly stated Congressional purpose—"[T]o promote the interests of social service program beneficiaries and taxpayers and to sustain the availability of programs, nonprofit organizations, and governmental entities that depend on volunteer contributions by reforming the laws to provide certain protections from liability abuses related to volunteers serving nonprofit organizations and government entities."

- State Law Adjuncts—M.G.L. c.231, § 85K
  - "No person who serves as a director, officer or trustee of an educational institution which is, or at the time the cause of action arose was, a charitable organization, … who is not compensated for such services … shall be liable solely by reason of such services … for any act or omission resulting in damage or injury to another, if such person was acting in good faith and within the scope of his official functions and duties, unless such damage or injury was caused by willful or wanton misconduct."

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Local Decisional Law Of Note

- *Estate of Moulton v. Puopolo*, 467 Mass. 478, 492-93 (2014)
  - Fiduciary duties are owed to the corporation itself,
- *Rockwell v. Trustees of Berkshire Museum*, No. 1776-cv-00253, 2017 WL 6940932 *10 (Mass. Sup. Ct. Nov. 7, 2017)
  - Not-for-profit directors owe a duty to the corporation that is virtually indistinguishable from the business judgment rule.
- *Calixto v. Coughlin*, 481 Mass. 157, 113 N.E.3d 329, 335 (2018)
  - Individual creditors have no right to assert direct claims for breach of fiduciary duties against corporate directors.
- *Lopez v. Medford Cmty. Ctr., Inc.*, 384 Mass. 163, 167 (1981)
  - It is the exclusive function of the attorney general to correct abuses in the administration of a public charity.
- *Weaver v. Wood*, 425 Mass. 270, 275 (1997)
  - The rule that the attorney general has the exclusive authority to represent "those entitled to the beneficial interests in a public charity" leaves no room for others, or "to the court to select a person … however honorable their intentions might be."
- *Harvard Climate Justice Coal. v. President & Fellows of Harvard Coll.*, 90 Mass. App. Ct. 444, 446, *review denied sub nom Harvard Climate Justice Coal. v. President*, 476 Mass. 1105 (2016)
  - Parties other than the attorney general may invoke the "special standing doctrine" to enforce "a personal right that directly effects the individual member of a charitable organization."

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re **WONDERWORK, INC.,** Debtor.	Chapter 11 Case No. 16-13607 (MKV)

FINAL REPORT OF JASON R. LILIEN, EXAMINER

SUMMARY TAKEN FROM FULL EXAMINER'S REPORT FOR THE PURPOSE OF EDUCATION RELATED TO THE 2019 ABI NORTHEAST PANEL ON NOT FOR PROFIT FIDUCIARY DUTIES

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I. INTRODUCTION AND SUMMARY CONCLUSION

WonderWork is not a sham charity, at least in the traditional sense. Over the years, it has funded numerous medical procedures in developing countries and seemingly operated within a traditional organizational structure. However, this Examination has revealed that WonderWork abused the public's trust from its inception. Through fundraising campaigns designed to mislead donors as to how their contributions would be spent, and an accounting system which failed to properly record and track those contributions, WonderWork raised, and then misapplied and misused, millions of charitable dollars.

WonderWork presents a case study on how a dominant CEO, left unchecked by a passive and overly deferential Board of Directors, can damage a charity beyond repair. The Examiner's five-month review revealed that WonderWork is a poorly governed, costly and highly inefficient operation in which only a small fraction of donations are used to help people in need. While laudable in concept, WonderWork failed in execution. Under Brian Mullaney's charge, WonderWork has operated in disregard of key legal requirements and industry standards regarding charitable solicitation, restricted gift practices, financial reporting, and compensation standards.

The Court is familiar with the history of this case, and the Examiner will not belabor the past. However a little background is instructive.

Brian Mullaney, CEO and "co-founder" of WonderWork was a successful advertising executive before he turned to fundraising for charity. As the co-founder, with Charles Wang, of SmileTrain, he helped build a huge direct-mail based charity, raising hundreds of millions of dollars over the span of nearly a decade. Towards the end of that period, Mullaney had a disagreement with Wang over which track SmileTrain should take. That disagreement grew into a feud, and that feud is what ultimately led WonderWork to Chapter 11. WonderWork's early days were plagued by litigation between Mullaney and SmileTrain, though with the support of his loyal donors, Mullaney managed to keep his new venture on course.

WonderWork then faced one last hurdle which it could not overcome. A dispute with HelpMeSee over who had breached a service contract between them grew into a multi-year, multi-million dollar, hotly-contested arbitration proceeding, encouraged, if not funded, by Wang. When the New York Supreme Court confirmed the arbitrator's initial $8 million plus judgment, WonderWork filed for Chapter 11, in a last ditch effort to stay in business.

The correctness of the arbitrator's award is not before this Court, and the Examiner felt bound to accept the state court judgment as final, unless and until it is reversed on appeal. But this background is important because it was HelpMeSee's motion seeking to appoint a trustee that led to the appointment of the Examiner.

WonderWork hoped to protect its "restricted" fund balances from HelpMeSee's adverse judgment (which, including interest and, if affirmed by the New York state court, attorney's fees, may exceed $16 million). In order to do that, both pre- and post-petition, WonderWork began to look back and see if it could reclassify some of its purportedly unrestricted funds as restricted. Those actions were among the reasons cited by HelpMeSee in its motion seeking a trustee.

Faced with the drastic choice of appointing a trustee and likely jeopardizing the Debtor's very existence, and with major donors indicating their support for Mullaney, the Court prudently chose to appoint an Examiner, tasked with two major jobs: first to determine, in accordance with New York State charity law, the Debtor's actual restricted fund balance, and second, to report to the Court on potential causes of action the estate might have, including traditional Chapter 5 avoidance actions, as well as potential claims arising from mismanagement or wrongful conduct by the principals of the Debtor.

New York charity law makes very clear that contributions donated to a charity for a particular purpose must be separately accounted for and spent only for that purpose. Accounting rules related to functional cost analysis may lead to a different presentation on an entity's financial statements, but the law on this subject is not ambiguous. Bankruptcy law and New York State law are both equally clear that restricted purpose donations cannot be used to satisfy creditors' claims.

As the Examiner initially approached his tasks, they appeared relatively limited in scope. The Debtor appeared to be trying to shelter its assets from a creditor by "restating" certain contributions it had been treating as unrestricted to restricted. What the Examination revealed however, was far more serious and far-reaching. In fact, the Debtor had been operating in violation of New York state charity law almost from inception. To a degree, the Debtor's actions could be attributed to a mistaken reliance on those accounting rules, but the Examiner believes that reliance was not innocent, and indeed was based on a deliberate attempt to take advantage of the rules. And in other respects, the Examiner believes the Debtor's actions, particularly in connection with its fundraising practices, now appear outright fraudulent.

And so an attempt to bring the Debtor's "restricted" accounts into balance, turned into an exercise in reconstructing, almost from scratch, the Debtor's entire fundraising history, all in the absence of the Debtor's most recent audit. This encompassing over 600 separate solicitations, hundreds of thousands of donations, and millions of dollars of misapplied and mishandled funds.

The Examiner did not anticipate that the issues regarding fundraising and record keeping would be so substantial. However, given the severity of issues uncovered, the Examination necessitated a much more thorough and comprehensive review of the Debtor's systems. While many of the problems with Debtor's solicitation practice quickly became apparent to the Examiner, the magnitude of the issues and, most importantly, the economic consequence could not be accurately quantified until the Examiner was far into the process. Indeed additional solicitation materials were being produced and analyzed as recently as over the last few weeks. And as further discussed below, there were good reasons for the Examiner not to reach – or announce – his conclusions prematurely.

Wonderwork claims to raise money to fund surgeries that would not otherwise be available in underdeveloped countries around the world. Skilled at both in-person donor cultivation as well as drafting compelling mass marketing appeals, Mullaney's fundraising approach for the Debtor focused principally on maintaining donor relationships he formed while at SmileTrain, while sourcing new donors through an extensive direct mail campaign.

In total, since its inception in 2011, the Debtor has raised approximately $54.4 million in charitable contributions under the WonderWork name and the names of the individual DBAs. However, the bulk of the money spent by the charity over the years has gone to feed the enormous fundraising machine itself, including both its own highly compensated employees, and third party direct mail service providers. And although it has tried, the Debtor cannot excuse these expenditures on the grounds that it is still a relatively new charity.

The Examiner has concluded, based on his thorough review of the Debtor's fundraising practices and solicitation materials that almost $5 million of contributions originally reported as unrestricted should be classified as restricted. He has also determined that Debtor failed to properly account for the "roll-forward" of its restricted fund balances over the years. In fact, contrary to their publicly reported position, the great majority of the Debtor's current funds should be deemed to be restricted. As detailed throughout this Report, the Examiner found that the Debtor:

- used false and misleading solicitation materials, in violation of applicable law.
- failed in its reporting obligations, making clearly false and misleading statements in its public filings;
- failed to apply their restricted assets in accordance with their intended purpose;
- failed to spend money raised for specific purposes in accordance with the solicitation materials;
- failed to honor and account for matching donations;
- failed to keep accurate accounts of its restricted funds; and
- lacked appropriate governance protocols and its Board failed in its duty to monitor and control management's misfeasance.

Management of the Debtor further abused the public's trust for their own benefit through excessive compensation and benefits and under reported income.

The result of the Examiner's review, and as explained at length in this Report, is that of the approximately $20.2 million dollars held by the Debtor as of the Petition Date, the Examiner believes $16.25 million should be treated as "restricted" funds and can be spent, in accordance with donors' wishes, only on the "surgeries" which WonderWork funds and, as permitted by New York law, on costs related to the administration of such funds.

As detailed in his Report, the Examiner's conclusion that most of the money remaining in the Debtor's possession should be deemed restricted raises difficult questions with respect to the application of unrestricted funds to replenish restricted dollars wrongly spent in the past. The Examiner has also struggled with the impact of his recommendation on creditors of the organization, who may find themselves disadvantaged as a result of the misfeasance and malfeasance of the Debtor's management. Debtor's principal creditors are (i) the so-called "impact loan" lenders, all of whom entrusted large sums of money to the Debtor to "jump start" what they thought would be a successful fundraising machine and did not place any restrictions on their money, and (ii) HelpMeSee, whose arbitration award, currently under appeal in the New York State courts, is what brought the Debtor to this Court in the first place, and who will also have to deal with the consequences of having sought third party intervention. The Examiner is aware that his conclusions regarding the Debtor's purported reliance on accounting rules related to cost allocation may also prove unpopular in the non-profit world. However, he is comfortable with his determination that such accounting rules cannot be used to supersede a legal determination on the use of restricted gifts.

The Examiner believes that his investigation has revealed that sufficient grounds exist to appoint a Trustee under the Bankruptcy Code, given the evidence of mismanagement and improper fundraising and reporting practices. While the Examiner is mindful of the extraordinary expense already incurred and does not wish to add to the administrative expenses in this case, nevertheless the Examiner recommends that the Court consider such an appointment. Alternatively, given the Examiner's conclusions regarding the Debtor's restricted and unrestricted fund balances, the Court could consider providing for payment of administrative expenses from the Debtor's remaining unrestricted funds and then dismissing the case and referring the matter to the New York State Attorney General's Office in order to determine whether or not WonderWork can properly continue as a participant in the non-profit sector and what causes of action might be brought outside of the bankruptcy process. In the interim, the

Examiner recommends that the Court continue the current suspension of the Debtor's operations pending decisions on the Trustee appointment and the Attorney General's review.

II. PROCEDURAL BACKGROUND

A. Commencement of Chapter 11 Case

On December 29, 2016 (the "Petition Date"), the Debtor commenced a voluntary case under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code") in the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court").[1] The Debtor continues to operate its business and manage its properties as a debtor in possession under section 1107 of the Bankruptcy Code.

In the *Declaration of Brian Mullaney Co-Founder and CEO of WonderWork, Inc. in Support of Chapter 11 Petition and First Day Pleadings* (the "Mullaney Declaration"), the Debtor disclosed that it filed for bankruptcy after an adverse arbitration award in the amount of $13,198,431.85, exclusive of interest but inclusive of attorneys' fees and arbitration costs, was entered against it in favor of another charity, HelpMeSee, Inc. ("HelpMeSee").[2] The Mullaney Declaration disclosed that if HelpMeSee were to enforce the Arbitration Award, the Debtor did not have enough unrestricted cash flow to pay the HelpMeSee arbitration award and continue to operate.[3] In its initial *Schedules of Assets and Liabilities*, the Debtor listed assets totaling $21,770,674 and claims totaling $25,882,442.[4]

[1] *See Chapter 11 Voluntary Petition for Non-Individual*, Docket No. 1. The case was originally assigned to Judge Bernstein, but was reassigned to Judge Vyskocil on March 3, 2017. *See Notice of Reassignment,* Docket No. 68.

[2] *See* Mullaney Declaration ¶¶ 19-20, Docket No. 2.

[3] *Id.* ¶ 22.

[4] *Schedule of Assets and Liabilities* (the "Initial Schedules"), Docket No. 12. The Debtor subsequently filed Amended Schedules E/F (the "Final Amended Schedules"), Docket No. 212, listing unsecured claims in the total amount of $26,567,042.28. HMS's claim in the Final Amended Schedules is listed as $16,059,833.50. *Id.* at 4.

Submitted this 25th day of October, 2017.

Jason R. Lilien, Court Appointed Examiner

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

CIVIL ACTION NO. 18-12438-RGS

TRISTAN SQUERI, MADELINE McCLAIN, and GEORGE O'DEA,
individually and on behalf of all others similarly situated

v.

MOUNT IDA COLLEGE, et al.

MEMORANDUM AND ORDER ON
DEFENDANTS' MOTIONS TO DISMISS

May 24, 2019

STEARNS, D.J.

After more than a century of operation, Mount Ida College closed suddenly at the end of the 2018 academic year. Three students, Tristan Squeri, Madeline McClain, and George O'Dea, brought this putative class action against Mount Ida College; its Board of Trustees; the Board's Chairwoman, Carmin Reiss; the President, Barry Brown; the Vice President, Chief Financial Officer, and Treasurer, Jason Potts; the Vice President of Enrollment Management and Dean of Admissions, Jeff Cutting; and the Chief Academic Officer and Provost, Ron Akie.[1] Plaintiffs, on behalf of

[1] Plaintiffs claim that the court has jurisdiction under the Class Action Fairness Act (CAFA), 28 U.S.C. § 1332(d), because "[t]he amount-in-controversy exceeds $5,000,000.00 and minimal diversity exists between the parties." Am. Compl. (Dkt # 12) ¶ 19. While CAFA contains a home-state

former and prospective Mount Ida students,[2] allege that defendants failed to inform them of Mount Ida's dire financial straits and shared their academic and financial profiles with the University of Massachusetts (UMass) Dartmouth without their consent. More specifically, the Amended Complaint sets out seven claims: violation of privacy under Mass. Gen. Laws ch. 214, § 1B (Count I), fraud (Count II), negligent misrepresentation (Count III), fraud in the inducement (Count IV), breach of fiduciary duty (Count V), breach of contract (Count VI), and unfair and deceptive practices in violation of Mass. Gen. Laws ch. 93A, § 9 (Count VII). Defendants move to dismiss the Amended Complaint for failure to state a claim.[3] For the reasons to be explained, defendants' motions to dismiss will be allowed.

BACKGROUND

The facts, viewed in the light most favorable to plaintiffs as the nonmoving party, are as follows. Mount Ida College was a not-for-profit

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exception under section 1332(d)(4)(B), Mount Ida represents that "at least one-third of its student body was typically from outside of Massachusetts." College Mem. (Dkt # 27) at 7 n.9.

[2] The putative class is of "[a]ll students and prospective students of Mount Ida College at the time Mount Ida College closed," Am. Compl. ¶ 47, purportedly consisting of over 1,400 members, *id.* ¶ 49.

[3] Mount Ida, the Board of Trustees, Reiss, Cutting, and Akie filed one motion to dismiss, while Brown and Potts filed separate motions of their own.

institution with a principal place of business in Foxborough, Massachusetts. Mount Ida closed its doors on May 17, 2018. According to the Amended Complaint, defendants knew that Mount Ida was struggling financially in as early as 2014, but failed to disclose its precarious fiscal state to current and prospective students. Plaintiffs point to the fact that in 2017, defendants reported to the New England Association of Schools and Colleges (NEASC) that, among other things, Mount Ida was financially stable. On February 24, 2018, Mount Ida announced that it had entered merger negotiations with Lasell College, but did not attribute the potential merger to any financial pressure. On March 21, 2018, defendants rejected the terms of the merger and, two days later, informed the Mount Ida community that they had broken off the talks with Lasell. On April 6, 2018, Brown sent a blast email to enrolled students informing them that Mount Ida had agreed to sell its Newton, Massachusetts, campus to UMass Amherst and that all current students would be guaranteed admission to UMass Dartmouth. On November 26, 2018, plaintiffs brought this lawsuit.

DISCUSSION

"To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009), quoting *Bell Atl. Corp.*

v. Twombly, 550 U.S. 544, 570 (2007). A claim is facially plausible if its factual content "allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Iqbal*, 556 U.S. at 678. "If the factual allegations in the complaint are too meager, vague, or conclusory to remove the possibility of relief from the realm of mere conjecture, the complaint is open to dismissal." *Rodríguez-Reyes v. Molina-Rodríguez*, 711 F.3d 49, 53 (1st Cir. 2013), quoting *SEC v. Tambone*, 597 F.3d 436, 442 (1st Cir. 2010) (en banc).

Violation of Privacy

Plaintiffs allege that defendants violated their privacy rights under Mass. Gen. Laws ch. 214, § 1B, by disclosing their "sensitive and private student academic data" to UMass Dartmouth without their consent.[4] Am. Compl. ¶ 57. "To sustain a claim for invasion of privacy, the invasion must be both unreasonable and substantial or serious." *Nelson v. Salem State Coll.*, 446 Mass. 525, 536 (2006). "Generally, whether an intrusion qualifies as unreasonable, as well as either substantial or serious, presents a question

[4] Although plaintiffs also allege that this disclosure violated the Family Educational Rights and Privacy Act (FERPA), 20 U.S.C. § 1232g, they concede in their Opposition that the statute does not confer a private right of action. Opp'n to College (Dkt # 36) at 12; *see also Gonzaga Univ. v. Doe*, 536 U.S. 273, 287 (2002) ("[T]here is no question that FERPA's nondisclosure provisions fail to confer enforceable rights.").

of fact." *Polay v. McMahon*, 468 Mass. 379, 383 (2014). However, "legitimate countervailing business interests . . . may render the disclosure of personal information reasonable and not actionable under the statute." *Bratt v. Int'l Bus. Machines Corp.*, 392 Mass. 508, 520 (1984).

Here, plaintiffs' allegations fail to establish that the disclosure of their records to UMass Dartmouth was unreasonable as a matter of law. To the contrary, Mount Ida submitted the records to UMass Dartmouth to facilitate plaintiffs' enrollment at the successor institution. The transfer of records, therefore, served a "legitimate purpose," *Polay*, 468 Mass. at 383, and was indisputably conducted in accordance with the Massachusetts Attorney General's May 15, 2018 guidance letter, *see* College Mem., Ex. F. at 5 (directing the transfer of student records using "an anonymized set of unique student identifiers" and noting that "UMass Amherst has agreed to become the 'institution of record'"),[5] and Massachusetts regulations, *see* 610 C.M.R. § 2.07(3)(f)(2) ("If an institution knows that it may close, . . . it shall arrange . . . to safeguard the needs of students by organizing educational

[5] Despite plaintiffs' objection, the court may consider this letter, along with Mount Ida's financial statements and the NEASC reports, because they are public records or are referenced in the Amended Complaint. *See Lydon v. Local 103, Int'l Bhd. of Elec. Workers*, 770 F.3d 48, 53 (1st Cir. 2014) ("On a motion to dismiss, . . . a judge can mull over 'documents incorporated by reference in [the complaint], matters of public record, and other matters susceptible to judicial notice.'").

transfer opportunities, and ensuring the preservation of student records[.]"). Thus, plaintiffs' privacy claim fails as a matter of law. *See Ortiz v. Examworks, Inc.*, 470 Mass. 784, 793 (2015) ("Because the examination was authorized under [Mass. Gen. Laws ch. 90,] § 34M, the invasions of privacy associated with its taking place were 'justified.'"); *Schlesinger v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 409 Mass. 514, 518 (1991) ("The statute obviously was not intended to prohibit serious or substantial interferences which are reasonable or justified.").

Fraud, Negligent Misrepresentation, Fraud in the Inducement

Plaintiffs next allege that defendants committed fraud, negligent misrepresentation, and fraud in the inducement by "continu[ing] to hold Mount Ida out as a viable institution" even though they knew, or should have known, that it was failing financially. Am. Compl. ¶¶ 65, 77. "To establish a claim for fraud under Massachusetts law, a plaintiff must prove that 'the defendant made a false representation of material fact with knowledge of its falsity for the purpose of inducing the plaintiff to act thereon, and that the plaintiff reasonably relied upon the representation as true and acted upon it to his damage.'" *Taylor v. Am. Chemistry Council*, 576 F.3d 16, 31 (1st Cir. 2009), quoting *Russell v. Cooley Dickinson Hosp., Inc.*, 437 Mass. 443, 458 (2002). To sustain a claim of negligent misrepresentation, a plaintiff need not show that a defendant knew the statement to be false, but must show that the defendant failed "to exercise reasonable care or competence in obtaining or communicating the information." *Nota Constr. Corp. v. Keyes Assocs., Inc.*, 45 Mass. App. Ct. 15, 20 (1998).

Defendants argue, and the court agrees, that plaintiffs fail to identify any statement that can be shown to have actually been false. According to the allegations of the Amended Complaint: (1) defendants announced, on February 24, 2018, a potential merger with Lasell College, without referencing Mount Ida's financial distress; and (2) President Brown sent an email to students, on March 23, 2018, stating that merger negotiations had broken off, but that "Mount Ida remained a top 30 school in the region," without divulging any information about the school's financial health. Am. Compl. ¶¶ 68, 79, 88. Plaintiffs do not allege that either statement was untrue.

In response, plaintiffs aver that "Mount Ida's withholding of information regarding its financial distress *is* the fraud alleged." Opp'n to College at 15 (emphasis in original); *see also Nei v. Boston Survey Consultants, Inc.*, 388 Mass. 320, 322 (1983) ("[A] partial disclosure or . . . a half truth . . . may be tantamount, under certain conditions, to a falsehood if there is no further expatiation."). In other words, plaintiffs assert fraud by omission, which "requires both concealment of material information and a duty requiring disclosure." *Sahin v. Sahin*, 435 Mass. 396, 402 n.9 (2001). But plaintiffs fail to make out such a claim.

Mount Ida's audited financial disclosures, which plaintiffs do not allege were inaccurate, were publicly available.[6] *See* College Mem., Exs. B, C. These disclosures revealed that Mount Ida had been operating at a deficit since 2015. *Id.* at 5. Although plaintiffs allege that defendants reported to NEASC in 2017 that "Mount Ida was financially stable," Am. Compl. ¶ 26, the October 2017 NEASC report reviewed Mount Ida's finances and specifically noted that Mount Ida "has produced deficits which is making it difficult for the College to support its mission," *id.*, Ex. D at 29. And while plaintiffs allege that defendants "intentionally omitted their merger talks with Lasell College from their Self-Study report to NEASC," Am. Compl. ¶¶ 69, 80, 89, the Self-Study report also includes Mount Ida's financials and states, in particular, that "[t]he financial plan projected several years of operating deficits," Brown Mem. (Dkt # 25), Ex. 1 at 60.[7] Even assuming Mount Ida's

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[6] Plaintiffs provide no support for their contention that "it is incredulous . . . [to] argue that college students should have done independent research to find these financial statements, interpret them, and make decisions based on them." Sur-Reply to College (Dkt # 50) at 3.

[7] Also, as Brown points out, the statement is directed at NEASC, not plaintiffs. *See* Brown Mem. at 18.

looming insolvency was material and *concealed* by defendants, plaintiffs fail to allege an actionable duty to disclose, including, as described below, any breach of a fiduciary duty.[8] *See Knapp v. Neptune Towers Assocs.*, 72 Mass. App. Ct. 502, 507 (2008) ("A duty to disclose exists where '(i) there is a fiduciary or other similar relation of trust and confidence, (ii) there are matters known to the speaker that he knows to be necessary to prevent his partial or ambiguous statement of the facts from being misleading, or (iii) the nondisclosed fact is basic to, or goes to the essence of, the transaction.'"). Plaintiffs' claims of fraud, negligent misrepresentation, and fraud in the inducement therefore fail as a matter of law.[9]

Breach of Fiduciary Duty

Plaintiffs allege that defendants breached a fiduciary duty owed to them by, again, failing to disclose Mount Ida's financial woes and by sharing

[8] While plaintiffs argue that the existence of the financial statements did not fulfill defendants' duty to disclose, they fail to articulate any duty of disclosure that defendants owed to them. *See* Sur-Reply to College at 3.

[9] Having so concluded, the court need not reach the issue of whether plaintiffs have satisfied the heightened pleading standard required by Fed. R. Civ. P. 9(b), *see Alt. Sys. Concepts, Inc. v. Synopsys, Inc.*, 374 F.3d 23, 29 (1st Cir. 2004) (Under Rule 9(b), "the pleader usually is expected to specify the who, what, where, and when of the allegedly false or fraudulent representation."), or whether they sufficiently allege fraud or misrepresentation "as to each defendant," *Goebel v. Schmid Bros.*, 871 F. Supp. 68, 73 (D. Mass. 1994).

their sensitive financial and academic information with UMass Dartmouth. According to the Amended Complaint, because "Mount Ida held a unique position of influence and trust with its students," defendants "had a fiduciary duty to exercise their rights and powers in good faith for the benefit of their students." Am. Compl. ¶¶ 96-97.

"A fiduciary relationship is one founded on the trust and confidence reposed by one party in the integrity and fidelity of another." *Estate of Moulton v. Puopolo*, 467 Mass. 478, 492 (2014). "Although some fiduciary relationships . . . are created by law, others arise from the nature of the parties' interactions." *Doe v. Harbor Sch., Inc.*, 446 Mass. 245, 252 (2006). Where, as here, "the fiduciary relationship is not one created by law, the existence of the relationship *ordinarily* is a mixed question of law and fact for which the party asserting the relationship bears the burden." *Id.* (emphasis added).

Plaintiffs' breach of fiduciary duty claim, however, fails as a matter of law.[10] Massachusetts courts have consistently held that no fiduciary

[10] The court assumes, without deciding, that plaintiffs have standing to bring a breach of fiduciary duty claim. *See Lopez v. Medford Cmty. Ctr., Inc.*, 384 Mass. 163, 167 (1981) ("Notwithstanding the Attorney General's exclusive and discretionary role as protector of the public interest in the efficient and lawful operation of charitable corporations, a private plaintiff possesses standing to assert interests in such organizations which are distinct from those of the general public."); *Harvard Climate Justice Coal.*

relationship exists between a student and his or her college. *See Williamson v. Bernstein*, 1996 WL 1185104, at *3 (Mass. Super. Feb. 20, 1996) (rejecting "plaintiff's assertion that a fiduciary relationship existed between her and [Fitchburg State] College because she was a student there"); *Morris v. Brandeis Univ.*, 2001 WL 1470357, at *6 (Mass. Super. Sept. 4, 2001), *aff'd*, 60 Mass. App. Ct. 1119 (2004) (same).[11] On the other hand, Massachusetts courts have at times found the existence of a valid contractual relationship between student and college, *see Morris*, 60 Mass. App. Ct. 1119 (Table), or the existence of a "special relationship" between students and their college, *see Nguyen*, 479 Mass. at 453. A special relationship, however, is not a fiduciary one. *See Knelman v. Middlebury Coll.*, 570 F. App'x 66, 68 (2d Cir. 2014) ("While schools, colleges, and educators assume the responsibility of

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v. President & Fellows of Harvard Coll., 90 Mass. App. Ct. 444, 446 (2016) ("Special standing applies only where 'the claim has arisen from a personal right that directly affects the individual member' of a charitable organization."), quoting *Weaver v. Wood*, 425 Mass. 270, 276 (1997).

[11] Plaintiffs do not cite any cases to the contrary, and their reliance on *Dzung Duy Nguyen v. Massachusetts Inst. of Tech.*, 479 Mass. 436 (2018), is inapposite. In *Nguyen*, the Supreme Judicial Court (SJC) held that "a university has a special relationship with a student and a corresponding duty to take reasonable measures to prevent his or her suicide" in limited circumstances, which were not satisfied in that case. *Id.* at 453, 458. While the SJC noted that "[u]niversities are clearly not bystanders or strangers in regards to their students" and that they "have special relationships with their students regarding athletics and other potentially dangerous activities," *id.* at 450, it did not find that these duties amount to a fiduciary relationship.

educating their students, the law does not recognize the existence of a special relationship for the purposes of a breach of fiduciary duty claim."). It follows that neither Mount Ida nor, correspondingly, the remaining defendants, owed a fiduciary duty to plaintiffs. To the extent that a fiduciary duty was imposed on defendants, it was owed to Mount Ida as a corporate entity. *See Estate of Moulton*, 467 Mass. at 492 ("Directors of a corporation stand in a fiduciary relationship to that corporation and have a duty to protect its interests 'above every other obligation.'"); *Cecconi v. Cecco, Inc.*, 739 F. Supp. 41, 45 (D. Mass. 1990) ("Under Massachusetts law, it is a 'basic principle' that officers and directors owe a fiduciary duty to protect the interests of the corporation.").

Breach of Contract

Plaintiffs allege that in the alternative defendants breached a contract between them and Mount Ida. "Under Massachusetts law, a breach of contract claim requires the plaintiff to show that (1) a valid contract between the parties existed, (2) the plaintiff was ready, willing, and able to perform, (3) the defendant was in breach of the contract, and (4) the plaintiff sustained damages as a result." *Bose Corp. v. Ejaz*, 732 F.3d 17, 21 (1st Cir. 2013), citing *Singarella v. City of Bos.*, 342 Mass. 385, 387 (1961). At a minimum, the plaintiff must "explain what obligations were imposed on each of the parties by the alleged contract." *Buck v. Am. Airlines, Inc.*, 476 F.3d 29, 38 (1st Cir. 2007), quoting *Doyle v. Hasbro, Inc.*, 103 F.3d 186, 195 (1st Cir. 1996).

According to the Amended Complaint, plaintiffs "fulfilled their contractual obligations to Mount Ida by remitting tuition payments . . . for the purpose of receiving a degree in their selected field" and "complied with all their financial and academic obligations." Am. Compl. ¶¶ 107-108. Defendants, in turn, "breached their contractual duty by failing to provide the education [that plaintiffs] bargained for and paid for." *Id.* ¶ 109.[12] These bare allegations do not suffice for a breach of contract claim. *See Brooks v. AIG SunAmerica Life Assur. Co.*, 480 F.3d 579, 586 (1st Cir. 2007) ("Plaintiffs . . . must do more than allege, in conclusory fashion, that the defendant breached the contract, by describing, with 'substantial certainty,' the specific contractual promise the defendant failed to keep."); *Doyle*, 103 F.3d at 195 ("Conclusory statements that 'Hasbro and its executives failed to meet their contractual requirement' are insufficient to satisfy the pleading requirements.") (citation omitted). Plaintiffs fail to identify, among other things, the specific terms of the purported contract, when it was formed, and

[12] The Amended Complaint also specifically alleges, however, that "a contract was formed between [plaintiffs] *and Mount Ida*," not any of the other defendants. Am. Compl. ¶ 106 (emphasis added).

who negotiated it.[13] Merely paying tuition in exchange for an education does not create a contract.[14] Ultimately, the lack of specificity is fatal to plaintiffs' breach of contract claim.[15]

Mass. Gen. Laws Chapter 93A

Finally, plaintiffs allege that defendants engaged in unfair and deceptive practices in violation of Mass. Gen. Laws ch. 93A, § 9. According to the Amended Complaint, defendants acted unfairly and deceptively by breaching the Memorandum of Understanding with Lasell College and subsequently mischaracterizing the failed merger, by disclosing plaintiffs'

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[13] Plaintiffs contend that, at a minimum, an implied contract was formed. *See Jackson v. Action for Bos. Cmty. Dev., Inc.*, 403 Mass. 8, 9 (1988) ("A contract implied in fact may be found to exist from the conduct and relations of the parties."), quoting *LiDonni, Inc. v. Hart*, 355 Mass. 580, 583 (1969); *Anthes v. New York Univ.*, 2018 WL 1737540, at *13 (S.D.N.Y. Mar. 12, 2018) ("When a student enrolls at a university, an implied contract arises: if the student complies with the terms prescribed by the university, she will obtain the degree she seeks.") (citations omitted). Their reliance on *Anthes*, however, is misguided because there, the court found that the breach of contract claim was "foreclosed by the lack of specificity as to the agreement between the parties." *Id.* Here, plaintiffs similarly fail to make sufficient allegations of an implied contract.

[14] Moreover, as defendants point out, plaintiffs received a semester of education for every semester for which they paid. College Mem. at 13 n.11.

[15] Having so concluded, the court need not address whether "the corporate veil should be pierced to confer liability" on Brown for breach of contract. Opp'n to Brown (Dkt # 38) at 6.

academic and financial information to UMass Dartmouth, and by failing to inform plaintiffs about Mount Ida's financial distress.

Chapter 93A prohibits "unfair or deceptive acts or practices in the conduct of any trade or commerce." Mass. Gen. Laws ch. 93A, § 2(a). It is true that "[a]n entity's status as a charitable corporation is not, in and of itself, dispositive of the issue" of whether Chapter 93A applies, but "[i]n most circumstances, a charitable institution will not be engaged in trade or commerce when it undertakes activities in furtherance of its core mission." *Linkage Corp. v. Trustees of Bos. Univ.*, 425 Mass. 1, 23, 26 (1997). Similarly, activities that are "purely incidental to the university's educational mission" are generally not subject to Chapter 93A. *Id.* at 25.

Plaintiffs contend that defendants engaged in "trade or commerce" by, among other things, "[o]ffering for sale a unique product" and "[c]ompeting in the marketplace with other schools" through "marketing and advertising." Am. Compl. ¶ 111.[16] However, these actions were in furtherance of Mount Ida's core educational mission or were, at least, incidental to that mission.[17]

[16] The statute defines "trade" and "commerce" to "include the advertising, the offering for sale, rent or lease, the sale, rent, lease or distribution of any services and any property." Mass. Gen. Laws ch. 93A, § 1(b).

[17] Plaintiffs also argue that "[s]uch an analysis is a factual one" inappropriate for this stage of the litigation. Sur-Reply to College at 9. The

Mount Ida did indeed compete with other schools to provide a "unique product," an education. Through its marketing, advertising, and offering of scholarships, Mount Ida was able to recruit, enroll, and educate students. Its attempted merger with Lasell College and subsequent transfer of student data to UMass Dartmouth also served to further the school's core mission of providing and advancing student education. Plaintiffs' Chapter 93A claim therefore fails because defendants were not engaged in "trade or commerce" for purposes of the statute.[18]

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court disagrees. *See Brodsky v. New England Sch. of Law*, 617 F. Supp. 2d 1, 7 (D. Mass. 2009) ("Because the Court concludes that NESL was not engaged in 'trade or commerce' for the purpose of Chapter 93A, Brodsky's claims under that statute will be dismissed[.]"); *Thornton v. Harvard Univ.*, 2 F. Supp. 2d 89, 95 (D. Mass. 1998) ("Harvard's administration of student financial aid is not 'trade or commerce' for purposes of chapter 93A.").

[18] Having dismissed all of plaintiffs' claims, the court need not reach defendants' arguments about whether the Board of Trustees is a proper party, whether individual unpaid trustees like Reiss are entitled to immunity under Mass. Gen. Laws ch. 231, § 85K and the federal Volunteer Protection Act, or whether plaintiffs have sufficiently pled allegations to support liability as to each defendant, not just Mount Ida.

ORDER

For the foregoing reasons, defendants' motions to dismiss are ALLOWED with prejudice.[19] The clerk will enter judgment for defendants and close the case.

SO ORDERED.

/s/ Richard G. Stearns
UNITED STATES DISTRICT JUDGE

[19] The court will not afford plaintiffs another opportunity to amend their Amended Complaint.