



ALAN WILSON  
ATTORNEY GENERAL

September 3, 2013

The Honorable J. Thomas McElveen, III  
Senator, District No. 35  
PO Box 57  
Sumter, South Carolina 29151

Dear Senator McElveen:

### **Introduction**

This Office received your request for an opinion regarding whether or not a South Carolina eleemosynary (or charitable) organization can indemnify its officers and board members from penalties levied as a result of a recent jury verdict against the corporation for a violation of federal law. We will discuss the applicable law herein, but leave the facts surrounding your question to the courts to determine.

Of course, as we have recognized many times, factual determinations are beyond the scope of an opinion of this Office. See *Op. S.C. Atty. Gen.*, December 12, 1983. Thus, for purposes of our conclusions herein, and without the benefit of a transcript of the trial, we must assume that the following facts, which are alleged in the complaint of the United States, are correct, based upon the jury's verdict, finding violations of federal law. Our understanding of the facts follows.

### **Facts as Alleged in Complaint of the United States**

In or about 2001, Tuomey d/b/a Tuomey Healthcare System, Inc. was the only hospital located in Sumter County. Westmark Ambulatory Surgery Center was opened in Sumter to perform less complicated and lower risk outpatient surgeries outside the confines of Tuomey and to provide services at a lower cost than Tuomey. Tuomey then opened its own outpatient surgery center. Tuomey determined that there would be substantial lost revenues from Sumter physicians' use of Westmark and began negotiations with various physicians in Sumter to hire them as full-time employees of Tuomey.

Tuomey had its local counsel review two proposed contract arrangements with physicians in Sumter, a full-time employment agreement and an exclusive services contract. The local counsel issued an opinion letter saying that an exclusive services contract might violate the federal Stark Statute. The physicians that Tuomey was negotiating with at that time said that they were not interested in a full-time employment contract with Tuomey.

Tuomey then asked its local counsel to review a part-time employment contract with a proposal for compensation. The local counsel recommended amendments. After the amendments were made, the local counsel opined that the contracts fell within an exception to the Stark Statute, based on a report

given by a healthcare consulting company. In the report, the consulting company said that paying the physicians 131% of the amount received as payment for professional services was within the fair market value for such services.

During 2004 and 2005, Tuomey undertook substantial efforts to recruit physicians to enter into part-time employment contracts. Tuomey advised the physicians that the contracts did not violate the Stark Statute or other federal laws. Several physicians entered into contracts with Tuomey.

Dr. Michael Drakeford, a Sumter physician, was approached by Tuomey concerning a part-time employment contract. He had his attorney review the contract and his attorney said that the contract violated the Stark Statute and potentially violated other federal laws.

Drakeford and Tuomey could not come to an agreement on the contract so they agreed to jointly hire an attorney to advise them. On or about June 22, 2005, the joint attorney said during a telephone conference with the parties that the employment contract violated the Stark Statute and that there were other problems with it. Tuomey objected to the joint attorney's opinion being put in writing and told the joint attorney by letter to do no further work on the case.

Tuomey hired yet another law firm to advise them. The law firm suggested two changes to the contract which Tuomey did not make.

In or about July 2005, Dr. Drakeford asked to meet with Tuomey's Board of Trustees to discuss his concerns about the part-time employment contracts. Tuomey asked Drakeford to put his request in writing and he did so. Tuomey's Board adopted a policy for a meeting with the Board in which the Chairman or CEO decided if the Board would meet with a person and no one was allowed to bring their attorney. The Board provided Drakeford with the new policy but did not respond to his request to meet.

On October 4, 2005, Dr. Drakeford filed suit against Tuomey on behalf of the United States alleging violation of the federal False Claims Act. The United States became actively involved and filed an amended complaint on December 21, 2007. In its amended complaint, the government alleged that Tuomey had violated the federal Stark Statute for entering into compensation arrangements with physicians that exceeded fair market value, that were not commercially reasonable, and which took into account the volume or value of referrals generated between the physicians and Tuomey. The United States also alleged in its complaint that Tuomey had violated the federal False Claims Act, by submitting false claims to Medicaid and Medicare, which included claims relating to inpatient and outpatient health services rendered to patients who were referred to the hospital by physicians who had improper contracts with Tuomey. The officers and Board of Trustees of Tuomey were not named as parties by either Dr. Drakeford or the United States.

After a trial, a jury found Tuomey had violated the Stark Statute and had violated the False Claims Act, by submitting 21,730 false claims in the amount of \$39,313,065.00. On May 22, 2013, the United States moved for damages in the amount of \$237,454,195.00.<sup>1</sup> This motion is still pending.

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<sup>1</sup> In a footnote on the motion, the United States recognized "that the defendant's resources may be inadequate to fully satisfy this judgment and, accordingly, the government remains open to discussing a settlement, on appropriate terms, at a level below the amount of the judgment."

**LAW/ANALYSIS**

**I. South Carolina Nonprofit Corporation Act**

Tuomey is a private, nonprofit corporation according to the amended complaint of the United States. Therefore, the South Carolina Nonprofit Corporation Act, S.C. Code Ann. section 33-31-101 *et seq.* (1976 Code, as amended), is applicable.

As stated above, the officers and Board of Trustees of Tuomey were not parties to the lawsuit. Accordingly, the code sections on indemnification (sections 33-31-850 to 33-31-858) which are part of the South Carolina Nonprofit Corporation Act appear not to be applicable to the case at hand, because they only address indemnification when an officer or director is made a party to a proceeding. Instead, the applicable sections of the South Carolina Nonprofit Corporation Act are sections 33-31-830, 33-31-842, and 33-31-834.

Section 33-31-830 of the South Carolina Code states:

(a) A director shall discharge his duties as a director, including his duties as a member of a committee:

(1) in good faith;

(2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and

(3) in a manner the director reasonably believes to be in the best interest of the corporation.

(b) In discharging his or her duties, a director is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by...

(2) legal counsel, public accountants, or other persons as to matters the director reasonably believes are within the person's professional or expert competence...

(c) A director is not acting in good faith if the director has knowledge concerning the matter in question that makes reliance otherwise permitted by subsection (b) unwarranted.

(d) A director is not liable to the corporation, a member, or any other person for any action taken or not taken as a director, if the director acted in compliance with this section...

(f) An action against a director asserting the director's failure to act in compliance with this section and consequent liability must be commenced before the sooner of (i) three years after the failure complained of or (ii) two years after the harm complained of is, or

reasonably should have been, discovered. This limitations period does not apply if the failure to act in compliance with this section has been fraudulently concealed.

S.C. Code Ann. section 33-31-830 (1976 Code, as amended).

Section 33-31-842 of the South Carolina Code provides that nondirector officers have the same general duty of care, loyalty, good faith, and fair dealing as that of directors as shown by the following:

(a ) An officer with discretionary authority shall discharge his duties under that authority:

(1) in good faith;

(2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and

(3) in a manner the officer reasonably believes to be in the best interests of the corporation, and its members, if any.

(b) In discharging his duties, a director is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by...

(2) legal counsel, public accountants, or other persons as to matters the officer reasonably believes are within the person's professional or expert competence...

(c) An officer is not acting in good faith if the director has knowledge concerning the matter in question that makes reliance otherwise permitted by subsection (b) unwarranted.

(d) An officer is not liable to the corporation, any member, or any other person for any action taken or not taken as an officer, if the officer acted in compliance with this section.

(e) An action against an officer asserting the officer's failure to act in compliance with this section and consequent liability must be commenced before the sooner of (i) three years after the failure complained of or (ii) two years after the harm complained of is, or reasonably should have been, discovered. This limitations period does not apply if the failure to act in compliance with this section has been fraudulently concealed.

S.C. Code Ann. section 33-31-842 (1976 Code, as amended).

Sections 33-31-830 and 33-31-842 provide the general standards of conduct of officers and directors of nonprofit corporations. A director or officer must act with the care of an ordinarily prudent person in a

like position under similar circumstances. This allows directors and officers to exercise their judgment, but they must act with common sense and informed judgment. See Official Comment, S.C. Code Ann. section 33-31-830 (1976 Code, as amended) (citing Model Nonprofit Corporation Act, section 8.30).

Moreover, directors and officers of a nonprofit corporation have a duty to act in good faith in a manner they reasonably believe to be in the best interest of the corporation. To determine whether directors and officers acted in good faith, a court will generally look to a director's or officer's state of mind to see if he or she acted with honesty and faithfulness to his or her duties. Furthermore, a director or officer must truly believe that an action is in the best interest of the nonprofit corporation. See Official Comment, S.C. Code Ann. section 33-31-830 (1976 Code, as amended) (citing Model Nonprofit Corporation Act, section 8.30).

It is also well recognized that a nonprofit corporation, unlike a business corporation, does not operate to maximize profits. See Official Comment, S.C. Code Ann. section 33-31-830 (1976 Code, as amended) (citing Model Nonprofit Corporation Act, section 8.30). "Non profit has been defined to mean 'not conducted or maintained for the purpose of making a profit; not based on the profit motive; or not organized on capitalistic principles.'" See Op. S.C. Atty. Gen., June 1, 2005 (2005 WL 1609285) (citing WEBSTER'S NEW INTERNATIONAL DICTIONARY 'Nonprofit' at 761)).

Moreover, Section 33-31-834 of the South Carolina Code states as follows:

(a) All directors, trustees, or members of the governing bodies of not-for-profit cooperatives, corporations, associations, and organizations described in subsection (b) are immune from suit arising from the conduct of the affairs of these cooperatives, corporations, associations, or organizations. This immunity from suit is removed when the conduct amounts to willful, wanton, or gross negligence. Nothing in this section may be construed to grant immunity to the not-for-profit cooperatives, corporations, associations, or organizations.

(b) Subsection (a) applies to the following...

(2) not-for-profit corporations, associations, and organizations, as recognized in and exempted from taxation under Federal Income Tax Code Section 501(c)(3), (c)(6), or (c)(12).

S.C. Code Ann. section 33-31-834 (1976 Code, as amended).

Further, according to Osborn v. University Medical Associates of the Medical University of South Carolina, 278 F.Supp.2d 720 (D.S.C. 2003):

South Carolina courts have recognized 'gross negligence' only when the defendant has failed to exercise a slight degree of care. Pilot Indus. v. Southern Bell Tel. & Tel. Co., 495 F. Supp. 356, 362 (D.S.C. 1979) (citing Wilson v. Etheredge, 52 S.E.2d 812, 52 S.E.2d 812 (1949)). Gross negligence is the 'intentional, conscious failure to do a thing that is incumbent [sic] upon one to do, or the doing to a thing intentionally that

one ought not to do.’ *Id.* (quoting Ford v. Atl. Coast Line R.R., 169 S.C. 41, 168 S.E. 143, 147 (S.C. 1932)).

The Osborn case also stated:

The test by which a tort is to be characterized as reckless, willful or wanton is whether it has been committed in such a manner or under such circumstances that a person of ordinary reason or prudence would then have been conscious of it as an invasion of the plaintiff’s rights... [T]he test [is]... that at the time of [a defendant’s] act or omission to act the [defendant] be conscious, or chargeable with consciousness, of his wrongdoing. (citing Rogers v. Florence Printing, O., 233 S.C. 567, 106 S.E. 2d 258, 263 (1958)).

Id.

To determine whether section 33-31-834 of the Code would apply to Tuomey d/b/a Tuomey Healthcare System, Inc., it would be necessary to know whether it is a not-for-profit corporation, association, or organization, “as recognized in and exempted from taxation under Federal Income Tax Code Section 501(c)(3), (c)(6), or (c)(12).” If Tuomey falls within this definition, then it needs to be analyzed whether its Board of Trustees and officers qualify for this immunity.

We also note that even if a Board of Trustees and the officers successfully argue the issue of immunity from liability, this Office has opined that “this statutory immunity would not generally serve to protect those persons from liability for federally created claims.” See Op. S.C. Atty. Gen., No. 89 - 53, May 1, 1989 (1989 WL 406143) (interpreting section 33-31-834’s predecessor, S.C. Code Ann. section 33-31-180 (1976 Code, as amended)). Thus, the issue of whether or not this state statute may provide immunity to the officers and trustees purported violations of federal law is questionable, based upon our earlier analysis in previous opinions.

## **II. South Carolina Trust Code**

It is our opinion that Tuomey is a public charity<sup>2</sup> which is subject to a charitable trust. According to S.C. Dep’t of Mental Health v. McMaster, 372 S.C. 175, 642 S.E.2d 552 (2007) (citing Scott on Trusts sections 24-25 (2d Ed. 1956); Restatement (2<sup>nd</sup>) Trusts section 24):

A charitable trust is defined as:

[A] fiduciary relationship with respect to property arising as a result of a manifestation of an intention to create it, and subjecting the person by whom the property is held to equitable duties to deal with property for a charitable purpose...Restatement (2<sup>nd</sup>) Trusts section 348 (1959)...The settlor must manifest an intention to create a charitable trust. It is not necessary that any particular words or conduct be manifest to create a

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<sup>2</sup> A hospital can be both a public charity and a private corporation. See Strauss v. Marlboro County General Hospital, 185 S.C. 425, 194 S.E. 65 (1937).

trust, and it is possible to create a trust without using the words ‘trust’ or ‘trustee.’

What characterizes a charitable trust is that a donor has left property to be distributed for charitable purposes. “A trust...may be created by: (1) transfer of property to another person as trustee during the settlor’s lifetime or by will or other disposition taking effect upon the settler’s death...” S.C. Code Ann. section 62-7-401 (1976 Code, as amended). “A charitable gift is one that confers a public benefit upon an uncertain group of beneficiaries and is of a quasi-public nature. Charitable trusts, although private in nature, are created for public purposes, and may not serve individual or family purposes.” 5 S.C. Jur. Charities section 8. “[T]he object and effect of any charitable gift or activity must be that it confers a public benefit, and that it not be for private profit.”...“Public benefit, as a threshold concept to the definition of a charity, involves the principle that the public must derive some value from the existence of the charity.” 5 S.C. Jur. Charities section 6. Furthermore, “properties conveyed to a public charity are also impressed with a charitable trust.” S.C. Dep’t of Mental Health v. McMaster, 372 S.C. at 182.

According to Tuomey’s website, Timothy Tuomey, a Sumter philanthropist, “left provisions in his will that led to the acquisition of the Sumter Hospital in 1913.” (<http://www.tuomey.com/about/history.aspx>). The former Sumter Hospital is now Tuomey. A marker explains that:

Sumter Hospital was begun 1904 by Drs. S.C. Baker, Walter Cheyne, Archie China, H.M. Stuckey, and was built shortly thereafter nearby. Renamed Tuomey following purchase in 1913 with funds from will of T.J. Tuomey (1842 - 1897) which specified that a community hospital be established...

See [http://www.waymarking.com/waymarks/WM7F6Z\\_43\\_23\\_The\\_Tuomey\\_Hospital](http://www.waymarking.com/waymarks/WM7F6Z_43_23_The_Tuomey_Hospital)

Hospitals have been recognized as charitable trusts. “The founding and maintenance of hospitals and asylums of various kinds...constitute charitable uses or trusts, and bequests, devises, or other gifts for such purposes will be upheld in equity with a strong hand. Trusts for such purposes may be established and carried into effect, when, if not of a charitable nature, they could not be supported.” S.C. Dep’t of Mental Health v. McMaster, 372 S.C. at 180 (citing Harter v. Johnson, 122 S.C. 96, 115 S.E. 217 (1922)). “A charitable trust may be created for...the promotion of health.” S.C. Code Ann. section 62-7-405 (1976 Code, as amended). “[A] trust for the prevention, cure or treatment of disease, or otherwise for the promotion of health is charitable.” Op. S.C. Atty. Gen., December 9, 2005 (2005 WL 3463708) (citing Porcher v. Cappleman, 187 S.C. 491, 198 S.E. 8, 10 (1938)). Therefore, Tuomey is impressed with a charitable trust.

There does not have to be specific language in a will to create a charitable trust. Op. S.C. Atty. Gen., December 9, 2005 (2005 WL 3463708) (citing Harter v. Johnson, 122 S.C. 96, 115 S.E. 217 (1922)) states:

[N]o formality in the use of language is necessary in order to create a public charitable trust. The court look[s] to the purpose for which the gift is made, rather than to the particular words used to designate that purpose. And while a gift cannot be made a charity unless made upon a trust, either express or implied, that it shall be devoted to uses which the

law recognizes as charitable, the omission from a bequest of the words 'in trust' is not material, where the intention is clearly manifested that the whole property shall be applied by the legatee for the benefit of other persons than himself.

Although we do not have a copy of Timothy Tuomey's will, it appears from Tuomey Healthcare System, Inc.'s website and from the marker that his intent was clearly to establish a hospital to serve the Sumter community.

Because Tuomey is a public charity subject to a charitable trust, the South Carolina Trust Code, S.C. Code Ann. section 62-7-101 *et seq.* (1976 Code, as amended), is applicable. Similar to the South Carolina Nonprofit Corporation Act, Tuomey's Board of Trustees and officers owe certain duties to Tuomey under the South Carolina Trust Code. "Upon acceptance of a trusteeship, the trustee shall administer the trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries, and in accordance with this article." S.C. Code Ann. section 62-7-801 (1976 Code, as amended). "A trustee shall administer the trust as a prudent person would, by considering the purposes, terms, distributional requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution." S.C. Code Ann. section 62-7-804 (1976 Code, as amended).

Furthermore, "[a] trustee shall take reasonable steps to take control of and protect the trust property." S.C. Code Ann. section 62-7-809 (1976 Code, as amended).

In addition, the South Carolina Trust Code provides:

(b ) A trustee is personally liable for torts committed in the course of administering a trust, or for obligations arising from ownership or control of trust property, including liability for violation of environmental law, only if the trustee is personally at fault.

(c ) A claim based on a contract entered into by a trustee in the trustee's fiduciary capacity, on an obligation arising from ownership or control of trust property, or on a tort committed in the course of administering a trust, may be asserted in a judicial proceeding against the trustee in the trustee's fiduciary capacity, whether or not the trustee is personally liable for the claim...

S.C. Code Ann. section 62-7-1010 (1976 Code, as amended).

We also note that "[a] violation by a trustee of a duty the trustee owes to a beneficiary is a breach of trust." S.C. Code Ann. section 62-7-1001 (1976 Code, as amended). There are various penalties a court may mete out for a breach of trust. Such penalties are as follows:

(b ) To remedy a breach of trust that has occurred or may occur, the court may...

(3) compel the trustee to redress a breach of trust by paying money, restoring property, or other means...



(5) appoint a special fiduciary to take possession of the trust property and administer the trust...

(6) remove the trustee as provided in Section 62-7-706<sup>3</sup>...

(7) reduce or deny compensation to the trustee...

Id.

The South Carolina Trust Code also provides for additional penalties for breach of trust, such as:

(a) A trustee who commits a breach of trust is liable to the beneficiaries affected for the greater of:

(1) The amount required to restore the value of the trust property and trust distributions to what they what have been had the breach not occurred; or

(2) The profit the trustee made by reason of the breach.

S.C. Code Ann. section 62-7-1002 (1976 Code, as amended).

There is a statute of limitations against bringing an action against the trustees and officers. It is as follows:

(a) Unless previously barred by adjudication, consent, or limitation, a beneficiary<sup>4</sup> may not commence a proceeding against a trustee for breach of trust more than one year after the date the beneficiary or a representative of the beneficiary was sent a report that adequately disclosed the existence of a potential claim for breach of trust.

(b) A report adequately discloses the existence of a potential claim for breach of trust if it provides sufficient information so that the beneficiary or representative knows of the potential claim or should have inquired into its existence.

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<sup>3</sup>S.C. Code Ann. section 62-7-706 (1976 Code, as amended) states: (a) For the reasons set forth in subsection (b), the settlor, a cotrustee, or a beneficiary may request the court to remove a trustee, or a trustee may be removed by the court on its own initiative. (b) The court may remove a trustee if: (1) the trustee has committed a serious breach of trust...

<sup>4</sup> A "beneficiary" under the South Carolina Trust Code "means a person that: (A) has a present or future beneficial interest in a trust, vested or contingent; or...(C) In the case of a charitable trust, has the authority to enforce the terms of the trust." See S.C. Code Ann. section 62-7-103 (1976 Code, as amended).

(c ) If subsection (a) does not apply, a judicial proceeding by a beneficiary or on behalf of a beneficiary against a trustee for breach of trust must be commenced within three years after the first to occur of :

- (1 ) the removal, resignation, or death of the trustee;
- (2 ) the termination of the beneficiary's interest in the trust; or
- (3 ) the termination of the trust.

S.C. Code Ann. section 62-7-1005 (1976 Code, as amended).

### **III. Indemnification**

With this background regarding the applicable legal principles in mind, the issue raised in your request is whether Tuomey can indemnify its directors and officers from monetary damages which Tuomey has incurred in the federal lawsuit. "South Carolina has recognized a right of indemnity in the absence of an express contractual provision when 'one person is compelled to pay damages because of negligence imputed to him as the result of a tort committed by another' 7 S.C. Jur. Contribution section 3 (citing Addy v. Bolton, 257 S.C. 28, 34, 183 S.E.2d 708, 710 (1971) (quoting Atlantic C. L. R. Co. v. Whetstone, 243 S.C. 61, 70, 132 S.E.2d 172, 176 (1963)). An indemnitee has no right of indemnity, however, if the indemnitee was personally at fault, separate from any negligence imputed to him. Id. "Ordinarily, if one person is compelled to pay damages because of negligence imputed to him as the result of a tort committed by another, he may maintain an action over for indemnity against the person whose wrong had thus been imputed to him; but this is subject to the proviso that no personal negligence of his own has joined in causing the injury." First General Services of Charleston, Inc. v. Miller, 314 S.C. 439, 445 S.E.2d 446 (1994).

You have provided us with a draft of the proposed bylaws of Tuomey Healthcare System. The draft states the following:

#### **INDEMNIFICATION PLAN**

Pursuant to sections 33-31-850 to [33-31]-858 of the Act [South Carolina Nonprofit Corporation Act], the Corporation [Tuomey] shall indemnify, defend and hold harmless the Corporation's officers and Trustees to the fullest extent permitted by the Act. This plan of indemnification shall constitute a binding agreement of the Corporation for the benefit of the officers and Trustees as consideration for their services to the Corporation, and may be modified or terminated by the Board only prospectively.

It is apparent that Tuomey's trustees and officers have not been named as parties to the federal lawsuit. Therefore, they are not "compelled to pay damages" and indemnification would not be appropriate at this time.

Furthermore, pursuant to the proposed bylaws, Tuomey can only indemnify its officers and trustees to the fullest extent permitted by the South Carolina Nonprofit Corporation Act. Should it be determined by a

court that Tuomey officers and board members breached their fiduciary duties, committed a breach of trust or violated the law in some other manner, then they cannot be indemnified by Tuomey because a court would have found that they were personally at fault or their personal negligence contributed to causing injury. In such event, indemnification would be unwarranted.

**Conclusion**

In our opinion, Tuomey may not indemnify its trustees and officers at this time, because Tuomey's officers and trustees are not parties to the federal lawsuit. In addition, if trustees and officers are found by a court of law to have violated the South Carolina Nonprofit Corporation Act, the South Carolina Trust Code, or any other law not addressed herein, then Tuomey may not indemnify these individuals. Again, this Office cannot, in an opinion determine facts but only may advise as to the applicable law. Such factual findings must be made by a court of law.

Sincerely,



Elinor V. Lister  
Assistant Attorney General

REVIEWED AND APPROVED BY:



Robert D. Cook  
Solicitor General