VIEWS FROM THE FIELD

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GRANT MAKERS IN HEALTH

Don't Call Us "Conversion Foundations"...Please

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A hot topic of discussion in philanthropic circles in recent years has been the phenomenon of sizable new foundations being created as the result of nonprofit health care organizations converting to for-profit status. There are good reasons for the interest. According to the latest figures from Grantmakers In Health's Support Center for Health Foundations, there have been more than 134 new foundations established as the result of conversions in the past fifteen years, with assets totaling more than $15 billion. In a relatively short period of time, the dollars available for health-related grantmaking have essentially doubled.

While for-profit conversions are increasingly a national phenomenon, California has been an epicenter for this "seismic" activity, and is home to the three largest foundations established through the conversion process. We work for one of them. The California Wellness Foundation was created in 1992 when Health Net, then the state's second largest HMO, became a for-profit corporation. The size of that transaction (initially about $350 million, which eventually increased to more than $1 billion after subsequent corporate mergers) attracted unprecedented attention from advocates, government regulators, and state legislators.

The conversion of a nonprofit health care provider to for-profit status is a significant event that can have multiple ripple effects for a community and an entire region. Our personal belief is that such conversions should receive careful scrutiny from a variety of stakeholders, including those who have the most difficulty obtaining access to health care — the uninsured and traditionally underserved. Our foundation has made two grants to Consumers Union to support their work in ensuring that health care conversions in California receive that kind of public examination. But we would argue that the critical time for that input is *before* the conversion is approved. Once the new philanthropic organization has been created, it should operate as does any other private foundation, with the trustees charged with the responsibility for good stewardship.

It is important to note that earlier conversions occurred in our state with minimal government oversight or public watchdog activity, resulting in substantial undervaluation of the corporate assets of converting entities. The foundations that were launched as a result of those processes were significantly smaller than they might have been if a more rigorous standard of valuing assets had been in place. The end result of the Health Net conversion was an asset base in our foundation three times the original figure proffered by the company, largely as the result of public scrutiny of the transaction. We strongly support the efforts by both government regulators and community advocates to ensure that a fair assessment of assets takes place.

In the case of hospital conversions, we also support the efforts of our state attorney general and others to help ensure that an appropriate sum is set aside to guarantee continuity of charity care in the region served by the hospital. A recent study by the University of California at San Francisco indicates there is a difference in the quality of care provided by for-profit and not-for-profit hospitals, and that is an appropriate concern in analyzing the impact of such conversions.

However, the 1995 conversion of Blue Cross of California (which resulted in the creation of two large foundations, The California Endowment and the California HealthCare Foundation) was characterized by prolonged acrimonious public wrangling over not only the valuation of assets, but also details of the foundations' corporate structures, including the composition of their boards. The approval of some subsequent hospital conversions in California has hinged on very detailed prescriptive charter restrictions on the scope of the new foundations' grantmaking.

At about the same time as the Blue Cross of California drama was unfolding, one began to see increasing reference to "conversion foundations" as if we represent a distinct subcategory or "class" of foundations. While it may have

served as a useful shorthand device to describe a trend in the making, we would argue that the continued widespread use of the term "conversion foundation" is not only inappropriate, but possibly even damaging to organized philanthropy as a whole.

Why the concern? Is the label "conversion foundation" really any more onerous than "family foundation," where the source of the endowment helps define a self-identified group of philanthropic institutions? We would argue that there is a key difference in how the two groups of foundations are perceived.

In the mid 1990s, a bill passed the California State Assembly to place the assets of all "health conversion foundations" into one large public foundation. Fortunately, that bill died in the State Senate. But can you imagine for a moment that the Legislature might attempt a similar diversion of assets from The David and Lucile Packard Foundation? Yet our institutions are both independent, private foundations.

Some have argued that there is a distinction to be drawn between "conversion foundations" and the more "conventional" type of foundations established by private wealth or corporate generosity. Their line of reasoning goes something like this: since the public is, in essence, the "donor" of the assets in the case of a conversion, the resulting foundation is a "public trust" and should be structured so that the public has a large voice in its governance and mission. That argument has been translated, in some cases, into a belief that someone other than the trustees should determine a foundation's activities. This belief manifests itself in articles and discussions about payout, perpetuity, governance and grantmaking focus.

According to our legal counsel, in California there is no basis for any such distinction, once the conversion has been completed. The conversion process involving health care entities is now aggressively regulated in our state, either by the Attorney General or by the Department of Corporations. The regulator's task is to ensure that the charity receives fair market value for the assets being converted, that the transaction is fair to the charity, that there is no private inurement, and that certain other criteria are met depending upon the applicable statute and regulation.

Once the charity is formed and funded, then it, along with all other California public benefit corporations, is governed by the California Nonprofit Public Benefit Corporation Law. In that body of law, there is no distinction made between corporations created via a conversion process or otherwise. All public benefit corporations have the same powers, rights, responsibilities and obligations under this law. Consequently, references to "public trusts" or other similar labels are meaningless under California law, which recognizes only a universal entity called a "public benefit" corporation (distinct only from mutual benefit and religious nonprofit entities).

It is true that the Internal Revenue Code (IRC) recognizes certain distinctions among nonprofits, such as the difference between public charities and private foundations. Moreover, there is a significant body of regulations distinguishing those two entities. However, there are no such distinctions in the IRC based upon whether the entity did or did not arise from a conversion.

We would argue, then, that continuing to refer to "conversion foundations" as a group only serves to give credence to a mistaken belief in some circles that we are different from other private independent foundations. It could also do damage to private philanthropy as a whole by encouraging the perception that our assets are "public" rather than that we serve as trustees of funds dedicated to charitable purposes.

At a time when we all need to be doing more to communicate and clarify the role of foundations in society — particularly to those in government — we would like to enlist your help in eliminating the use of the term "conversion foundations." If labels are necessary, we'd prefer "health foundations" or "new health foundations" since the mission of most is to promote health and/or provide access to health care.

Do we think we merit special treatment? Not at all. We simply want to be acknowledged as what we are — individual private nonprofit public benefit corporations that are as different from one another in operation as we may be alike in mission — just like other private foundations. Whatever our origins, what we *share* is most important — which is a commitment to accountability for good stewardship of our foundations' assets for the benefit of the grantseeking public and those populations in need that they serve.

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