

1.0 DISCOVERY CONTROL PLAN

1.1 The Attorney General intends to conduct discovery under Level 3 of Rule 190 of the Texas Rules of Civil Procedure.

2.0 AUTHORITY OF ATTORNEY GENERAL AND NATURE OF THIS SUIT

2.1 This suit is brought by the Attorney General pursuant to the authority granted him under the common law, the Constitution of Texas, Chapter 123 of the Texas Property Code¹, the Texas Non-Profit Corporation Act², the Texas Miscellaneous Corporation Laws Act³, and acting within the scope of his duty to protect the public interest in charitable funds held in trust.

3.0 JURISDICTION AND VENUE

3.1 Jurisdiction in this Court is proper under § 115.001 of the Texas Property (Trust) Code and venue is proper in Travis County under §123.005(a) of the Texas Property (Trust) Code, because this is a proceeding brought by the Attorney General alleging, among other things, breach of fiduciary duty.

4.0 PARTIES

4.1 Greg Abbott, Attorney General of the State of Texas, is the petitioner in this suit, acting on behalf of the public interest in charity. The Attorney General's principal office is located at 300 West 15th Street, Austin, Texas 78701.

¹TEX.PROP. CODE ANN. §§ 123.001-123.005

²TEX.REV.CIV.STAT.ANN., Arts. 1396-1.01 through 1396-11.02. In this pleading, the articles of the Non-Profit Corporation Act are cited as "NPCA, Art. X.XX," e.g., TEX.REV.CIV.STAT.ANN., Art. 1396-1.01 is cited as "NPCA, Art. 1.01."

³TEX.REV.CIV.STAT.ANN., Arts. 1302-1.01 through 1302-7.09. In this pleading, the articles of the Miscellaneous Corporation laws Act are cited as "MCLA, Art. X.XX," e.g., TEX.REV.CIV.STAT.ANN., Art. 1302-1.01 is cited as "MCLA, Art. 1.01."

4.2 Defendant DMH, is a Texas nonprofit corporation with its principal place of business in Smith County, and may be served with process by serving its attorney, Blake Armstrong, Birdstrong & Armstrong, 211 East Houston Street, Tyler, Smith County, Texas 75202.

4.3 Defendant DMH Foundation is a Texas nonprofit corporation with its principal place of business in Smith County, and may be served with process by serving its attorney, Blake Armstrong, Birdstrong & Armstrong, 211 East Houston Street, Tyler, Smith County, Texas 75202.

4.4 Defendant Clem, a director of DMH and DMH Foundation and formerly the CEO of DMH, is an individual residing and doing business in Texas as alleged specifically below, and may be served with process by serving his attorney Lance Vincent, Ritcheson, Lauffer, Vincent & Dukes, P.C., 821 ESE Loop 323, Suite 530, Tyler, Texas 75701.

4.5 Defendant Norris, a director of DMH and DMH Foundation, is an individual residing and doing business in Texas as alleged specifically below, and may be served with process at his residence, 3301 South Cameron Avenue, Apt. 2, Tyler, TX 75701.

4.6 Defendant Truitt, a director of DMH at the time the hospital closed through September 11, 2002, is an individual residing and doing business as in Texas as specifically alleged below, and may be served with process at his residence at 171 Twin Springs Road North, Gate 1878, Kerrville, TX 78028-9883.

4.7 Defendant Blaine, currently a director of DMH and DMH Foundation, was the COO of DMH until 2004, was paid by DMH to be the sole employee of Doctors Memorial Foundation from 2006 through April of 2008, and is an individual residing and doing business in Texas as alleged specifically below, and may be served with process by serving her attorney Lance Vincent, Ritcheson, Lauffer, Vincent & Dukes, P.C., 821 ESE Loop 323, Suite 530, Tyler, Texas

5.0 STATEMENT OF FACTS

5.1 Doctors Memorial Hospital, Inc. ("DMH"), a nonprofit, 501(c)(3) organization, was incorporated on September 9, 1967. Beginning in the late 1960's, DMH opened and operated a small nonprofit hospital in Tyler, Texas.

5.2 In early 2000, the Texas Department of Health ("TDH") conducted an investigation of DMH and issued a report citing DMH for numerous deficiencies in care. Upon receipt of this report, the Health Care Finance Administration ("HCFA") suspended the Medicare Provider Agreement of DMH on May 27, 2000. The DMH Officers overseeing DMH's operations and quality of care during this period were CEO, Mr. Clem, and COO, Ms. Blaine. After unsuccessfully appealing this suspension of Medicare funding, on August 23, 2000, the DMH Board of Directors voted to close DMH, and to offer one year severance packages for Chief Financial Officer ("CFO") Davis Norris, Jr., and executive secretary Dolly Hale. DMH discharged its last patients and permanently closed its doors on August 31, 2000.

5.3 Remarkably, the winding down process for DMH, a small 30 bed hospital, was prolonged for four years during which time, the CEO, Mr. Clem, and COO, Ms. Blaine, were paid full salaries including benefits. From the time the hospital closed through December 31, 2004, there was little day to day work for Mr. Clem to perform, and on information and belief, he rarely came into his office at DMH to work. Ms. Blaine's work mainly involved supervising the archiving of hospital medical records and inventorying and valuing hospital equipment for sale. Mr. Clem and Ms. Blaine augmented their salaries during this period by paying themselves the value of their sick

leave and vacation leave as part of their annual salary. Through these salary enhancements, Mr. Clem was able to supplement his salary by \$155,531.00 and Ms. Blaine by \$100,636.00. Following their termination of their full-time employment on December 31, 2004, both Mr. Clem and Ms. Blaine were then paid two years of additional full salaries and benefits as severance in 2005, and 2006. All told, almost \$2 million in salary was paid to Mr. Clem and Ms. Blaine, between August 31, 2001, the day the hospital closed its doors, and December 2006.

5.4 On December 12, 2001, the DMH board, in gratitude for past service by Mr. Clem and Ms. Blaine, authorized approval of "a two year severance package with current benefits" provided that the officers remain for the winding down and dissolution of the corporation. The approval for the severance package was passed by a unanimous vote of three⁴ with Mr. Clem removing himself from the room for the vote. By awarding these lavish severance packages to Mr. Clem and Ms. Blaine, the executives in charge of DMH at the time it was forced to close, the board of directors chose to reward them for the business failure of DMH. The approval of the severance packages constituted unreasonable compensation under Art. 1396-2.24 of the Texas Non-Profit Corporation Act ("the act"). While the act allows compensation in a reasonable amount to be distributed to corporate officers, the compensation provided through the severance packages was not proper in the context of the hospital being closed, and the reduced duties of both corporate officers. The approval of these improper severance packages which constituted a breach of Clem and Norris's duties under the NPCA, ultimately cost the public over \$550,000 in charitable assets that should have been preserved and distributed to other healthcare charities in the Tyler area.

5.5 Following its closure in 2000, the DMH Board of Directors failed to replace any

⁴ The directors voting for the severance package were Dr. Norris, Dr. Rockwell, and Dr. Truitt.

of its directors who retired or died. The original board of directors that authorized the closing of the Hospital in August 2000 consisted of five directors: (1) Dr. Carl List; (2) Dr. David F. Norris; (3) Dr. Norman Truitt; (4) Dr. E.B. Rockwell; and (5) CEO, Mr. Ollie Clem. This number was actually less than the six directors required by the bylaws of Doctors Memorial Hospital. A few months after the board of directors voted to close the hospital, Dr. List passed away. No additional directors were added following the death of Dr. List, leaving the board with only four members. On September 11, 2002, the board was reduced to two members when Dr. Truitt resigned and Dr. Rockwell ceased to attend board meetings for health reasons. This two man board of directors, consisting of Dr. Norris and Mr. Clem, has conducted all board meetings and business of DMH from September 11, 2002, to the present day. The NPCA requires that the number of directors of a corporation shall be not less than three (NPCA Art. 2.15), while the Bylaws of DMH require six directors and the replacement of any departing directors.

5.6 Despite the fact that a two person board of directors violated both Art. 1396-2.15 of the Texas Non-Profit Corporation Act, which states that the number of directors of a corporation shall be not less than three, and the bylaws of DMH, which require six directors, no attempts were made to recruit additional directors. This failure to add directors deprived DMH of the services of a full and independent board of directors to exercise careful oversight of the disposition of DMH's charitable assets held in trust for the public during the winding down of its business. Additionally, one of the directors, Mr. Clem, had inherent conflicts of interest in regard to his continued compensation as an officer of DMH, and the compensation of his daughter, COO, Lisa Blaine. The lack of such a board contributed to further breaches of duty by the two person board of directors.

5.7 The failure to replace board members resulted in all of the official acts and

business transactions by the DMH board between September 11, 2002 and the present date, being void for lack of a board quorum to transact of business. The Texas Non-Profit Act requires that a quorum for the transaction of business by the board of directors shall be the lesser of: (1) a majority of the number of directors fixed by the bylaws; (2) if the bylaws fail to set such a number, the majority of the number of directors stated in the articles of incorporation; (3) any number, not less than three, fixed as a quorum by the articles of incorporation or bylaws. Art. 1396-2.17 (A)(1). The bylaws of DMH set the number of directors at six (6)(Article IV. Section 1) and provide that any vacancies occurring in the board of directors are to be filled (Article IV. Section 8).

5.8 On January 26, 2006, at the Board meeting of DMH, Mr. Clem⁵ and Dr. Norris voted to make Lisa Blaine the sole employee of the DMH Foundation at a salary of \$50,000 per year. The DMH Foundation was incorporated on November 18, 2004, with the intention of creating a 501(c)(3) organization that could accept the remaining assets of DMH. The DMH Foundation is a nonprofit corporation, separate and distinct from DMH, with a board consisting of Mr. Clem, Dr. Norris, and Ms. Blaine. At the time the decision was made to pay Ms. Blaine a salary as a DMH Foundation employee, the Foundation had no assets, and had not even received its 501(c)(3) certification from the Internal Revenue Service⁶. Ms. Blaine's salary, which was paid out of the funds of DMH from 2006 until April 2008, totaled over \$100,000. This salary was paid to Ms. Blaine despite the fact that there was no need for a full time employee at Doctors Memorial Foundation, as it did not have any assets nor nonprofit program activities and any needs of the Foundation could have been performed by volunteers. Ms. Blaine's salary at the Foundation was

⁵ Mr. Clem did not recuse himself from the vote despite the fact that Ms. Blaine is his daughter.

⁶ The Foundation still has no assets or property and has never been granted 501(c)(3) status.

terminated in April 2008 at the urging of the Attorney General.

6.0 CAUSES OF ACTION

Violations of the NPCA

6.1 The Attorney General reasserts the factual allegations contained in paragraphs 5.1 through 5.8 above.

6.2 DMH is a non-profit, charitable corporation based in the State of Texas and holds its assets in charitable trust on behalf of the public, subject to the statutory duties of officers and directors. Defendant DMH itself has a fiduciary duty to the public and other statutory duties imposed by the NPCA.

6.3 Defendant Clem, in his capacity as CEO and Director, Defendant Norris, in his capacity as Director, Defendant Truitt, in his capacity as Director, and Defendant Blaine in her capacity as COO, are subject to the fiduciary duties imposed by the NPCA.

6.4 The individual defendants (Clem, Norris, Truitt, and Blaine) have, through acts and omissions, breached the duties imposed on them as officers and directors of DMH by failing to use DMH's charitable assets exclusively for the organization's mission and purpose as expressed in DMH's Articles of Incorporation and Mission Statement. Instead, individual defendants have allowed or acquiesced to the use of DMH's assets to pay excessive compensation, including improper and excessive severance pay, during the six year period after DMH closed its doors and ceased operations. Individual defendants have also failed to properly and sufficiently manage corporate assets and to manage DMH through a properly constituted and independent Board of Directors. Directors Clem and Norris had, or should have had knowledge of the these wrongdoings, and have failed to take any action at all. These acts and omissions of the individual defendants

amount to a failure to act in good faith and with ordinary care and in a manner that directors and officers reasonably believe to be in the best interest of DMH as required for directors and officers of non-profit corporations by the NPCA, Arts. 2.22, 2.28.. Such failures amount to a violation of the act and a breach of fiduciary duty.

6.5 DMH, and individual defendants Clem, Norris, Truitt, and Blaine, in their representative capacities as officers and directors and employees, have also violated the following other provisions of the NPCA:

- A) NPCA, Art. 2.14, by failing to maintain the required number of directors (not less than three) as set out in DMH's articles of incorporation;
- B) NPCA, Art. 2.15(a)(1)&(2), by attempting to conduct board of directors meetings without an effective quorum of directors;
- C) NPCA, Art. 2.24, by distributing the assets of the corporation to the employees, directors, and officers of the corporation in excess of reasonable compensation for services provided in furtherance of the charitable mission of the corporation, including the distribution of improper severance pay.
- D) NPCA, Arts.2.24 by accepting compensation as officers of the corporation in excess of reasonable compensation for services provided in furtherance of the charitable mission of the corporation.

These violations of the NPCA by Defendants amount to gross breaches of the Defendants' fiduciary duties to the public.

6.6 Individual defendants are jointly and severally liable for compensatory damages in the amount of any misappropriated or misdirected assets of DMH, and for any dispensation of the nonprofit corporation's assets over and above amounts determined to be reasonable compensation for services rendered.

6.7 Individual defendants are further liable for all taxes, fines, and other civil

penalties and all actual and exemplary damages, including all pre-judgment and post-judgment interest on all awards of damages, civil penalties, and other recoveries as provided by law, to which the Attorney General, on behalf of the public interest in charity, may show himself entitled. To the extent required by Texas law, the above claims are made against the nominal corporate defendant DMH.

Statutory and Common Law Breach of Fiduciary Duty

6.8 The Attorney General reasserts the factual allegations contained in paragraphs 5.1 through 5.8 above.

6.9 DMH is a nonprofit corporation with its headquarters in the State of Texas and holds its assets in charitable trust subject to the common law fiduciary duties and statutory duties of officers and directors. Clem, Norris, and Blaine in their capacities as directors, officers and employees, are subject to the fiduciary duties imposed by common and statutory law.

6.10 The law regarding charitable trust assets requires that such assets be used for the charitable purposes for which they were received. Defendants owe various fiduciary duties to the general public to disburse those funds and services accordingly and not otherwise. By failing to do so, defendants have breached their fiduciary duties to the general public.

6.11 Defendant DMH and Clem, Norris, Truitt and Baine, in their capacity as directors, officers and employees misappropriated and wasted the assets of DMH through the distribution of excessive and unreasonable compensation and improper severance packages. Additionally, Clem, Norris, Truitt and Blaine, in their capacity as directors, officers and employees misappropriated and wasted the assets of DMH through the payment of compensation that was not used for purposes related to the charitable purposes of DMH. Specifically, Clem and Norris

authorized payment of salary to Blaine, who accepted such salary, as the employee of a separate nonprofit organization, Doctors Memorial Hospital Foundation, that held no assets, performed no program services, and required no day to day work on the behalf of its employee. As a result, Clem, Norris, and Blaine have breached their fiduciary duties to DMH and to the general public.

6.12 Based on the conduct alleged in the preceding paragraphs, individual defendants have, by means of inappropriate and unlawful acts and omissions, breached their duties as fiduciaries or managerial agents of a charitable trust. Such acts by defendants violate the common law and statutory laws of the State of Texas pertaining to charitable organizations. DMH holds its assets in trust for the benefit of the public and for the charitable purposes for which the nonprofit corporate entity is dedicated, defendants owe fiduciary duties to the citizens of the State of Texas, as well as to DMH as a nonprofit corporate entity, to use the nonprofit corporate assets for the mission and purposes intended, and for no other. As defendants have failed to properly hold these assets in trust, they have breached their fiduciary duties and a constructive trust should be imposed, as specifically requested below, on all assets of the nonprofit corporate defendant DMH which have been used for any improper purpose, including paying compensation to the employees, directors, and officers of the corporation in excess of reasonable compensation for services provided in furtherance of the charitable mission of the corporation.

6.13 Based upon the common law, state charitable trust law, and their fiduciary duties, defendants are liable for the diversion of any DMH assets over and above amounts determined to have been appropriately used for DMH's charitable purposes. Defendants are further liable for all taxes, fines, and other civil penalties and all actual and exemplary damages, including all pre-judgment and post-judgment interest on all awards of damages, civil penalties, and other

recoveries as provided by law, to which the Attorney General, on behalf of the public interest in charity, may show himself entitled.

Grossly Negligent Mismanagement

6.14 The Attorney General reasserts the factual allegations asserted in Paragraphs 5.1 through 5.8 above.

6.15 Individual defendants have violated the special duty of care imposed upon them in their capacities as fiduciaries, by failing to oversee the management and control of DMH in accordance with the law governing nonprofit charitable organizations, as alleged above. Individual defendants have exercised their fiduciary duties in such a negligent and irresponsible manner that their lack of diligence results in breach of their fiduciary duties and subjects them to damages as a result of their gross negligence.

Negligent Mismanagement

6.16 The Attorney General reasserts the factual allegations asserted in Paragraphs 5.1 through 5.8 above.

6.17 Individual defendants, in their management and oversight of DMH, have breached the duty of care imposed upon them in their capacities as a fiduciaries, as alleged above. Individual defendants have failed to exercise their fiduciary duties in such a negligent manner that their lack of diligence caused harm to the public. For such harm, individual defendants breach of fiduciary duty subjects them to damages as a result of their negligence.

7.0 EQUITABLE REMEDIES

Request for Involuntary Dissolution and Liquidation of DMH Corporate Assets

7.1 The Attorney General requests that the Court enter a decree that the Doctors

Memorial Hospital, Inc., nonprofit corporation be dissolved and its affairs liquidated pursuant to NPCA 7.01(A)(3) and 7.06 (A)(1). DMH is no longer operating as a hospital and any actions that it now takes are outside of its original articles of incorporation and bylaws which limit DMH to operating a hospital.

Request for Involuntary Dissolution of DMH Foundation

7.2 The Attorney General requests that the Court enter a decree that Doctors Memorial Hospital Foundation, a nonprofit corporation, be dissolved and its affairs liquidated pursuant to NPCA 7.01(A)(3) and 7.06 (A)(1).

Request for Appointment of a Temporary Receiver to Liquidate and Distribute DMH Assets

7.3 In accordance with principles of equity, the special powers of Texas courts in matters pertaining to charity, the Attorney General's request for involuntary dissolution and liquidation of DMH's assets by a receiver, and in light of the seriousness of the allegations raised in this pleading and potential for continual damage to the corporation, the appointment of a temporary receiver to conserve DMH's assets and avoid damage to the interests of the public of the State of Texas is necessary. The appointment of a temporary receiver is authorized by NPCA, Art. 7.04 and/or 7.05 ; MCLA, Art. 5.10; and TEX.CIV.PRAC.&REM. CODE §§ 64.001 *et seq.*

7.4 The Attorney General requests that a temporary receiver be appointed to represent the interests of DMH during the pendency of this litigation, and to choose legal representation for DMH in this litigation solely for the benefit of the corporation; and order that such temporary receiver be given the authority and duty to conduct the general business of DMH. Finally, the Attorney General requests that Receiver appointed be ordered liquidate the assets of DMH and distribute them to another nonprofit corporation, exempt from taxes under 501(c)(3) of the Internal

Revenue Code, and providing health care services in the Tyler area, pursuant to the equitable doctrine of cy pres and NPCA Art. 7.06 (B)(3). No other adequate remedy is available at law or in equity to accomplish these goals.

7.5 The Attorney General's sworn petition demonstrates that he has pleaded a cause of action upon which he will probably prevail on the merits. There is no remedy at law which will adequately protect the public's interest in charity. The granting of the extraordinary relief requested is in the public interest because it will protect the public's interest in charity.

Accounting

7.6 In the event that the Court does not appoint a receiver, the Court should order the defendants to provide the Attorney General and the Court with a complete accounting of the charitable assets of DMH, performed in accordance with generally accepted accounting principles by a professional public accountant named by the Court.

Imposition of a Constructive Trust

7.7 Clem, Norris, Truitt and Blaine misappropriated, misused or misdirected charity-dedicated funds and other property in violation of their fiduciary duties. Pursuant to principles of equity applicable to charity assets, defendants' wrongdoing imposes a charitable trust on the property so misappropriated, misused, or misdirected. Thus, based on the facts set forth in this petition, the amounts so misappropriated, misused or misdirected are thus subject to the imposition by this Court of a constructive trust to be held solely for the specific charitable purposes of DMH.

Replacement of Directors

7.8 Clem, Norris, and Truitt have consistently and repeatedly failed to perform their fiduciary duties as directors of DMH in a manner which preserves the charitable assets of the

corporation and advances the charitable purposes of the corporation. Therefore, the Court should exercise its equitable powers to preserve the resources and charitable mission of DMH by removing the aforesaid individual defendants from their positions as officers and appointing a temporary receiver to conserve the assets and manage the business of DMH.

8.0 TRIAL BY JURY

8.1 The Attorney General herein requests a jury trial. Pursuant to Attorney General Opinion No. MW-447 and No. MW-447A, the state is not required to pay fees or give any other security for the costs in advance.

9.0 ATTORNEYS' FEES

9.1 Due to the acts of defendants, the Attorney General has found it necessary to investigate and prosecute this action. Consequently, the Attorney General requests that this Court adjudge against defendants, jointly and severally, all attorneys' fees, investigators' fees and costs of court pursuant to TEX.GOV'T. CODE ANN., § 402.006(c), TEX.PROP. CODE ANN. §§ 123.005(b), and §114.064.

PRAYER

WHEREFORE, Attorney General Greg Abbott, on behalf of the public interest in charity, respectfully prays the Court:

1. To issue citation to Defendants Norris and Truitt to appear and answer herein (citation is not required for Defendants DMH, DMH Foundation, Clem, or Blaine as their attorneys have agreed to waivers of citation and acceptance of service);
2. After notice and hearing, issue a decree dissolving the Doctors Memorial, Inc. nonprofit corporation, and the Doctors Memorial Hospital Foundation pursuant to NPCA 7.01;
3. After notice and hearing, appoint a temporary receiver to protect the assets and administer the business of Doctors Memorial Hospital, Inc., and then to liquidate the

assets of the Doctors Memorial Hospital, Inc. and to distribute them to a 501(c)(3) nonprofit corporation providing health care in the Tyler area pursuant to the equitable doctrine of cy pres and NPCA Art. 7.06 (B)(3) ;

4. After notice and hearing, order a complete accounting of the assets of Doctors Memorial Hospital, Inc.;
5. Order the individual defendants to disgorge all of the wrongfully acquired charitable assets of Doctors Memorial Hospital, Inc.;
6. Impose a constructive trust on all improperly acquired assets of Doctors Memorial Hospital, Inc. held by the individual defendants or subject to their control;
7. Order that the existing board of directors of DMH be replaced with a receiver;
8. Award the Attorney General his costs of court, including his reasonable attorneys' fees and investigatory expenses; and
9. Award such other relief, whether legal or equitable, as may be necessary to vindicate the public's interest in charity.

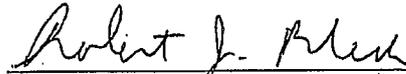
Respectfully submitted,

GREG ABBOTT
Attorney General of Texas

C. ANDREW WEBER
First Assistant Attorney General

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VERIFICATION

STATE OF TEXAS

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COUNTY OF TRAVIS

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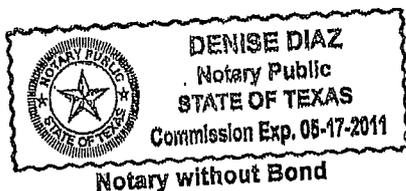
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BEFORE ME, the undersigned authority, on this day personally appeared Susan Galloway known to me to be the person whose name is subscribed to the following instrument and duly sworn by me, stated as follows:

1. "that I am an investigator with the Charitable Trusts Section of the Consumer Protection and Public Health Division of the Office of the Attorney General;
2. that I am over the age of eighteen and fully competent to make this statement;
3. that I am duly authorized to make this verification; and
4. that I assisted in an investigation by the Charitable Trusts Section of the Consumer Protection and Public Health Division of the Office of the Attorney General regarding Doctors Memorial Hospital, Inc. (Tyler, Texas) and Doctors Memorial Hospital Foundation (Tyler, Texas), in which I reviewed various documents pertaining to the Defendants and spoke with witnesses. Based upon that investigation, documents provided, and other sources, I have reason to believe that the factual allegations contained in the foregoing Attorney General's Verified Original Petition are true and correct."

Susan Galloway
Susan Galloway

This instrument was acknowledged before me on this 11th day of March, 2009, to certify which witness my hand and official seal.



Denise Diaz
Notary Public, State of Texas