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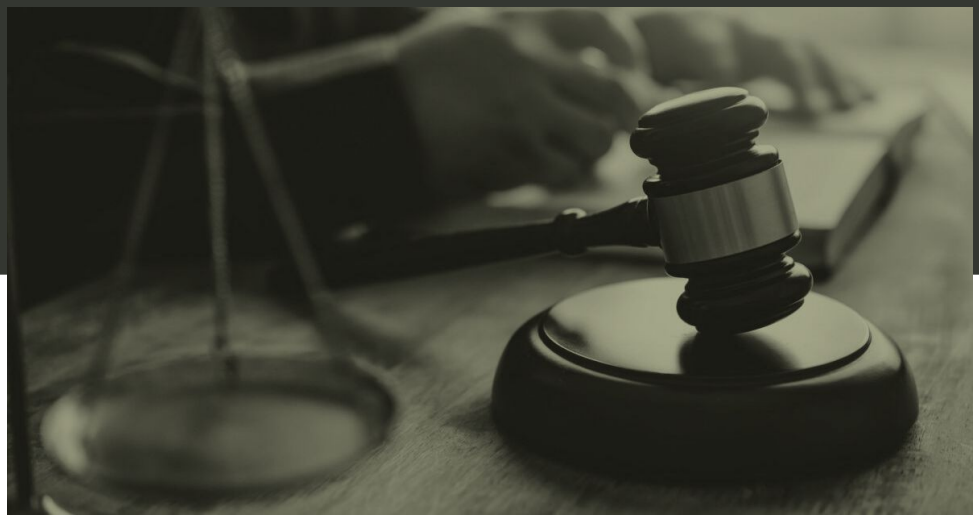
An Ed, a Med, and a Hybrid: Litigation Updates

06.30.21 | Linda J. Rosenthal, JD



For about a year and a half, we've been following – and reporting on – "three big juicy" cases making legal headlines. See *Recent Court Cases: Philanthropy Related* (December 19, 2019) and *The Latest on Three Intriguing Nonprofit Lawsuits* (April 6, 2021).

It was slow-going between the first and second posts; during the pandemic, most courts around the nation closed entirely for a while. But the pace is certainly picking up now. There are already tantalizing updates in each of these courtroom sagas involving several of the nation's leading "eds and meds."

"*Eds and Meds*"

There are two categories of powerhouse community organizations: higher education and medical centers. Popular shorthand for these conglomerates is "eds and meds." As "[a]nchor institutions" in a region, they are often the biggest employers and most influential drivers of the local economy.

It's not uncommon for enormous entities to sue or be sued on routine matters. There are good reasons why *these* three lawsuits have attracted special attention.

The first case involves the most well-known "ed" in the United States: Harvard University. It's been embroiled since 2014 in a dicey affirmative-action lawsuit. Twice, Harvard has won: at both the trial and appellate levels. As expected, the losing student-applicant group filed a petition for certiorari in the U.S. Supreme Court in February 2021. Now there's a development that may delay – perhaps into next year – the high court justices' decision to take the case or not.

The second case concerns a "med," the massive nonprofit Sutter Health System that dominates the healthcare market in Northern California. Its inscrutable billing practices and monopolistic business model were targeted by plaintiffs' groups and the California Attorney General. Sutter caved on the eve of trial last fall and agreed to a landmark settlement of $575-million and promises (backed up by

injunctions) to make major operational changes. A few months ago, the settlement received preliminary approval by the judge. But there are questions about whether it will make it through to final approval; that hearing is set for July.

In the third case, the plaintiff is the world-renowned Mayo Clinic and its affiliated medical schools which are properly classified as … well, … no one's quite sure. That's the issue here. Are they (together) primarily a "med" with "eds" tagging along or vice versa? Or is this a hybrid conglomerate with neither predominating? It's more than a mere ivory-tower intellectual exercise; there's quite a bit of money involved in unrelated business income tax liability. Since our last post, the Eighth Circuit has issued its decision, but the next step is not the expected petition for certiorari in the Supreme Court. Instead, the case is going back to the trial court for a bit more fact-finding.

The "Ed": Harvard

For decades, the question of affirmative action at the college level has been a highly emotional and politically charged issue. This case, filed in 2014, has the unusual twist that it pits Asian-American applicants against those from other minority groups. It wasn't until 2019 that the litigation made it all the way through the trial level to a decision. In ruling for Harvard after a bench trial, the federal district court judge, commented that [this Harvard] case has "major stakes for higher education nationwide." Indeed, it's been "one of the most closely watched lawsuits concerning affirmative action and higher education in recent years."

She based her decision, in part, on an intervening development in 2016 at the United States Supreme Court. See *Fisher v. University of Texas at Austin*, SCOTUSBlog docket. In that Texas case, the high court justices, by a 4-3 vote, narrowly affirmed that racial preferences in higher education continue to be allowable. See *Affirmative action advocates shocked — and thrilled — by Supreme Court's ruling in University of Texas case* (June 23, 2016) Emma Brown & Danielle Douglas-Gabriel, *The Washington Post*.

In November 2020, Harvard garnered its second victory. The First Appellate Circuit ruled even more decisively in the college's favor than the trial judge. *Appeals court upholds ruling that Harvard admissions process does not discriminate against Asian Americans* (November 12, 2020) Nick Anderson, *The Washington Post.*

As expected, the losing student-applicant-group filed a petition for writ of certiorari in February 2021. *Group that sued Harvard asks Supreme Court to end use of race in college admissions* (February 25, 2021) Nick Anderson & Robert Barnes, *The Washington Post*.

The high court agreed to extend the briefing schedule (on the question of certiorari) until at least mid-May 2021. See SCOTUSBlog's complete docket information: *Students for Fair Admissions v. President and Fellows of Harvard College (Harvard Corporation)* including the Petition, the first 20 or so of what will likely be an avalanche of amicus curiae briefs, the responsive brief by Harvard (5/17/21) and the reply by Students (5/24/21).

In conference in mid-June, the justices decided to ask "… the federal government to weigh in on whether the justices should once again wade into the battle over affirmative action." *Justices*

request government's views on Harvard affirmative-action dispute (June 14, 2021) Amy Howe, *SCOTUSBlog.* The court asked Acting Solicitor General Elizabeth Prelogar to "… file a brief expressing the government's views on a challenge to Harvard's race-conscious admissions policy." Ms. Howe notes that, "even if the justices ultimately decide to grant review …, the call for the government's views likely postpones the case until next spring at the earliest." See also *Editorial: The Supreme Court shouldn't take up the Harvard affirmative action case* (June 14, 2021) The Times Editorial Board, *The Los Angeles Times.*

And – as Ms. Howe points out – "it has been five years since a divided court, after the death of Justice Antonin Scalia and with Justice Elena Kagan recused, upheld the University of Texas' consideration of race as a factor in its undergraduate admissions process. Justice Anthony Kennedy wrote for the majority in Fisher v. University of Texas, joined by Justices Ruth Bader Ginsburg, Stephen Breyer and Sonia Sotomayor." Of course, there have been major changes in the court's composition after the retirement of Justice Kennedy and the death of Justice Ginsburg.

The "Med": Sutter Health

"[I]t ain't over 'til it's over." The type of complex class-action litigation that landed healthcare behemoth Sutter Health System in major hot water doesn't end when the tentative agreement is reached. It requires multiple sign-offs. In March 2021, the trial judge gave preliminary approval. See *Sutter Health agreed to pay $575 million in antitrust settlement. Now judge has weighed in* (March 9, 2021) Dale Kasler, *Sacramento Bee.* The final approval hearing is set for mid-July 2021.

But there are ongoing concerns about Sutter Health's commitment to making serious, enduring changes that will result in Northern California heart attack patients no longer having to pay three times as much for care as their Southern California neighbors. Sutter agreed to have its "business operations monitored for 10 years" under a strict monitoring system. Among the requirements are: limiting out-of-network charges under a fixed cap; ceasing "anticompetitive bundling of services and products"; stopping "contracting tactics" that prevent health plans and employers from steering members to lower-cost plans; stopping "all or nothing contracting deals"; and increasing "transparency through access to pricing, quality and cost information." See *Landmark settlement in Sutter Health antitrust case creates opportunity for billing reform* (February 22, 2021), Alan Goforth, benefitspro.com ["These are really significant new rules of the road for [the] health system."]

And it hasn't been an easy year or so for Sutter in any event; like nonprofits everywhere, the massive healthcare system has suffered COVID-19-related financial upheaval. See *Layoffs. Losses. Lawsuits. 'Rules are being rewritten' for California healthcare giant* (June 1, 2021) Dale Kasler, *The Sacramento Bee.*

Hospitals and health systems around the nation are watching nervously, particularly now that the (former) California AG, Xavier Becerra, a key figure in the court proceedings, has become U.S. Secretary of Health and Human Services. In the few short months since his confirmation, he's shown he's willing to take a hard line to benefit ordinary citizens over large corporations.

For California taxpayers, there's been another interesting development in this case. In April 2021, the court approved an attorneys fee award of 32% of the $575-million. While the bulk of it will go to five private law firms that took the case on a contingency basis, the California Attorney General's Office is set to receive 2%, or about $11.2 million. Not bad.

The "Ed/Med": Mayo Clinic

In our April 2021 update, we indicated that the tax bar continues to wait on pins and needles to learn the fate of Treasury Regulation section 1.170A-9(c)(1).

In September 2019, a federal district judge in Minnesota had tossed out this long-standing regulation, which includes the administrative definitions relevant to which 501(c)(3)s qualify as "educational organizations." A 501(c)(3) that squeezes into that definition can take advantage of a special and quite valuable "get-out-of-UBIT" benefit.

It's not well known outside the medical community or perhaps Minnesota that the world-renowned Mayo Clinic has several affiliated medical schools. Nevertheless, at first blush, it seems a stretch for Mayo to portray itself as primarily an *educational* rather than a *medical* institution. But the trial judge in *Mayo Clinic v. United States* 412 F. Supp. 3d 1038 (D. Minn. 2019) took that leap. See full court ruling. See also *INSIGHT: Mayo Clinic Is an 'Educational Organization'* (September 27, 2019) Robert Willens, CPA *Bloomberg Tax;* and *Mayo Clinic held to be an educational organization despite engaging in noneducational activities* (November 1, 2019) Charles J. Reichert, CPA, *Journal of Accountancy*. [This is quite deep-in-the-weeds legal minutiae. For anyone interested in diving in, we took a stab at explaining it in (more or less) plain English in our December 2019 post.]

It's not unheard of for a federal judge to invalidate a federal administrative regulation interpreting and applying a statute. But neither does it happen every day, so it wasn't exactly surprising that the Treasury Department and the IRS appealed the result. In our April 7, 2021 post, we noted that Eighth Circuit judges gave little clue at the October 2020 oral argument about how they might rule, except for the cryptic comment by one of them: "It's a fascinating, potentially very difficult issue." [Audio link to oral] See also *Judge Signals Uncertainty Over Ruling on Mayo Clinic Tax Refund* (October 20, 2020) Aysha Bagchi, *Bloomberg Tax*.

At long last, on May 13, 2021, a three-judge panel of the Eighth Circuit handed down its ruling. The bottom line is a bit murky, but still – according to many commentators – the court's analysis is helpful. The regulation wasn't fully invalidated but neither was it given a clean bill of health. For two excellent explanations of what happened, and why the case is on its way back to the district judge for more fact-finding, see *Eighth Circuit Holds the Mayo in Tax Regulation Invalidity Case* (May 17, 2021) McDermott Will & Emory, *National Law Review* and *Eighth Circuit reverses and remands district court's summary judgment grant for Mayo Clinic in UBIT refund case* (May 20, 2021) *Ernst & Young Tax News Update*.

Arising out of all of this muck, though, there's some very good news for "nonprofit educational magazines and museums" in the Eighth Circuit (and perhaps elsewhere) which are "dedicated to educating the public" but "do not offer formal instruction." Under the court's analysis, they "may be

able to avail themselves of this special "don't have to pay UBIT" perk for their real-estate investment debt-financed income under IRC 514(c)(9)(C)(i).

Conclusion

Stay tuned, especially for developments in the Sutter Health System case.

— Linda J. Rosenthal, J.D., FPLG Information & Research Director