

# Bickerstaff Heath Delgado Acosta LLP

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February 15, 2012

## *Via Hand Delivery*

The Honorable Greg Abbott  
Attorney General of Texas  
Office of the Attorney General  
300 West 15<sup>th</sup> Street  
P.O. Box 12548  
Austin, Texas 78701

Dear General Abbott:

On behalf of the Weslaco Hospital Authority (“Authority”), I am submitting this complaint concerning the Knapp Medical Center Board of Directors (“Board”)<sup>1</sup> and requesting that you investigate and institute remedial action under your oversight authority over charitable trusts in Texas.

Knapp Medical Center (“Hospital”) is a non-profit, acute care hospital located in Weslaco, Texas. It was established in 1962 as Knapp Memorial Methodist Hospital. The Knapp family made the initial major contribution (\$300,000) and volunteers raised an additional \$500,000 which was matched by a Hill-Burton grant to found the Hospital.

The Authority was created by the City of Weslaco under the Texas Health and Safety Code to also facilitate the creation and operations of the Hospital, including the issuance of municipal bonds to fund construction of the Hospital facilities. In the 1970’s, the facilities of Knapp Memorial Methodist Hospital were transferred to the Authority, which issued certain bonds to construct additional facilities, which were then operated by Knapp Memorial Medical Center. The Authority owned the facilities of the Hospital for many years until it transferred the facilities back to the Hospital by deed in 1987 (“1987 Deed”). Certain covenants in the 1987 Deed preclude sale of Hospital facilities to a for-profit entity.

Notwithstanding these covenants, the Hospital has recently made arrangements to sell the facilities to a for-profit entity. Only after the City of Weslaco and the Authority pointed out to the Board that the sale was in contravention of deed restrictions, has the Board of the Hospital acknowledged violation of the provisions. The Board has now requested that the Authority lift the covenants in the 1987 Deed so as to allow it to sell its facilities to a for-profit entity. The Authority believes that, by entering into a contract to sell the Hospital facilities, the Board has breached the covenants in the 1987 Deed as well as its fiduciary duty of care to the Hospital and its duty of obedience to the law.

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<sup>1</sup> The Knapp Board of Directors is composed of John L. Lackey, Rudy Salinas, Anabell Cardona, James A. Summersett, III, Brian A. Humphreys, Norma I. Montalvo, Bertha Suarez, and Abraham Tanus.

The Authority has also initiated an inquiry into the matter as part of its due diligence in addressing the Board's request to lift the deed restrictions. While the Authority has had difficulty in obtaining financial and other information from the Hospital to conduct its analysis, the limited public information available to the Authority suggests that the Board of the Hospital has not only violated the deed covenants in the 1987 Deed, but has also authorized excessive compensation to Hospital administrators in recent years which, at a minimum, suggest improprieties and mismanagement by the Board that further threatens the continued viability and good standing of the Hospital.

Because we understand the Attorney General's Office, through its Charitable Trusts Division, has oversight authority in connection with the operation of nonprofit corporations in Texas, we respectfully request the Texas Attorney General's Office investigate (including conducting a management audit) to determine the extent of Board nonfeasance/malfeasance, if any. If the Attorney General so determines based on this inquiry, the Authority urges that the Attorney General take such steps as may be appropriate to remove and replace the current Board and management of the Hospital with individuals committed to fulfilling their fiduciary duty so that the best interests of the Hospital and the public are preserved or to appoint a receiver to perform an accounting of the assets of the estate under the Texas Civil Practice and Remedies Codes.

Additional information supporting the complaint is included below.

The Special Warranty Deed dated December 17, 1987. The covenants in question appear in the 1987 Deed (*see Tab A*) as follows:

1. The above described tracts or parcels of land *shall be administered, operated, maintained, occupied, and used faithfully, efficiently and exclusively for and in connection with a not-for-profit hospital* and health care delivery system rendering hospital and health care services, which may include health care education and research, at all times and available, without discrimination as to race, color, religion, sex, or national origin, to the public generally, including, without limitation, all inhabitants of the City of Weslaco, for the public purpose of better providing for the present and prospective health, safety, and general welfare of the people of the State of Texas *by enhancing the availability, efficiency, and economy of hospital and health care facilities*, which may include health care education and research, and the services rendered thereby.

2. Although nothing herein shall be deemed to prohibit the free exercise of religion and guaranteed by the First Amendment to the Constitution of the United States of America, and although there shall be no interference with the religious rights of conscience of patients of or visitors to the not-for-profit hospital and health care delivery system operated upon it, the Subject Property will not be used or operated for sectarian purposes; for the teaching of doctrines or tenets of any particular faith, sect or religion; or as a place for worship or in connection with any part of any program specifically for the education of students to prepare them to become ministers of religion or to enter into or upon any other religious vocation or to prepare them to teach theological subjects.

3. In the event the covenants and agreements set forth in the two paragraphs next preceding this paragraph 3 shall be violated or breached, *or an attempt shall be made to violate or breach any of same, the Grantor, the Grantee, the successors of the Grantor or of the Grantee, and any other person or party aggrieved or at interest, or any one or more such parties, may institute and prosecute any proceedings at law or in equity to abate, prevent, or enjoin any such violation or attempted violation.*

4. The covenants set forth in the next three preceding paragraphs hereto shall be valid and binding and remain in full force and effect until cancelled and removed by an instrument in writing executed by the Grantor, the Grantee, or their respective successors and assigns, and consented to in writing by the Attorney General of the State of Texas, and such instrument and consent are filed for record in the Office of the County Clerk of Hidalgo County, Texas.

Emphasis added.

The Deed makes clear that this covenant is binding unless cancelled and removed by an instrument agreed to by the Authority (Grantor) and with the written consent of the Texas Attorney General.

On November 30, 2011 the Board announced the sale of the Hospital to South Texas Health System (“STHS”), a for-profit subsidiary of the Pennsylvania-based University Health Services, Inc., which is one of the largest hospital management companies in the country.<sup>2</sup> Under the terms of the proposed sale, the Hospital will become part of STHS’s for-profit healthcare system.

Board Violates Covenants it is Duty-Bound to Enforce. From the statements made by representatives of the Hospital it appears the Board was aware of the restrictive covenant at the time that it entered into a contract with Universal Health Systems to sell the Hospital. In statements by the Board President to the public, which were published by the media, (*see* article dated December 22, 2011 from *The Monitor* at **Tab D**), he indicates that the Board was aware of the restriction, but decided to enter into the contract notwithstanding the covenant. Other representatives of the Hospital suggest that the Hospital may not have been aware of the restriction until it was pointed out to them by the City Attorney. Either circumstance is problematic.

If the Board of the Hospital was aware of the existence of the restrictive covenant but opted to enter into the contract to sell the Hospital notwithstanding the covenant, then the Board has clearly violated paragraphs 1 and 3 of the covenant which obligates the Board, as the Grantee, to administer and maintain the property as a non-profit and to “abate, prevent or enjoin any such violation or attempted violation” of the covenant. On the other hand, if the Board was unaware of the restrictive covenant at the time it entered into the contract to sell the Hospital, it

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<sup>2</sup> See STHS Announcement attached at **Tab B** and Knapp Medical Center Announcement attached at **Tab C**.

seems to have failed in conducting basic due diligence to determine whether it could indeed sell the property.

The Board of the Hospital only sought the consent of the Authority after the City of Weslaco and the Authority pointed out the existence of the restrictive language and suggested to the Board that they were prepared to examine information that would support the Hospital's request for consent. Even then, the Board has refused to make requested information available to allow the Authority to determine if the sale is in the best interests of the community.

The Board's Refusal to Make Information Available to the Authority. The Board of the Hospital has refused to provide information to the Authority to allow the Authority to assess whether the requested sale is in the best interest of the community. A list of the requested information is attached at **Tab E**. The Board of the Hospital, in protracted negotiations finally entered into a confidentiality agreement which it insists is necessary to protect certain elements of the transaction. While the Authority consented to the agreement with the expectation that it would expedite the provision of the requested information, thus far the only information that has been made available to the representatives of the Authority is very limited and does not include the bulk of the information on the list.

After the Authority consented to the confidentiality agreement, the Board of the Hospital complained that members of the Board of Directors of the Authority might be conflicted from participating in the decision making process under Texas Local Government Code Chapter 171. While it was unclear whether such complaints were valid, to expedite the process, one of the challenged representatives on the Authority Board resigned and the other has agreed to abstain from any further participation in the matter. The City of Weslaco is in the process of appointing new member to fill the vacancy. The remaining members of the board (sufficient under law to make a determination) have continued to indicate their willingness to receive and review the requested information so that a decision on the matter can be made. No additional information has been made available to the Authority. The Hospital has asked that the Authority lift the deed restriction, but has insisted that the Authority take this action without providing the information required to perform any due diligence to corroborate the findings and conclusions of the Board of the Hospital.

The Board Failed to Assess the Value of the Estate. Without a thorough evaluation of the transaction, there is the potential for private inurement of benefits to Universal Health Systems by undervaluing the assets of the charitable estate and the improper disposition of the Hospital's assets. The records available to the Authority do not indicate that a proper or adequate valuation of the assets of the estate has been made so that there is a substantial question as to whether or not any amount offered by Universal for the Hospital adequately compensates Knapp Medical Center for the value of the facilities. An examination of the requested information should confirm whether the Board has taken prudent steps to value the assets of the charitable estate and negotiate a fair and adequate price for these. More importantly, it will allow the Authority and the Attorney General to determine if the sale of the Hospital to a for-profit entity will indeed present the best means of preserving quality health care for residents of Weslaco for the foreseeable future.

Excessive Compensation of Hospital Administrators. Because information was not forthcoming from the Board, the Authority has had to resort to examination of the few public records which are available. These include the publicly available IRS Form 990s filed by the Hospital and an affiliated charitable foundation (attached as **Tab F**) provided to the Authority by city staff. An examination of these records suggests that the Board has in recent years over-compensated the Chief Executive Officer and other staff at the Hospital in a manner that grossly exceeds compensation levels for such offices in hospitals of commensurate size (entities of similar size, similar number of beds, etc.). Such actions, standing alone, suggest that there are potential mismanagement issues at the Hospital and require examination whether or not the Hospital is ultimately sold. If the Attorney General determines that the compensation paid to senior administrators by the Board is excessive, you should take steps to recover the misappropriated funds by seeking monetary damages and/or restitution from the Board and the executives.

The Board through its actions in this matter has demonstrated that it is unwilling or unable to properly fulfill its legal obligations to the Hospital and the public. On behalf of the Authority, I request the Attorney General's Office conduct a full investigation, including a management audit. In addition, if you determine it is appropriate, the Authority urges that the Attorney General take such legal steps as necessary to replace the Knapp Board of Directors and the Knapp administration with a Board and management committed to fulfilling its fiduciary duty and to assure that the Hospital is operated in a manner consistent with the restrictive covenant and in the best interests of the community that it was created to serve.

Please do not hesitate to contact me if you require additional information. Thank you for your time and attention to this important matter.

Respectfully submitted,



David Mendez

cc: Susan K. Staricka  
Chief, Charitable Trusts Section  
Consumer Protection & Public Health Division

Ingrid Ellerbee  
Charitable Trusts Section  
Consumer Protection & Public Health Division

The Honorable Eddie Lucio, Jr.  
Texas State Senate

The Honorable Armando A. Martinez  
Texas House of Representatives