COMMENTARY

Point/Counterpoint

When is a Nonprofit Hospital a for Profit Hospital?

by Abbott Brown and Erin Bedell

One of the hottest issues in medical malpractice litigation is the attack on the limitation of liability provided by N.J.S.A. 2A:53A-8 to 'nonprofit' hospitals. The plaintiff's medical malpractice bar is contesting whether many of the large hospital systems in New Jersey are entitled to nonprofit status. The authors provide both sides of the argument below.

Point: Arguments Why Some Hospitals Aren't Entitled to the Limited Liability Provided by N.J.S.A. 2A:53A-8

The term nonprofit is defined as "not existing or done for the purpose of making a profit."[1] This definition is critical to defining the liability of a hospital, because N.J.S.A. 2A:53A-8 states:

> Notwithstanding the provisions of the foregoing paragraph, any *nonprofit* corporation...organized exclusively for hospital purposes shall be liable to respond in damages to such beneficiary who shall suffer damage from the negligence of such corporation...to an amount not exceeding $250,000, together with interest and costs of suit, as the result of any one accident and to the extent to which such damage, together with interest and costs of suit. (emphasis added.)

However, modern hospital systems are no longer operating as the small, community hospitals from which they originated. These hospital systems own and operate many hospitals, as well as physical therapy, pharmacy, food services, captive insurance companies, and numerous related operations. Many of these large hospital systems earn revenue well in excess of a billion dollars annually.

As one commentator has observed:

> Hospitals were traditionally immune from suit in tort under the doctrine of charitable immunity. The charitable immunity doctrine exempted charitable organizations from claims of tort liability brought by the beneficiaries of the subject entity's health care offerings. Application of this general immunity was motivated in large part by public perception of hospital organizations as caregivers insulated from profit-based incentives. Standards of hospital operation in the nineteenth century necessitated the exemption of hospi-

> tals from tort suits brought by aggrieved patients. During that time, hospitals were known for 'providing medical services to the lowest classes of society, without regard to a patient's ability to pay.' Given the philanthropic motivation of such institutions, the application of tort liability was thought to be inappropriate and inconsistent with societal interest.[2]

However, arguably many of the large hospital systems in New Jersey can no longer in good faith be deemed 'nonprofit' institutions.

For example, in 2012, the total revenue of the Atlantic Health System (AHS), which operates the Morristown Memorial Hospital, was $1,577,612,718.[3] AHS's total revenue minus total expenses (*i.e.*, the 'profit') was $70,130,700.[4] Further, in 2012, the president and chief executive of AHS received compensation in the amount of $10,693,661.[5] Similarly, in 2012, the Hackensack University Medical Center earned total revenue of $1,210,959,972, and expenses of $1,147,869,062 yielded a profit of $63,090,910.[6] The CEO of the Hackensack University Medical Center received compensation of $2,890,640.

Perhaps the most extreme compensation package paid by a so-called nonprofit was provided to the former president and chief executive of Barnabas Health, who received total compensation of $21,678,657 in 2012, the year after he retired from New Jersey's largest health system.[7] While this was a one-off golden parachute, in 2012 the current CEO of the hospital system was paid $2,838,336, three other non-physician employees were paid more than $1,000,000 and 12 employees and former employees were paid more than $500,000.[8] This should not be construed as criticism of the great work these hospitals do in providing critically needed medical services. These executives are no doubt well worth their compensation, and certainly should be paid on a level equal to those executives at other large, highly profitable corporations. However, the criticism is based upon the legal fiction that these institutions are nonprofits.

By claiming to be nonprofits, these hospitals seek to limit their maximum liability to $250,000, regardless of the severity of the injury or the amount of economic loss. Yet, the New Jersey Nonprofit Corporation Act[9] only permits a nonprofit corporation to pay "reasonable" compensation to its officers. The question is whether a jury should be able to determine whether such substantial levels of compensation are reasonable for a purported nonprofit. Clearly, with the guidance of expert testimony on the levels of compensation of nonprofits, a jury could determine that while such compensation is reasonable for a for-profit corporation, it is unreasonable for a nonprofit to pay such sums to its executives. This is not a question of whether the executives are paid 'too much money,' but rather whether these executives are paid an unreasonable amount for a purported nonprofit.

The counterpoint that follows indicates that "[w]hen dealing with revenues in the billions of dollars, running a hospital is essentially akin to sitting at the helm of a Fortune 500 company. In 2012, *Forbes* magazine reported that the average total compensation for a Fortune 500 CEO as of the 2012 Fortune survey was $10.5 million." Yet, this statement proves this point, since all of the Fortune 500 companies are for-profit companies.

It is for this very reason—that hospital executives in New Jersey are paid on the same level as those at the largest and most profitable corporations in the country—that case law is rapidly recognizing that an entity may lose its nonprofit status if its actions are no longer consistent with that of a nonprofit organization.

In *AHS Hosp. Corp. v. Town of Morristown*,[10] the tax court recognized that a hospital may be a for-profit hospital despite its federal tax status as a nonprofit. If is it true that all nonprofit hospitals operate like the hospital in this case, as was the testimony here, then for the purposes of the property tax exemption modern nonprofit hospitals are essentially legal fictions, and it is long established that 'fictions arise from the law, not law from fictions.' After the tax court held that *AHS* was a for-profit institution and, therefore, liable for property taxes, *AHS* conceded the point and agreed to pay $15,500,000 in property taxes.[11]

In an analogous situation, *Klein v. Bristol Glen, Inc.*,[12] the Appellate Division applied substance over form regarding the Charitable Immunity Act. In *Klein*, the plaintiff brought suit against an elder care community. The community raised the Charitable Immunity Act, N.J.S.A. 2A:53A-7 and -9, as a defense. The trial court granted a motion for summary judgment, but the Appellate Division reversed, finding the "relevant inquiry" focuses upon the defendant's method of operation, which must be that the defendant's "dominant motive is charity [and not] some other form of enterprise."[13]

The court noted that the "source of funds" is critical to this issue. If most of the medical provider's funding comes from governmental assistance, insurance or patients, the immunity does not apply because it would not have applied at common law.[14] The *Klein* court explained that the common law sought to "avoid diverting charitable trust funds to non-charitable purposes in order to live up to the reasonable expectations of the benefactor."[15] The proper inquiry is "the organization's source of funds," since immunity will not apply if the amount of charitable donations is "too insignificant."[16] As explained by the court, if the organization obtains the bulk of its funding from either the gov-

ernment or from "compensation paid by the private market for value received," immunity should not apply, since it does not serve the purposes underlying the immunity at common law.[17]

The issue of the 'source of funds' also served as a basis to deny immunity in *Walters v. YMCA*.[18] In *Walters*, the court found the YMCA was not entitled to immunity under N.J.S.A. 2A:53A-7 because the actual function of the organization and its funding did not support the legal requirements of the statute.

The court explained:

> Looking to the source of its funding, Defendant has provided documentation that of the $7,305,752.00 of the Newark YMCA's revenue from 2012, only 8.11% or $592,472.00 came from contributions and grants. Thus, the overwhelming majority of Defendant's revenue that year derived from other sources, including for fee services and government grants. Although there is no rigidly defined amount of charitable funding that an organization must show, a court can determine whether the amount is significant enough or not. *See*, *Estate of Komninos v. Bancroft Neurohealth, Inc.*, 417 N. J. Super. 309 (App. Div. 2010). *In this case, the court finds that a fitness facility whose revenue is overwhelmingly derived from sources other than charitable donations, is not entitled to charitable immunity*.[19]

The other issues raised by the counterpoints can be refuted quickly. Whether an institution is organized exclusively for hospital purposes or whether the patient is a beneficiary of those services is simply irrelevant to the issue of whether a hospital is operated as a nonprofit. The argument that plaintiffs lawyers simply 'want to make a lot of money' is equally irrelevant, and offensive to a noble profession. Finally, the statement that most healthcare providers are only 'apparent agents' and have insurance in the amount of $1,000,000, and that 'the hospital is not the tortfeasor' misses the mark by quite a large margin. There are many occasions when the hospital is the only tortfeasor, and other occasions when an actual employee of the hospital is the negligent party. In such cases, the hospital may have procured insurance policies to cover such losses. Indeed, there are cases where the hospital has obtained many millions of dollars in insurance coverage, and still may hide behind the legal fiction of being a nonprofit.

Arguably then, the only rationale conclusion is that if a hospital system acts like a Fortune 500 for-profit corporation, generates profits like a Fortune 500 for-profit corporation, and pays its management like a Fortune 500 for-profit corporation, it should not be able to shield itself from tort liability to the most catastrophically injured persons by resource to the 'legal fiction' that it is a nonprofit. The bottom line is that the bottom line matters.

Counterpoint: Arguments Why All Hospitals are Entitled to the Limited Liability Provided by N.J.S.A. 2A:53A-8

The argument that injured plaintiffs should have access to more money because hospital systems pay important employees high salaries is misplaced. Ignoring the statutory language and legislative intent to assure plaintiffs and their lawyers a bigger pool of money in which to wade rings hollow when viewed in the context of the great things hospitals and their employees do for people. The New Jersey Legislature has declared that a nonprofit corporation is one that "may be organized under this act [New Jersey Nonprofit Corporation Act] for any lawful purpose other than for pecuniary profit."[20]

The act specifically addressees executive compensation. It states:

> No corporation organized under this act shall have or issue capital stock or shares. No dividend shall be paid and no part of the income or profit of a corporation organized under this act shall be distributed to its members, trustees or officers, but a *corporation may pay compensation in a reasonable amount to its members, trustees and officers, for services rendered, may pay interest on loans or other credit advances by members, trustees and officers, may confer benefits on its members in conformity with its purposes*, and, upon dissolution, may make distributions to its members as permitted by this act; except the payment, benefit, or distribution shall not be deemed to be a dividend or distribution of income or profit.[21]

To aid in the interpretation of statutory language, the Legislature has advised that "Technical words and phrases, and words and phrases having a special or accepted meaning in the law, shall be construed in accordance with such technical or special and accepted meaning."[22] As such, the position that the dictionary definition of nonprofit should trump the legal definition and the law's intent is specious.

Thus, arguably multi-million dollar salaries for those persons who shape the state's healthcare are "reasonable," consistent with the meaning of the statute, and any contention to the contrary stating "that's just too much money" is suspect. Reasonable is defined as "fair and sensible."[23] That definition must be viewed in the context of the environment to which it applies. A hospital CEO is required to manage the operations of the hospital on a daily basis. The job includes attempting to insure, in a minefield of human behavior, that all patients receive a quality level of care. The job requires constant collaboration with senior leaders, such as the chief financial, nursing and medical officers, among others. The job involves frequent consultation with the board of trustees and medical staff members regarding community outreach, infrastructure, maintenance

and improvement, as well as the development of planned direction and policies for the facility. Dealing with revenues in the billions of dollars, running a hospital is essentially akin to sitting at the helm of a Fortune 500 company. In 2012, *Forbes* magazine reported that the average total compensation for a Fortune 500 CEO as of the 2012 *Fortune* survey was $10.5 million.[24] The executive compensation received by hospital CEOs is certainly fair and sensible when compared to their peers, who have similar responsibilities. But their goals are different. Can it fairly be said that a gaming technology company's CEO, who is rewarded for unprecedented profit, is more important than the hospital executive, who champions healthcare for the underprivileged?

The position that hospital executives are paid too much and, therefore, hospitals should be stripped of their limited immunity as nonprofit corporations flies in the face of the Legislature's clear commitment to the charitable immunity doctrine. In 1959, the Legislature enacted N.J.S.A. 2A:53A:7-11, and carved out a limited liability exception for hospitals:

> Notwithstanding the provisions of the foregoing paragraph, any nonprofit corporation, society or association organized exclusively for hospital purposes shall be liable to respond in damages to such beneficiary who shall suffer damage from the negligence of such corporation, society or association or of its agents or servants to an amount not exceeding $10,000, together with interest and costs of suit, as the result of any one accident and to the extent to which such damage, together with interest and costs of suit, shall exceed the sum of $10,000 such nonprofit corporation, society or association organized exclusively for hospital purposes shall not be liable therefor.

In 1991, the Legislature raised the limitation on liability on hospitals from $10,000 to $250,000. The Legislature recognized the increased cost of potential damages and acted accordingly to expand the limited immunity afforded to hospitals. It is clear the intent of the Legislature is to protect hospitals from extreme verdicts that could cripple the purpose for which they were established. The New Jersey Supreme Court has held, "it would be contrary to the interests of society that funds dedicated to a charitable use be permitted to be diverted or diminished by the payment of judgments resulting from the torts of agents, servants or employees of the organization or institution administering the charity where suit is instituted by the beneficiary of the charity."[25]

To qualify for the limited charitable immunity provided by N.J.S.A. 2A:53A-8, a hospital needs to prove: 1) that it is a nonprofit "organized exclusively for hospital purpose[s]," 2) it was engaged in a hospital purpose at the time the care at issue was provided, and 3) the plaintiff was a beneficiary of the hospital's works at the time.[26] The court in *Kuchera v. Jersey Shore Family Health Center*[27] appropriately distinguished the two different types of charitable immunity, acknowledging that the clinic where the plaintiff fell was engaged in the broader definition of 'hospital purposes.' As a result, the defendant hospital clinic was not entitled to absolute immunity under N.J.S.A. 2A:53A-7, but rather was entitled to the limitation of damages afforded to nonprofit institutions organized exclusively for hospital purposes pursuant to N.J.S.A. 2A:53A-8.

In *Hunterdon Med. Ctr. v. Twp. of Readington*,[28] the Court discussed the meaning of the phrase "organized exclusively for hospital purposes" in the context of considering whether an offsite facility owned and operated by a nonprofit hospital was exempt from local property taxation. There, the Court stated that "the core aspects of a hospital's purposes are to address the needs of all of the types of patients that a hospital is expected to serve," and further held that the site of the delivery of the service does not detract from its inclusion as a hospital purpose.[29]

In *Kuchera*, the Court declared, "the modern hospital is a place where members of the community not only seek emergency services but also preventative services, therapy, educational programs, and counseling, and the conception of 'hospital purposes' must expand to reflect the many health-related pursuits of the modern hospital."[30]

In *AHS Corp v. Town of Morristown*, the tax court did not make an affirmative finding that the hospital was not a charitable institution; rather, it said that the defendant hospital did not meet its burden of proof establishing its claimed tax exception for the "entire" property. As a result, the court ordered that portions of the property were subject to taxation.

Until the Legislature acts to change the definition of a nonprofit corporation or the purpose thereof, all hospitals are entitled to their nonprofit corporate status regardless of the compensation paid to executives, so long as any profits are not paid as dividends. In that same regard, until the Legislature again determines that the limited liability 'cap' on damages needs modification, which it should not, all nonprofit organizations organized for hospital purposes are entitled to this legislative protection.

Hospitals provide medical care for those who are uninsured, underinsured, without a primary care physician, and/or who lack access to regular medical care. The Legislature apparently understands that excessive verdicts would thwart hospitals' ability to provide services to the community at large. What gets lost when this issue is discussed is the underlying reason for the desire to extinguish the $250,000 cap. Plaintiffs' lawyers are not upset hospital executives make a lot of money. They, too, want to make a lot of money. Rather, they are upset that the hospital's apparent agents have insur-

ance that arguably is insufficient to compensate a tort victim. There is no mention that most of the healthcare providers who have privileges at hospitals have their own insurance. These apparent agents have private insurance of $1,000,000 or more, from which plaintiffs can and do collect. The hospital is not the tortfeasor.

The argument that hospitals generate considerable income, and their executives are paid too much, and, therefore, an apparent agent's negligence should result in opening the hospital's coffers beyond $250,000, is illogical and unfair. Arguments that hospitals' nonprofit status should be dismantled are a sly endeavor to circumvent the Legislature and deepen the well from which to drink. ⚖

Abbott S. Brown *is a partner with the law firm of Lomurro, Munson, Comer, Brown and Schottland in Freehold. His practice concentrates on medical and professional malpractice litigation.* ***Erin A. Bedell*** *is a partner with the law firm of Orlovsky, Moody, Schaaff, and Conlon in West Long Branch. Her practice focuses primarily on the defense of physicians, nurses and hospitals in malpractice suits.*

ENDNOTES

1. http://www.merriam-webster.com/dictionary/nonprofit.
2. Comment, Ryan Montefusco, Hospital Liability for the Right Reasons: A Non-Delegable Duty to Provide Support Services, 42 *Seton Hall L. Rev.* 1337, 1339 (2012)(Emphasis supplied and citations omitted).
3. *See* http://pdfs.citizenaudit.org/2013_12_EO/65-1301877_990_201212.pdf.
4. *Id.*
5. *Id*. *See also*, Hospital Execs Receive Sky High Payouts, available athttp://www.crainsnewyork.com/article/20140406/HEALTH_CARE/140409916/hospital-execs-receive-sky-high-payouts. *See also*, Medical millionaires: The compensation packages of hospital heads are drawing attention, available at http://www.njbiz.com/article/20140305/NJBIZ01/140309913/medical-millionaires-the-compensation-packages-of-hospital-heads-are-drawing-attention.
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8. *Id.*
9. N.J.S.A. 15A:2-1, *et seq.*
10. *AHS Hosp. Corp. v. Town of Morristown*, 2015 N.J. Tax LEXIS 12 (Tax Ct. June 25, 2015).
11. *See* Atlantic Health to pay Morristown $15.5M to settle tax case, available at http://www.nj.com/morris/index.ssf/2015/11/atlantic_health_to_pay_morristown_155m_to_settle_t.html.
12. *Klein v. Bristol Glen, Inc*., No. A-1382-08T3, 2010 N.J. Super. Unpub. LEXIS 1868, (App. Div. Aug. 4, 2010).
13. *Id.*
14. *Id.*
15. *Klein v. Bristol Glen, Inc*., 2010 WL3075582, at *4 (App. Div. Aug. 4, 2010) (emphasis added).
16. *Id.* at 5-6.
17. *Id*. at 5-6 (*citing Abdallah v. Occupational Ctr. of Hudson County. Inc*., 351 N.J. Super. 280, 284 (App. Div. 2002)).
18. *Walters v. YMCA*, Slip Opinion, Docket No. ESX-L-2830-12, appeal pending (App. Div. 2015).
19. *Id.* (emphasis added.)
20. N.J.S.A. 15A:2-1a.
21. N.J.S.A. 15A:2-1d (emphasis added).
22. N.J.S.A. 1:1-1.
23. http://www.merriam-webster.com/dictionary/reasonable.
24. http://www.forbes.com/lists/2012/12/ceo-compensation-12_rank.html.
25. *Jones v. St. Mary's Roman Catholic Church*, 7 N.J. 533, 537-538 (1951).
26. *See, e.g*., *Ryan v. Holy Trinity Evangelical Lutheran Church*, 175 N.J. 333 (2003).
27. 221 N.J. 239 (2015).
28. 221 N. J. 239 (2015).
29. *Id*. at 572.
30. *Id*. at 251.