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DEPARTMENT OF JUSTICE**

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February 13, 2017

The Honorable Joseph A. Foster
Attorney General of New Hampshire
Department of Justice
33 Capitol Street
Concord, NH 03301

Re: Fiduciary Duty of Corporate Members of Charitable Organizations

Dear Attorney General Foster:

This letter arises out of concern about the nature of the relationship created when one charitable organization becomes the member of another charitable organization so that the former may exercise governance and operational control of the latter. Our conclusion is that the corporate member owes its member organization a limited fiduciary duty.

At common law, the attorney general exercises supervisory rights and duties with respect to charitable trusts. That authority extends to charitable trusts organized as voluntary corporations pursuant to RSA Ch. 292. In 1943, New Hampshire became the first state to recognize statutorily that responsibility. Today the Attorney General's common law and statutory authority is exercised through the Director of Charitable Trusts. RSA 7:20.

In recent years the Charitable Trusts Unit of the Department of Justice has seen an increase in the use of memberships to create affiliations between previously unrelated charitable organizations. In many cases, one organization may become the sole member of another. Generally speaking the former organization thereby gets the right to appoint some or all of the directors of the latter. The member may also obtain certain reserved powers over the other organization, including the right to approve budgets, make by-law changes, and appoint or remove key staff.

The use of corporate members is an alternative to more traditional means of consolidating charitable organizations by merger or asset purchase. Hospitals in particular have found the membership model to be a desirable method to bring organizations together. This construct provides control while preserving pre-existing health insurance contracts, Medicare reimbursement rates and local identity. *See Reiser, Decision-Makers without Duties: Defining*

the Duties of Parent Corporations Acting as Sole Corporate Members in Nonprofit Health Care Systems, 53 Rutgers L.Rev. 979, 988 - 91 (2001). It may also avoid some Attorney General oversight or court filings requesting application of the *cy pres* doctrine or statutory deviation. See, RSA 7:19-b; 547:3-c – 3-h.

The membership model does raise concerns affecting the Attorney General’s oversight of charitable organizations. Traditionally, members of non-profit organizations can and do consider their own best interests in exercising their membership rights. A member may vote his or her self-interest, just as a stockholder does in a for-profit corporation. See Klimon, Re-membering the Nonprofit – Uses of Memberships in Corporate Governance, Taxation of Exempts, November 2012 at 22. But when a charitable corporate member uses its reserved power over another organization, the possibility exists that the member might consider only its interest to the detriment of the other. See, *Lifespan Corp. v. New England Medical Center*, 731 F.Supp.2d 232, 236 - 41 (D.R.I. 2010) (controlling member corporation invested common funds for its own benefit and to the detriment of its member organization); Decision-Makers without Duties, 53 Rutgers L.Rev. at 987 – 94 (example of terminating a service at one hospital solely to benefit another hospital that is its corporate member).

Faced with this challenge, courts applying Rhode Island and Ohio law have ruled that corporate members who assume control of another charitable organization must exercise their director appointment right and their reserved powers as a fiduciary, i.e. in their actions they must consider the interest of the organization controlled by the member. *Lifespan Corp. v. New England Medical Center*, 731 F.Supp.2d 232, 239 - 41 (D.R.I. 2010); *Health Alliance of Greater Cincinnati v. Christ Hospital*, 2008 Ohio App. LEXIS 4191 (2008). The seminal scholarly work to reach this conclusion is Decision-Makers without Duties. In turn the American Law Institute and other writers have more recently accepted this approach. Restatement of the Law of Charitable Organizations (Tent. Draft No. 1, 2016) §2.01, Comment (c); Hesse and Szabo, The Fiduciary Duty of a Charitable Corporation’s Sole Corporate Member: New Law and New Questions, 7 Boston Health L.Rep., Winter 2012 at 4.

There is no direct precedent in New Hampshire with respect to the duties of members toward their charitable organization. Still, there are statutes that support the existence of a fiduciary duty. For instance, RSA 7:19-a establishes specific due diligence and voting requirements before a charitable organization may enter into a contract with a director or officer. RSA 7:19-a. This is a statutory expression of the fiduciary duty of loyalty that nonprofit directors owe to their organization. While transactions with members of a charitable organization are exempt from the statutory reporting requirements, RSA 7:19-a, IX states that any transactions between an organization and its member must be “fair” to the organization. The language implies that members do owe a fiduciary duty toward their organization.

Another example comes from the emerging use of directed trusts with limited-purpose trustees. *See, Shelton v. Tamposi*, 164 N.H. 490, 496 – 98 (trust instrument interpreted to divide trustee powers between investment and distribution trustees). A trust protector of a directed trust has limited responsibilities (such as dealing with trust real estate or investments). The New Hampshire Trust Code establishes that a trust protector of a charitable trust is a fiduciary with respect to the powers granted. *See*, RSA 564-B:1-105(b)(16); 7-711; 12-1202. *See also*, Restatement (Third) of Trusts §70. Similarly here, a corporate member has limited powers with respect to its member organization, but its exercise of those powers comes with a fiduciary responsibility.

Finally on this point, New Hampshire courts tend to apply the common law in accordance with the view presented in the various Restatements. *See, Attorney General, Director of Charitable Trusts v. Loreto Publications, Inc.*, 169 N.H. 68, 72 (2016) (citing to Restatement (Third) of Trusts); *Smith v. Lillian V. Donahue Trust*, 157 N.H. 502, 506 (2008); (citing to Restatement (Second) of Trusts); *Concord National Bank v. Haverhill*, 100 N.H. 416 (1958) (citing to Restatement of Trusts). While the Restatement of the Law of Charitable Organizations is still a Tentative Draft, the language in §2.01, Comment (c) specifically imposes a fiduciary duty upon corporations acting as members of other charitable organizations.

After reviewing New Hampshire statutes, case law from other states, and scholarly opinion, our conclusion is that New Hampshire courts would hold that a charitable organization acts as a fiduciary to the extent it employs governance and operational control over another charitable organization. Accordingly, in exercising his or her common law and statutory oversight authority over charitable organizations, the Attorney General should similarly require that corporate members act as a fiduciary when they exercise their control.

Some explanation may be helpful to understand what the imposition of fiduciary duties may mean for corporate members. The core fiduciary duties that apply to charitable organization directors are the duty of loyalty and the duty of care. The duty of loyalty requires a director to place the organization's interests ahead of his or her interest when conducting the organization's business. The duty of care requires a director to pay attention to the management and finances of the organization. Restatement of Charitable Organizations, §2.02, 2.03 (describing duties of charitable organization directors). A corporate member of a charitable organization therefore would owe a duty of loyalty and a duty of care toward its member when exercising its voting and reserved powers. When organizations are part of a larger system with common goals, it may be in many cases that their interests are the same. Occasionally, however, clear win/lose decisions may arise affecting the corporate member and the member organization, and in those cases the corporate member must consider carefully how to act given its duty of loyalty. These dilemmas have been discussed extensively in the context of hospital systems. *See* Decision-Makers without Duties, 53 Rutgers L.Rev. at 987 – 94, 1013 – 26; Huberfeld, Tackling the 'Evils' of Interlocking Directorates in Healthcare Nonprofits, 85 Neb.L.Rev. 681, 716 - 32 (2007); Hershey and Jarzab,

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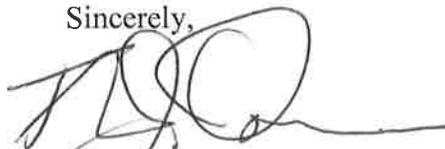
Fiduciary Duties of Interlocking Directors within a Nonprofit Health System, 38 J. Health Law 449 (2005).

Prior to the issuance of this letter, the Charitable Trusts Unit sought comment from charitable organizations, including those using a corporate membership structure. Some practitioners noted that the governance and contractual documents which create and define the member's control often contain terms imposing specific member duties which meet or exceed any obligations imposed by any common law fiduciary duty. In fact, recent hospital acquisition transaction documents reviewed by the Charitable Trusts Unit do contain governance and contractual language that impose duties arguably as rigorous as those that would be imposed by the common law. But articles of agreement, by-laws and management agreements can change over time. The obligations created in a fiduciary relationship remain even as the terms of other documents change.

Other practitioners noted that charitable organizations sometimes create their own supporting organizations for management purposes. In those cases, one corporation may serve as the member of the other organizations within the group. In doing so, the entire family of organizations is created with a unified vision and a common set of goals. Given that initial founding unity, no disparate corporate purposes could develop that would separate the goals of the "parent" organization from its member organizations.

This opinion is intended to guide the Attorney General in his or her oversight of charitable organizations that act as a corporate member of another organization. It also may assist charitable organization directors and their advisors in the governance of their institutions. To provide further practical guidance, attached is a set of questions and answers dealing with the subject matter of this letter.

Sincerely,



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GUIDANCE FOR CHARITABLE ORGANIZATIONS THAT ARE CORPORATE MEMBERS OF OTHER CHARITABLE ORGANIZATIONS

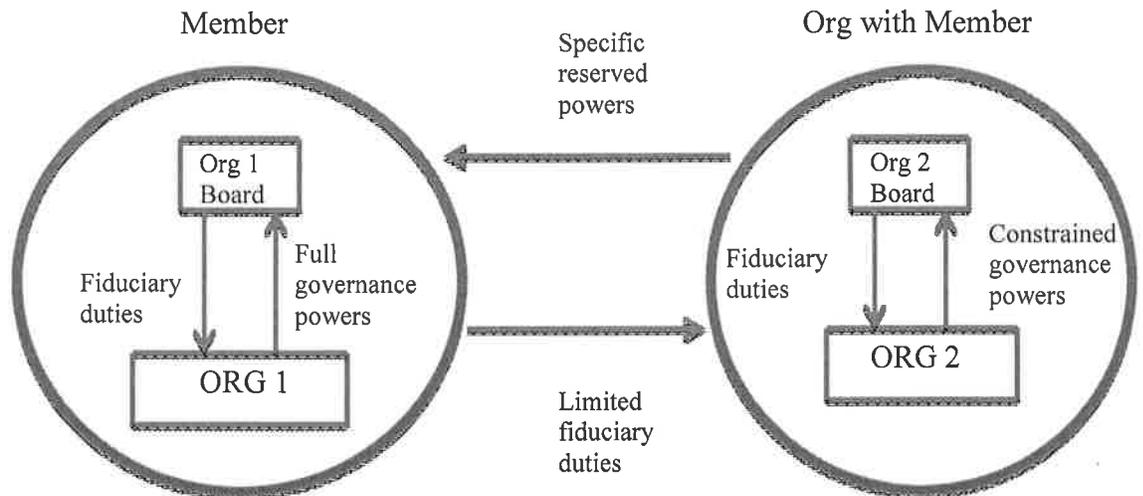
Attorney General Joseph A. Foster announces that the Charitable Trusts Unit will be guided by an opinion letter dated February 13, 2017 from Director of Charitable Trusts Thomas J. Donovan. That letter concerns the fiduciary duty of charitable corporations that are corporate members of other charitable corporations. The following questions and answers provide guidance on the topic.

Q. The opinion letter applies to what types of charitable organizations?

A. Charitable organizations that are corporations may also be the member of another charitable corporation. A member of a charitable corporation is similar to a shareholder in a for-profit corporation, but without profit motives or rights. The membership right is created in the articles of agreement of the membered organization. The details are sometimes further described in the bylaws of the membered organization and perhaps in other documents. The opinion letter only applies to charitable organizations in which the articles, bylaws and perhaps other documents describe how one corporation is the member of another.

Q. How is this relationship structured?

A. Here is a chart that describes the relationship between one corporation (Org 1) that is the sole member of another corporation (Org 2). This membership structure may resemble a parent (Org 1) and subsidiary (Org 2) relationship.



Q. What rights and powers apply to a corporate member of a charitable organization?

A. It depends upon what the articles, bylaws and other documents say because the membered organization can limit or tailor the membership rights that it grants. The member may have the right to appoint some or all of the directors of the membered organization. The member

may have the power to appoint or remove key staff, ratify budgets, approve the purchase or sale of assets and decide key policy matters.

Q. What duties apply to a corporate member of a charitable organization?

A. The point of the opinion letter is that the corporate member owes certain duties toward the membered organization. The corporate member owes fiduciary duties, specifically the duty of care and the duty of loyalty, toward the membered organization. Those are the same duties that the directors of any charitable organization owe to the organization. But, in the case of the corporate member, its fiduciary duty is limited to the scope of its member rights and powers. In other words, the corporate member owes a fiduciary duty with respect to director appointment or budget approval only if the governing documents give the member that authority.

Q. Can conflicts arise between the corporate member and the membered organization?

A. Yes. When the organizations are brought together with others to form a coordinated system, an individual right or power exercised by a member may benefit all organizations or may benefit one but not the other. In the latter case, the member exercising its rights and powers must balance what is best for the system and for the membered organization. Sometimes a conflict between the interests of the organizations in the system can be resolved, sometimes not. There may be conflict resolution procedures written into the bylaws or other documents. The member organization should seek legal advice in those circumstances.

Q. If one organization creates a new supporting organization, does the member organization owe fiduciary duties toward the other organization?

A. Yes, but it should not add any new duties. A fiduciary relationship exists, but since the two organizations arose from a common origin, their interests remain aligned.

Q. Can the scope of the fiduciary duties of the member be defined in written documents?

A. Yes. The bylaws or agreements between the organizations can describe specific expectations that meet or exceed common law fiduciary duties. So long as the documented standards are no weaker than those described in the opinion letter, the parties can adhere to the written document.