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PRIVILEGED & CONFIDENTIAL

March 5, 2013

Daniel D. Regan, City Solicitor
City of Pittsburgh Law Department
313 City-County Building
414 Grant Street
Pittsburgh, PA 15219

Dear Mr. Regan:

This letter is submitted in connection with the City's consideration whether to initiate a pair of related legal actions—Taxing Jurisdiction Exemption Challenges to be filed with the Allegheny County Office of Property Assessments, and a civil action to be filed with the Court of Common Pleas of Allegheny County—contesting the exemption from payroll taxes¹ that are currently enjoyed by the largest landowner and employer in the City, the University of Pittsburgh Medical Center ("UPMC"). The gravamen of both actions would be identical, namely, that UPMC is not eligible for exemption from these taxes because it is not an "institution of purely public charity" ("IPPC") within the meaning of Article VIII, section 2(a)(v) of the Pennsylvania Constitution. You have requested our opinion regarding the merits of these proposed actions.

As we have discussed, waging a legal battle against a behemoth like UPMC will be neither quick nor easy. However, we believe that both challenges are well-justified, because UPMC appears to fail the constitutional test for qualifying as an IPPC. As the Pennsylvania Supreme Court recently emphasized in *Mesivtah Eitz Chaim of Bobov, Inc. v. Pike Cnty. Bd. of Assessment Appeals*, 44 A.3d 3 (Pa. 2012) ("Mesivtah")—a decision that, as explained below, paves the way for the legal actions proposed by the City—an organization claiming exemption from tax as an IPPC must establish that it satisfies five legal requirements articulated in the Court's 1985 decision, *Hospital Utilization Project v. Commonwealth* ("HUP").² Based on our review of the public record,³ we believe that UPMC fails at least three of these requirements and, arguably, fails all of them.

¹ City of Pittsburgh Payroll Tax Regulations, § 202(I).

² *Hosp. Utilization Project v. Commw.*, 487 A.2d 1306 (Pa. 1985).

³ In connection with preparing this opinion, we have reviewed UPMC's audited financial statements and Form 990 information returns; public property tax records; media reports; UPMC's website; and other public records.



I. Legal Framework.

Over the past year, the standards to qualifying for exemption as an IPPC have been the subject of much discourse in the courts, the General Assembly, and the media. Because this area of law is somewhat complex, our analysis begins with an explanation of the legal framework that would apply in the proposed exemption challenges.

A. *The Pennsylvania Constitution.*

The cornerstone of our analysis is Article VIII section 2(a)(v) of the Pennsylvania Constitution. As you are aware, this provision permits the General Assembly to exempt "institutions of purely public charity" from tax. However, the framers of the state constitution did not define—nor did they empower the General Assembly to establish standards and qualifications defining—the requirements for qualifying as an "IPPC." Because the Constitution does not specifically empower the General Assembly to define this constitutional provision, the task falls to the Pennsylvania courts under traditional separation-of-powers principles.⁴

B. *Hospital Utilization Project v. Commonwealth (1985).*

The Supreme Court of Pennsylvania exercised this authority and fulfilled its constitutional obligation to interpret Article VIII, section 2(a)(v) in its 1985 HUP decision. The Court therein established the following five criteria, all of which must be satisfied for an organization to qualify for exemption as an institution of purely public charity (the "HUP test"):

- i. advances a charitable purpose;
- ii. donates or renders gratuitously a substantial portion of its services;
- iii. benefits a substantial and indefinite class of persons who are legitimate subjects of charity;
- iv. relieves the government of some of its burden; and
- v. operates entirely free from private profit motive.

An organization seeking to obtain or retain exemption from local taxes—in this case, UPMC—bears the burden of proving that it meets every prong of the HUP test.⁵

⁴ *Stilp v. Commw.*, 905 A.2d 918 (Pa. 2006) ("the ultimate power and authority to interpret the Pennsylvania Constitution rests with the Judiciary, and in particular with [the Pennsylvania Supreme] Court (citing Pa. Const. art. V, § 2 and *The Federalist No. 78* (1788)).

⁵ *HUP*, 487 A.2d at 1312. The HUP test is considerably more difficult to satisfy than the requirements for exemption from federal income tax under section 501(c)(3). Thus, an organization that has been recognized as exempt from federal income tax may still fail to qualify for exemption from Pennsylvania tax. See e.g., *Biosciences Info. Serv. v. Commw.*, 551 A.2d 672 (Pa. Commw. Ct. 1988) ("BIOSIS attempts to persuade this Court that it operates without private profit motive by arguing, *inter alia*, that BIOSIS is exempt from the payment of Federal income taxes, BIOSIS' corporate officers serve without compensation, and that BIOSIS is only able to 'make ends meet' because its clients have advanced BIOSIS money None of these arguments are persuasive....").

C. The Institutions of Purely Public Charity Act (1997).

Following the *HUP* decision, many counties and school districts challenged the exempt status of properties previously determined to be exempt from tax on the grounds that the property owner was not an IPPC. Because these taxes are assessed locally, the General Assembly expressed concern that inconsistent standards for charitable exemptions were being applied across the Commonwealth.⁶ Thus, in 1997, it enacted Act 55, *The Institutions of Purely Public Charity Act*, to provide “specific legislative standards defining the term ‘institution of purely public charity’.”⁷

Among other things, Act 55 attempted to standardize each of *HUP* factors using criteria that were far less nuanced, and far more generous, than those applied by the courts in interpreting the State Constitution.⁸ It also imposed limits on the lobbying activities of a “purely public charity”—something not addressed by the *HUP* test.⁹ In addition, Act 55 created a presumption that if the Department of Revenue determined that an organization was an IPPC for sales and use tax purposes, it was presumed to be an IPPC for real estate tax purposes as well—further relaxing the standards for exemption.¹⁰ Thus, Act 55 expanded the criteria for qualifying as an IPPC—and the class of organizations entitled to exemption from tax—beyond what was contemplated by the courts exercising their constitutional role.

D. The 2012 Mesivtah Decision.

Act 55 raised a significant separation of powers issue because the General Assembly had essentially stepped in to modify—and expand—the State Supreme Court’s interpretation of what “purely public charity” means under the Pennsylvania Constitution. In *Mesivtah*, a 4-3 decision that was handed down last year,¹¹ the Pennsylvania Supreme Court resolved this issue by ruling that the General Assembly had exceeded its authority by attempting to codify the *HUP* test and define “institution of purely public charity” for purposes of Article VIII, section 2(a)(v) of the Pennsylvania Constitution.

At issue in *Mesivtah* was whether a religious camp satisfied the third prong of the *HUP* test (relieving the government of some of its burden) as defined by the courts. The organization argued that was not required to satisfy the judicial standard because “the General Assembly enacted [Act 55] after *HUP* was decided [and the] Act ... define[d] the element of ‘burden relieving’ more expansively than the *HUP* test.”¹² The Court rejected this argument, stating:

The question is whether the General Assembly may, by statute, influence the definition of the constitutional phrase “purely public charity.” While the General

⁶ See 10 P.S. § 372 (explaining the “Legislative Intent” behind Act 55).

⁷ 10 P.S. § 372(a)(4).

⁸ See 10 P.S. § 375 (“Criteria for institutions of purely public charity”).

⁹ 10 P.S. § 375(i).

¹⁰ 10 P.S. § 376.

¹¹ One of the dissenters was Justice Melvin. Given her likely removal from the Court, the current split would be 4-2.

¹² *Mesivtah*, 44 A.3d at 6.



Assembly necessarily must attempt to interpret the Constitution in carrying out its duties, the judiciary is not bound to the legislative judgment concerning the proper interpretation of constitutional terms. The General Assembly cannot displace our interpretation of the Constitution because the ultimate power and authority to interpret the Pennsylvania Constitution rests with the Judiciary, and in particular with this Court.¹³

Examining the history of Article VIII, section 2(a)(v), the Court explained that the constitutional provision was “was designed not to grant, but limit, legislative authority to create tax exemptions,” and that “[t]o eliminate judicial review of the constitutionality of the General Assembly’s creations would defeat this purpose.”¹⁴

The Court further held that its “prior jurisprudence”—namely the *HUP* case—“sets the constitutional minimum for exemption from taxes.”¹⁵ Thus, an organization must first satisfy the *HUP* test as developed by the courts—and, only if it does, the second step in the “public charity” analysis is to determine whether it also meets the requirements of Act 55. As the Court explained:

to receive an exemption without violating the Constitution, the party must meet the definition of “purely public charity” as measured by the test in *HUP*. If it does so, it may qualify for exemption if it [also] meets the statute’s requirements. Act 55, however, cannot excuse the constitutional minimum—if you do not qualify under the *HUP* test, you never get to the statute.¹⁶

Thus, when an organization like UPMC seeks exemption from local taxes, it may not simply point to the definition of “purely public charity” set forth in Act 55—or the presumption of exemption for organizations that have been recognized as exempt by the Department of Revenue. Instead, it must first carry its burden to prove that it satisfies the more detailed and less forgiving *HUP* test. If an organization clears this threshold, then—and only then—does it also need to confirm that it meets any additional requirements imposed by Act 55, such as the requirement in section 375(i) that the organization engage in only insubstantial lobbying activities.

2. UPMC Fails the HUP Test and Thus is Not Entitled to Exemption from Pennsylvania Taxes.

Mesivtah has definitively resolved any open questions regarding the legal standard that applies in charitable exemption cases. Indeed, since *Mesivtah* was decided in April, the Pennsylvania Commonwealth Court has handed down two decisions in the same vein, each concluding that an organization, which had previously qualified as an IPPC under the Act 55

¹³ *Id.* at 7.

¹⁴ *Id.* at 8.

¹⁵ *Id.* at 5.

¹⁶ *Id.* at 9.



standard, failed to qualify under the HUP test and thus was not entitled to a property tax exemption.¹⁷

Mesivtah also confirms that an organization claiming exemption, not a challenger, bears the burden of proving that it continues to qualify as an IPPC. If the City proceeds with its proposed challenges, we believe that UPMC will be unable to carry this burden. The HUP test is an “all or nothing” test—and UPMC must meet all five prongs to pass it. For the reasons set forth below, we believe UPMC clearly fails at least three prongs of the HUP test and, arguably, fails all of them.

A. UPMC Does Not Operate “Entirely Free From Profit Motive.”

Based on the publicly-available information we have reviewed to date, it seems virtually certain that UPMC would fail to carry its burden of proving that it satisfies the fifth prong of the HUP test by “operating entirely free from profit motive.” As the Pennsylvania Supreme Court has explained, “the word ‘purely’ as used in the Constitution in the phrase ‘purely public charity’ means that the institution must be entirely free from private profit motive.”¹⁸ UPMC, quite simply, cannot satisfy this constitutional requirement.

In its last two fiscal years, UPMC has generated excess revenues totaling almost \$1 billion and it has amassed reserves in excess of \$3 billion.¹⁹ While this certainly suggests a profit-motivated enterprise, accumulation of substantial surpluses is not dispositive of the question. Rather, as the Pennsylvania Supreme Court explained in *Wilson Area School District v. Easton Hospital*, “the appropriate inquiry is whether the Hospital’s surplus revenue is being utilized in furtherance of its charitable purpose.”²⁰ In *Easton Hospital*, the Court surveyed other decisions analyzing the “profit motive” factor of the HUP test and explained that, broadly speaking:

the focus of the court in determining whether the fifth prong of the HUP test is met should be:

- 1) Whether the utilization of the revenue is made with the expectation of a reasonable return or some non-monetary benefit;
- 2) Whether the utilization of the revenue ultimately supports or furthers the eleemosynary nature of the charitable entity; and

¹⁷ *Camp Hachshara Moshava v. Wayne Cnty. Bd. for the Assessment and Revision of Taxes*, 47 A.3d 1271 (Pa. Commw. 2012); *In re Appeal of Dumwoody Village*, 2012 Pa. Commw. LEXIS 195 (Pa. Commw. 2012). In addition, we understand that the Warren Cnty. Board of Assessment Appeals recently revoked the property tax exemption of Warren General Hospital on the similar grounds. See, e.g., Ben Klein, *Loss of tax-exempt status financial gain for city, others*, Warren (Pa.) Times-Observer (Jan. 5, 2013), available at <http://www.timesobserver.com/page/content.detail/id/561832.html>.

¹⁸ *HUP*, 487 A.2d at 1315.

¹⁹ See UPMC Audited Consolidated Financial Statements (year ended June 30, 2012), available at <http://www.upmc.com/about/finances/Documents/2012-audited-financials.pdf>.

²⁰ *Wilson Area School District v. Easton Hospital*, 747 A.2d 877, 878 (Pa. 2000).



3) Whether the utilization of the revenue inures, directly or indirectly, to any private individual related to the charitable entity or related organization(s).²¹

Applying this framework, courts have ruled that the following circumstances belie a profit motive that would cause an organization to fail the fifth prong of the HUP test, and thus fail to qualify as an IPPC:

- the organization deliberately structures its operations to generate substantial profit²²;
- the organization does not dedicate all of its surplus exclusively to charitable purposes—by, for example, investing it in ventures that do not provide charitable services²³;
- the organization engages in anti-competitive business practices²⁴;
- the organization provides commercial services to for-profit businesses²⁵; and
- the organization pays excessive compensation (salaries or fringe benefits) to officers or directors.²⁶

Every one of these circumstances appears to be present in UPMC's operations.

²¹ *Id.* at 880.

²² *E.g.*, *City of Wash. v. Bd. of Assessment Appeals of Wash. Cnty.*, 704 A.2d 120 (Pa. 1997); *Biosciences Info. Serv. v. Commw.*, 516 A.2d 434 (Pa. Commw. Ct. 1986).

²³ *Easton Hosp.*, 747 A.2d at 881 (discussing *Pinnacle Health Hosp. v. Dauphin Cnty. Bd. of Assessments Appeals*, 708 A.2d 845 (Pa. Commw. Ct. 1998) (“[T]he analysis is properly directed at the whether the money is being used in furtherance of the organization's charitable purpose.”); *Cnty. Gen. Osteopathic Hosp. v. Dauphin Cnty. Bd. of Assessment Appeals*, 706 A.2d 383 (Pa. Commw. Ct. 1998) (“Community's medical practices are very different from medical offices operated as for-profit businesses. The fact that Community made the practices part of the hospital, subject to its open admission policy, and located some of its practices in underserved rural areas, strongly militates against the conclusion that [it] has a profit motive.”).

²⁴ *Unionville-Chadds Ford School Dist. v. Chester Cnty. Bd. of Assessment Appeals*, 692 A.2d 1136, 1143 (Pa. Commw. Ct. 1997) (“Whether an organization has a proscribed profit motive may depend on whether it is engaged in a commercial venture in competition with others engaged in similar businesses.”); *Bower Hill Civic League Appeal*, 215 A.2d 305 (Pa. Super. Ct. 1965); *School Dist. of Erie v. Hamot Med. Ctr.*, 602 A.2d 407 (Pa. Commw. Ct. 1992) (“Hamot operated an answering service and paging system company which competes with local answering service companies and also operates a health club which competes with local health spas and nautilus clubs. Further, HHSI controls, through Bayfront Development Corporation, space which is rented to non-affiliated private businesses.”).

²⁵ *The Couriers Susquehanna v. Cnty. of Dauphin*, 693 A.2d 626 (Pa. Comonw. 1997) (“factors suggesting that an entity operates with a profit motive include providing services to for-profit businesses, making loans at market interest rates, and owning for-profit subsidiary corporations”); *Sacred Heart Healthcare Sys. v. Commw.*, 673 A.2d 1021 (Pa. Commw. Ct. 1996) (“[E]vidence also demonstrates that SHHS provides services to for-profit businesses, and had loaned money to a for-profit business ... at more than a nominal interest rate. ... In our view, selling services and making funds available for loans to profit making businesses is a characteristic of an organization that is, to some extent, interested in earning income.”); *School Dist. of Erie v. Hamot Med. Ctr.*, 602 A.2d 407 (Pa. Commw. Ct. 1992).

²⁶ *E.g.*, *St. Margaret Seneca Place v. Allegheny Cnty. Bd. of Prop. Assessment Appeals*, 640 A.2d 380 (Pa. 1994); *W. Allegheny Hosp. v. Bd. of Prop. Assessment, Appeals & Rev.*, 455 A.2d 1170 (Pa. 1982); *Lewistown Hosp. v. Mifflin Cnty. Bd. of Assessment Appeals*, 706 A.2d 1269, (Pa. Commw. Ct. 1998); *Unionville-Chadds Ford School Dist.*, 692 A.2d at 1142; *Gateway Rehab. Ctr. v. Bd. of Comm'rs of Cnty. of Beaver*, 710 A.2d 1239 (Pa. Commw. Ct. 1998).



First, the public record strongly suggests that UPMC is carefully structuring its operations to prioritize profits-generation over charity. UPMC's annual report self-describes the organization as a "\$10 billion integrated global health enterprise"²⁷ with rapidly expanding business operations that include investment partnerships and more than 50 taxable corporations.²⁸ These businesses include a health insurance concern that generated more than \$2 billion in operating revenues in the second half of 2012.²⁹ They also include several companies which, we believe, provide services to for-profit companies. UPMC's healthcare-related operations—which it claims are charitable activities—include "400 doctors' offices and outpatient sites."³⁰ We understand that many of these private facilities do not offer any charitable services.³¹ In addition, UPMC has a well-documented record of closing facilities in locations with relatively high numbers of Medicare-eligible, Medicaid-eligible or uninsured patients (e.g., UPMC Braddock and UPMC South Side), and opening or expanding facilities where there are proportionately more privately-insured patients (e.g., UPMC East and UPMC Passavant).³² We believe that UPMC would likely fail the fifth prong of the HUP test on these facts alone.

Second, it is quite clear from UPMC's Form 990, audited financials, and press reports that the health system does not dedicate all of its surplus exclusively to charitable purposes. For example, it is well-documented that UPMC's rapidly-growing insurance business is generously supported by capital contributions from the health system.³³ In addition, UPMC's most recent disclosure to bondholders reveals that its International and Commercial Services Division ("ICSD") is *losing money* and thus requires cross-subsidies from UPMC's more profitable activities, including patient care activities.³⁴ Officially, the purpose of ICSD "is to leverage UPMC's capabilities to generate new revenue streams . . . [to] support UPMC's core mission and help to revitalize the

²⁷ UPMC 2011 Annual Report at 1.

²⁸ See Schedule R, Part IV of UPMC Group's 2010 Form 990.

²⁹ UPMC Unaudited Quarterly Disclosure to Bondholders for the Period Ended December 31, 2012, available at <http://www.upmc.com/about/finances/Documents/upmc-q2-fy2013-bondholder-disclosure.pdf>.

³⁰ UPMC 2011 Annual Report at 1.

³¹ This certainly would appear to be true of UPMC's recently-announced plans to partner with the Pittsburgh Penguins on a sports medicine complex and dual ice hockey rink practice facility in Cranberry. Jeremy Boren, *UPMC, Penguins' rink deal in Cranberry months off*, Pittsburgh Tribune-Review (February 9, 2013), available at <http://triblive.com/news/butler/3451934-74/cranberry-development-penguins>.

³² We also understand that UPMC engages in the regular practice of facilitating the creation of, and then offloading its unprofitable patients to, federally-qualified health centers ("FQHCs"). FQHCs are federally funded clinics that are eligible for enhanced reimbursements from Medicare and Medicaid. While we are still learning the details, this "patient dumping" practice would certainly undermine any claim by UPMC that satisfies the requirement under the HUP test that it relieve a governmental burden.

³³ A.M. Best Co., Press Release, *A.M. Best Upgrades Ratings of UPMC Health Plan, Inc. and Its Affiliates* (Jan. 21, 2013) ("UPMC Health Plans has the explicit financial support of UPMC through capital contributions, which primarily have come in the form of surplus notes. The organization recently improved the quality of its capital structure by converting its shorter-term notes to longer term, 20-year surplus notes, which A.M. Best views as a more permanent form of capital.")

³⁴ UPMC Unaudited Quarterly Disclosure to Bondholders for the Period Ended December 31, 2012, at 3 ("Organizational Overview").



economy of Western Pennsylvania.”³⁵ However, its consolidated financial statements indicate that the core tax-exempt operations of UPMC are subsidizing risky investments in commercial ventures and operations in locations around the globe, including some that are renowned as locations for facilitating undisclosed financial transactions. Specifically, UPMC reports business and financial activities in Ireland, Italy, the United Kingdom, the Cayman Islands, Kazakhstan, Singapore, China, and Jordan.³⁶ These activities appear to have little to do with fulfilling UPMC’s charitable mission—to provide healthcare to all patients, without regard to their ability to pay—and more to do with trying to attract wealthy patients from Europe and the Middle East (or, as our research suggests, to provide junkets for favored executives and staff³⁷). By devoting substantial surpluses to its international and commercial operations, rather than investing them in its core charitable programs, UPMC also clearly violates the fifth prong of the HUP test.

Finally, the compensation paid by UPMC to its officers, directors, and certain key employees certainly appears to be “excessive,” and likely would be found to constitute private inurement. UPMC Group’s 2011 Form 990 reveals that more than 20 officers, directors, and key employees received compensation in excess of \$1 million. UPMC’s CEO received a reported \$5.9 million in total compensation in 2011 (including \$3.7 million in incentive compensation); \$4.7 million in 2010; and \$3.5 million in 2009. That same CEO occupies among the most lavish office space in the City, and has a private chef and dining room, private chauffeur, and private jet at his disposal. This compensation package dwarfs the amounts paid by other nonprofit health systems to their CEOs—including health systems located in higher-cost areas like Manhattan and Los Angeles, and elite health systems like Johns Hopkins, the Cleveland Clinic and the Mayo Clinic.

These facts—presented here in a very summary form—mirror the precise circumstances that the courts have ruled, time and time again, to be inconsistent with exemption from tax as an IPPC. We believe that a court reviewing UPMC’s operations would quickly conclude that the enterprise does not operate “entirely free from profit motive” and fails the HUP test on that basis.

B. UPMC Does not Advance a Charitable Purpose.

There are good arguments that UPMC fails other factors of the HUP test as well. One such example is the first factor, which requires that an organization “advance a charitable purpose” to qualify for exemption. Review of the cases defining this factor suggests that UPMC does not advance a charitable purpose for purposes of qualifying as an IPPC.

³⁵ *Id.*

³⁶ See 2011 Form 990, Sch. R; UPMC 2011 Annual Report at 24.

³⁷ It is rumored, for example, that UPMC’s founder, the late Thomas Detre, established UPMC’s Italian operations in Palermo as a pleasant post-retirement assignment for himself. While we have not found this written down explicitly, Detre’s sentimental ties to Italy are well-known and well-documented. He secured an appointment at the Italian National Research Council as a way to get out of postwar Hungary, and lived in Italy from 1947 to 1953. In a profile written by the late industrialist and University of Pittsburgh trustee William S. Dietrich, Detre compared his time in Italy to *La Dolce Vita*: “That was the period I lived in Rome. I had a good time!”



The definition of "charitable purpose" was first articulated in the *Hill School Tax Exemption Case*, a 1952 Pennsylvania Supreme Court decision that is quoted in *HUP* and in other cases applying the HUP test.³⁸ In *Hill School*, the Court stated:

The word "charitable" in a legal sense includes every gift for a general public use, to be applied, consistent with existing laws, for the benefit of an indefinite number of persons, and designed to benefit them from an educational, religious, moral, physical, or social standpoint. In its broadest meaning it is understood "to refer to something done or given for the benefit of our fellows or the public...."³⁹

Determining whether an organization serves a charitable purpose requires consideration of all the surrounding circumstances.⁴⁰

It is well-settled in Pennsylvania that, for a hospital to advance a charitable purpose and thereby to qualify as an IPPC, it must do more than provide medical care for a fee.⁴¹ Rather, it must have an *open admissions policy*—a policy of opening its facilities to all comers and providing them with comprehensive care without regard to a patient's ability to pay.⁴² Simply providing emergency services to patients without regard to ability to pay is not sufficient to constitute an open admissions policy.⁴³ The open admissions policy must apply to "comprehensive" (*i.e.*, all types of) care.⁴⁴

Even if a hospital claims to have an open admissions policy courts look to all the facts and circumstances to determine if it actually operates in accordance with the policy. Whether or not the hospital in question has an open admissions policy is a question of fact guided by the circumstances of each case. Factors weighing against a finding that a hospital has an open admissions policy and serves a charitable purpose include excessive executive compensation, large advertising budgets, large intergroup transfers, and aggressive debt collection practices.⁴⁵

UPMC would no doubt argue that it has policies in place to provide "charity care" to those who cannot afford to pay for its medical services. Our understanding, however, is that UPMC's usual practice differs markedly from its stated policy—and these practices are simply not sufficient to constitute "advancing a charitable purpose" under *HUP* and its progeny. Consider the following:

³⁸ *Hill School Tax Exemption Case*, 87 A.2d 259 (1952).

³⁹ *Hill School*, 87 A.2d at 262 (quoting *Taylor v. Hoag*, 116 A. 826 (1922)).

⁴⁰ *Id.* at 25.

⁴¹ *Hill School*, 87 A.2d at 261; *Hosp. Utilization Project*, 487 A.2d at 1315–16.

⁴² See *W. Allegheny Hosp.*, 455 A.2d at 1171; *Hill School*, 87 A.2d at 263.

⁴³ *Hamot Med. Ctr.*, 602 A.2d at 412–13 (Pa. Commw. Ct. 1992) (discussing *W. Allegheny Hosp. v. Bd. of Property Assessment*, 455 A.2d 1170 (1982)) ("While it is undisputed that Hamot would provide emergency health care to individuals who could not afford it, the trial court concluded that this was a condition of licensure. If it is compelled by law to perform this service, it cannot be said to perform it voluntarily or charitably.")

⁴⁴ *Id.* at 414.

⁴⁵ *Id.* at 411.



- We understand that UPMC's practice is not to provide medical services to patients until it first verifies the patient's insurance coverage—and UPMC's general operating procedure is to offer care only to those who demonstrate their ability to pay for such care prior to admittance.¹⁶ UPMC's policies make it clear that any failure to pay will result in accounts being turned over to a collection agency or a law firm for further collections and legal action against its patients.¹⁷
- While UPMC does have a "charity care" program we understand that its business practice is to limit charity care to emergency services, services for life threatening conditions, and medically necessary services, as determined by UPMC.¹⁸ Furthermore, only the poorest residents qualify. Full charity care is available only to patients whose annual income is less than two times the poverty level. Thus, for 2013, only individuals making less than \$22,980¹⁹ qualify for full benefits under UPMC's "Charity Care"—and this coverage is only available for absolutely necessary services, as discussed above.

Because it appears that UPMC maintains an "open admissions policy" in name only, there is a good argument that the health system does not "advance a charitable purpose" and, therefore, fails the first prong of the HUP test.⁵⁰

¹⁶ See, e.g., UPMC Presbyterian Patient Handbook p 16–17. Available at, <http://www.neurology.upmc.edu/patients/pdf/PatientHandbook.pdf>.

¹⁷ *Id.* While some courts have found that simply because a hospital has a collections policy it does not fail the HUP test, see, e.g., *Lehigh Area Sch. Dist.*, 708 A.2d at 1305; *Easton Hosp.* 708 A.2d at 841, this is by no means a universal rule. In deed, *Easton* distinguished the *Hamot Medical Center* case by noting that latter institution's "aggressive pursuit of bill collection from non-paying patients could not establish [an] open admissions policy ... particularly where there was no indication that Hamot ... provided non-emergency services to people who it knows cannot pay for them." *Id.* at 841 n.16. It is certainly not mandatory in the industry that hospitals aggressively pursue former patients who were unable to pay their bills. See, e.g., *In re Appeal of Community Gen. Hosp.*, 708 A.2d 124, 127 (Pa. Commw. Ct. 1998) ("Community does not sue patients who do not have the ability to pay outstanding medical bills; only once in the seven years prior to the trial court's decision in this matter, did Community sue a patient for an unpaid bill."); *St. Joseph Hosp. v. Berks Cnty Bd. of Assessment Appeals*, 709 A.2d 928, 932 (Pa. Commw. Ct. 1998) ("It [Saint Joseph] does not attempt to recover unpaid medical bills by lawsuit or file reports with credit bureaus.").

¹⁸ UPMC Financial Assistance Policy. Available at, <http://www.upmc.com/about/community-commitment/financial-assistance/Pages/policy.aspx>.

¹⁹ Dept. of Health & Human Services, *Annual Update of the HHS Poverty Guidelines* (Jan. 2013), available at <https://www.federalregister.gov/articles/2013/01/24/2013-01422/annual-update-of-the-hhs-poverty-guidelines#t-1>.

⁵⁰ If a court concludes that UPMC fails the "profit motive" prong of the HUP test (which we believe is virtually certain), and the "charitable purpose" prong (which we believe is reasonably certain), UPMC will likely also fail the third prong of the HUP test, which requires its policies to "[b]enefit[] a substantial and indefinite class of persons who are legitimate subjects of charity." *Hosp. Utilization Project*, 487 A.2d at 1317. The Commonwealth Court, in affirming a trial court's revocation of a hospital's property tax exemption, has ruled that an organization fails to benefit a substantial and indefinite charitable class where the hospital operated with a profit motive and engaged in aggressive debt collection practices. *Hamot Med. Ctr.*, 602 A.2d at 683 ("The trial court opined that Hamot failed to meet the third prong of the [HUP] test, i.e., that it benefit a substantial and indefinite class of persons who are legitimate subjects of charity, essentially because it found that Hamot had a profit motive. Specifically, the court wrote '[Hamot] accepts defeat only after collection and execution processes fail to yield fruit. [Hamot's] charity is determined when the debt is

C. UPMC Does Not Donate or Render Gratuitously a Substantial Portion of its Services.

A third prong of the HUP Test is that UPMC render a "substantial portion of its services" free-of-charge. While its promotional materials trumpet that UPMC provides upwards of \$500 million in "community benefits" each year, the portion of this figure attributable to gratuitous hospital services, as defined by the courts, is hardly "substantial"—and certainly does not constitute the primary focus of its patient care activities, as is required by *HUP* and its progeny.

In UPMC's favor courts define "gratuitous services" fairly broadly in the hospital context. Although hospitals are "obliged under [federal programs] to offer some level of free care to indigent patients," giving care in excess of the federal requirements qualifies as gratuitous donations, for purposes of determining whether hospital has donated a substantial portion of its services to charity.⁵¹ In addition, Medicare and Medicaid shortfalls are considered gratuitous donations.⁵² Other free medical services offered and then written off at cost, and unpaid medical bills written off as bad debt also constitute gratuitous donations.⁵³ And uncollected billings may be properly included as part of community donations.⁵⁴

When analyzing whether services donated by a hospital are "substantial," courts have emphasized that

[the] determination [is] to be made based on the totality of circumstances surrounding the organization. The word "substantial" does not imply a magical percentage. It must appear from the facts that the organization makes a bona fide effort to service primarily those who cannot afford the usual fee.⁵⁵

Nevertheless, after considering all of the facts and circumstances, most courts do ultimately quantify the gratuitous services provided by an organization before deciding whether it satisfies the second prong of the *HUP* test.

deemed uncollectible, not prospectively upon admittance. [Hamot] fully anticipates payment at the time of admittance."").

As discussed above, UPMC, clearly operates with a profit motive and we understand that it has a policy of aggressively pursuing patient debts. Furthermore, while the Pennsylvania Supreme Court has found that having an open admissions policy which benefits a designated class of people is sufficient to meet the third prong of the HUP test, *St. Margaret Seneca Place*, 640 A.2d at 384, UPMC lacks such a policy.

⁵¹ *Lehigh Area Sch. Dist. v. Carbon Cnty. Bd. of Assessment*, 708 A.2d 1297, 1304 (Pa. Commw. Ct. 1998).

⁵² *Lehigh Area Sch. Dist. v. Carbon Cnty. Bd. of Assessment*, 708 A.2d 1297, 1304 (Pa. Commw. Ct. 1998); *Lewistown Hosp. v. Mifflin County Bd. of Assessment Appeals*, 706 A.2d 1269, 1272 (Pa. Commw. Ct. 1998).

⁵³ *Lewistown Hosp.*, 706 A.2d at 1272.

⁵⁴ *Easton Hosp.*, 708 A.2d at 840.

⁵⁵ *Hosp. Utilization Project*, 487 A.2d at 1315, n. 9 (emphasis supplied); see also *Allentown Hosp.-Lehigh Valley Hosp. Ctr. v. Bd of Assessment Appeals, Lehigh County*, 611 A.2d 793, 797 (Pa. Commw. Ct. 1992) (rejecting the establishment of a quantitative formula to address the second prong of the HUP test).



In cases involving hospitals, the minimum for "substantiality" appears to be a donation of 6% of total revenue to "charity" (as defined above).⁵⁶ However, other courts have required a greater percentage to satisfy the "substantiality" standard. In one case, the Pennsylvania Commonwealth Court found that a hospital's charity care satisfied the second prong of the HUP test by two measurements: (1) donated services were 8-10% of the hospital's total operating expenditures, and (2) donated services were far greater than the hospital's surplus revenue (496%, 306%, 276% for the three years in question).⁵⁷ And a trial court found that a "substantial portion of services" meant either that the hospital had (a) operated at a loss in the previous year considering all sources of income, (b) donated uncompensated care equal to at least 75% of surplus revenue from all sources, or (c) donated uncompensated care equal to at least 51% of surplus revenue if major hospital construction has been approved and will start in the next four years.⁵⁸

Thus, when applying the second prong of the HUP test to hospitals, courts have defined the services that count as "gratuitous" quite broadly, and set the threshold for "substantiality" quite low. Even so, we believe that UPMC would have difficulty establishing that it "donates or renders gratuitously a substantial portion of its services." Consider the following:

- According to UPMC Group's 2010 Form 990 information return, which was filed under penalties of perjury, the health system collected nearly \$5.7 billion in net patient revenues in 2011. However, it reports to have donated only \$204,000,000—3.6% of that amount—to "charity care."
- The Form 990 may present a best-case picture of the degree to which UPMC donates services to charity. UPMC's audited financials for the 2011 fiscal year report that the health system earned \$5.05 billion in net patient revenues, and provided \$96.5 million in charity care (again, broadly defined). Again applying the most generous formula used by the courts, this amounts to a commitment of only 1.9% of net patient revenue to charity care.
- And even the amount of charity care reported on the financials may be overstated. In a recent public letter, aptly titled, *UPMC Has Never Been Misleading on Charity Care*, a UPMC executive stated that the health system provided \$87.2 million in charity care during the 2011-12 fiscal year—\$9.3 million less than the amount reported in the audited financial statements. If this revised figure is accurate, then UPMC may have donated as little as 1.74% of net patient revenue to charity.

If these figures were recalculated using total revenues as the denominator—as the court did in the *Leighton School District* case, UPMC's percentage of donated services would be less than 1%.

⁵⁶ *Leighton Sch. District*, 708 A.2d at 1304, n.9.

⁵⁷ *Easton Hosp.*, 708 A.2d at 841 n. 17.

⁵⁸ *St. Luke's Hosp. v. Bd. of Tax Assessment Appeals of Lehigh Cnty.*, No. 88-C-2691 (Ct. of Common Pleas 1990) (unpublished).



Although courts are unwilling to adopt a "magical percentage" to measure the substantiality of services, we believe that a court applying the IIUP test to UPMC would find UPMC's level of charity care to be insubstantial in light of all the facts and circumstances, particularly the system's significant profit-motivated pursuits. Thus, we believe that UPMC would fail to prove that it satisfies second prong of the IIUP test.

3. Conclusion.

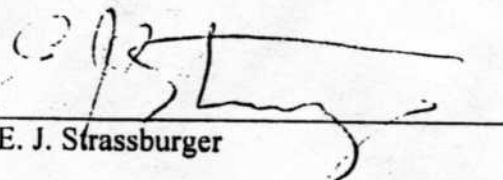
In our view, it would be exceedingly difficult for UPMC to carry its burden of proving that it satisfies all five prongs of the IIUP test because its commitment to charity is dwarfed by its preoccupation with profits. In its 2011-2012 fiscal year, UPMC invested more than \$490 million in its health insurance business (an increase of \$42 million from the previous year), and paid its top 8 executives more than \$15 million. At the same time, it spent less than \$100 million on charity care. Challenging the tax-exempt status of the largest employer, landowner, and business in the City will certainly not be an easy undertaking. Nevertheless, with facts like these, we believe that the City is well-justified in challenging UPMC's exemption from property and payroll taxes, and it is our carefully considered opinion that the City would likely prevail in these challenges.

Please do not hesitate to contact me if you have any questions regarding this opinion.

Sincerely,

STRASSBURGER MCKENNA
GUTNICK & GEFSKY

By


E. J. Strassburger

EJS/dcs