

NO. 13-12-00099-CV

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IN THE COURT OF APPEALS  
FOR THE THIRTEENTH DISTRICT OF TEXAS

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KNAPP MEDICAL CENTER, INC.,  
Appellant,

v.

JEFFREY C. GRASS,  
Appellee.

---

ON APPEAL FROM THE 430TH JUDICIAL DISTRICT COURT  
HIDALGO COUNTY, TEXAS

---

**BRIEF OF *AMICI CURIAE* TEXAS MEDICAL ASSOCIATION, AMERICAN  
MEDICAL ASSOCIATION, REP. ARMANDO MARTINEZ AND THE O.W.L.S.**

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DONALD P. WILCOX  
State Bar No. 21449000  
JEFFREY S. GDULA  
State Bar No. 24056729  
TEXAS MEDICAL ASSOCIATION  
401 WEST 15TH STREET  
AUSTIN, TEXAS, 78701  
Phone: (512) 370-1300  
Fax: (512) 370-1636

**ATTORNEYS FOR *AMICI CURIAE*  
TEXAS MEDICAL ASSOCIATION,  
AMERICAN MEDICAL  
ASSOCIATION, REP. ARMANDO  
MARTINEZ AND THE O.W.L.S.**

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**MOTION TO RECEIVE AND CONSIDER BRIEF OF *AMICI CURIAE* TEXAS  
MEDICAL ASSOCIATION, AMERICAN MEDICAL ASSOCIATION, REP.  
ARMANDO MARTINEZ AND THE O.W.L.S.**

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To the Honorable Court of Appeals

Pursuant to Tex. R. App. P. 11, The Texas Medical Association and American Medical Association respectfully request that the Court of Appeals for the Thirteenth District of Texas receive and consider this *Amici Curiae* brief in the above styled and numbered case.

**IDENTITY OF PARTIES AND COUNSEL**

**Appellant/Plaintiff Knapp Medical Center, Inc.**

Richard A. Sheehy  
State Bar Number 18178600  
Raymond A. Neuer  
State Bar Number 14928350

Steven Gonzalez  
State Bar Number 08131900  
Gerald Castillo  
State Bar Number 24012399

Sheehy, Ware & Pappas, P.C.  
2500 Two Houston Center  
909 Fannin Street  
Houston, Texas 77010  
Telephone: (713) 951-1000  
Facsimile: (713) 951-1199

Gonzalez Palacios LLP  
1317 E. Quebec Avenue  
McAllen, Texas 78503  
Telephone: (956) 618-0115  
Facsimile: (956) 618-0445

**Appellee/Defendant Jeffrey C. Grass**

Ernst Mitchell Martzen  
State Bar Number 24055916

Ramon Garcia  
State Bar Number 07641800

Martzen PLLC  
3102 Maple Avenue, Suite 400  
Dallas, Texas 75201  
Telephone: (214) 444-7200  
Facsimile: (214) 613-1558

The Law Office of Ramon Garcia, P.C.  
222 W. University Drive  
Edinburg, Texas 78539  
Telephone: (956) 383-7441  
Facsimile: (956) 381-0825

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## **STATEMENT OF INTEREST OF *AMICUS CURIAE***

The Texas Medical Association (TMA) is a private, voluntary, non-profit association of more than 45,000 Texas physicians and medical students. TMA was founded in 1853 to serve the people of Texas in matters of medical care, prevention and cure of disease, and improvement of public health. Today, TMA's maxim continues in the same directions: Physicians caring for Texans. TMA's diverse physician members practice in all fields of medical specialization. TMA supports Texas physicians by providing distinctive solutions to the challenges they encounter in the care of patients.

The AMA is the largest professional association of physicians, residents and medical students in the United States. Additionally, through state and specialty medical societies and other physician groups seated in its House of Delegates, substantially all United States physicians, residents and medical students are represented in the AMA policy making process. The objectives of the AMA are to promote the science and art of medicine and the betterment of public health. AMA members practice in every medical specialty area and in every state, including Texas.

State Representative Armando Martinez (District 39) served on the Knapp Medical Center Board of Directors from July 2006 until March 2010. Rep. Martinez informed the Board that he would be absent from meetings when he was in Austin on State business. He was told this would not be a problem. In his role as a Board member, Rep. Martinez served as the chair of the finance committee. Once he began asking for financial documents, and became vocal in his concerns about transparency at the hospital,

he was asked to resign. He did not, and was subsequently voted off and was told this was due to absenteeism.

The O.W.L.S. (Objective Watchers of the Legal System) are an unincorporated association that follows cases of interest in the Weslaco area. Members attend legal proceedings in an attempt to make sure there is transparency when it comes to issues affecting the interests of Weslaco's citizens. The O.W.L.S. have approximately 15 members. With regard to Knapp Medical Center, their objective is to promote the most effective and economical health care facility for the community.

In this case, TMA and the AMA have an interest in the health care and safety of patients treated by TMA and AMA physician members on staff at Knapp Medical Center in Weslaco, Texas. The Appellee in this case represents members of TMA and AMA who are advocating on behalf of their patients and the community in Weslaco. Rep. Martinez represents the interests of his constituents from District 39 (which includes Weslaco) as well as the citizens of Texas. These interests include the health care and safety of patients treated at Knapp Medical Center. The O.W.L.S. have an interest (among other things) in promoting the most effective health care facility for Weslaco.

TMA, AMA, Rep. Armando Martinez and the O.W.L.S. (hereinafter referred to as "Amici") received no compensation or fees in connection with the preparation or submission of this brief and will provide all attorney fees incurred in connection herewith.



### **STATEMENT OF THE CASE**

Amici adopt the Statement of the Case of the Appellant.

### **ISSUE PRESENTED**

Amici comment on the following issue:

1. The trial court correctly ruled that § 22.355 did not exempt the hospital from its disclosure requirements under § 22.353.

### **STATEMENT OF FACTS**

Amici adopts the Statement of Facts of the Appellee.

### **SUMMARY OF THE ARGUMENT**

KMC created KMCF in response to a new exception which allows “a corporation that does not intend to solicit and receive and does not actually raise or receive during a fiscal year contributions in an amount exceeding \$10,000 from a source other than its own membership” from complying with the law regarding financial record-keeping and disclosure requirements of non-profit corporations.

KMC relies on contributions from the public in order to provide services. As a steward of those contributions, it should be held accountable for those funds. The state of Texas recognizes that and has enacted laws designed to protect members of the public who wish to contribute to non-profit organizations. These laws are not burdensome. All they require is that non-profit corporations who solicit and receive large contributions

from the public keep financial records, books and annual reports and make those available to the public for three years.

While there is nothing wrong with non-profit corporations soliciting donations from the public, there is something wrong with those corporations creating sham entities in order to circumvent the laws designed to protect the public from those seeking donations. The legislative history and citing cases of the legislation of the exception make its purpose clear. The sequence of events makes it apparent that KMC created KMCF to circumvent the requirement of accountability. Such conduct should not be permitted to avoid the requirements of the Texas Business Organizations Code. KMC solicits and actually receives large contributions from the public and should be required to comply with the law by making financial records available to the public.

### **ARGUMENT**

Plaintiff Knapp Medical Center (“KMC”) filed an original petition for declaratory judgment, asserting that it is exempt from complying with the defendant’s request for the production of financial records. KMC argues that Section 22.355(2) of the Texas Business Organizations Code allows it to avoid complying with Section 22.353 because it established the Knapp Medical Center Foundation (“KMCF”) to solicit donations from the public rather than KMC soliciting donations itself.

Amici assert that KMC does solicit donations from the public, and does so through a foundation it established for that purpose and to circumvent the requirement of accountability. Based on the legislative history of the relevant code provisions (and the

only potentially available exception in this case), corporations which rely on the support of public donations cannot be allowed to avoid compliance by setting up a foundation to solicit the public funds on their behalf. Public policy demands accountability from non-profit corporations, especially hospitals, who solicit donations from the public. If that were not the case, the statute would never have been passed into law.

**I. Knapp Medical Center is not exempted from complying with the disclosure requirements of TEX. BUS. ORG. CODE § 22.353.**

**A. The legislative history of Texas Business Organizations Code §§ 22.353 and 22.355(2) makes it clear that corporations like Knapp Medical Center, who seek out and rely on donations from the public, are to be held accountable to that same public by keeping and making available certain financial records**

When the Texas Business Organizations Code was being developed, the drafters looked to the then-current law (Article 1396-2.23A of the Texas Non-Profit Corporation Act) regarding financial record-keeping and disclosure requirements of non-profit corporations. The drafters adopted this code, with only a minor change—which did not affect the relevant exception in this case, clause (2)—and stated “no substantive changes intended” in their notes. TEX. BUS. ORG. CODE § 22.355, Revisors’ Note. Since the adoption of the Texas Business Organizations Code, there have been some minor changes to Section 22.355, but none of these modifications substantively affected clause (2).

While Section 22.355(2) does not have any citing cases or substantial legislative history, its predecessor, Article 1396-2.23A(E)(2), has both.

Therefore, the best indication of the legislative intent behind the exception contained in § 22.355(2) can be found in the background section of the bill analysis of

Article 1396-2.23A:

During the last interim, the author attempted to conduct a study of a non-profit drug rehabilitation program in Houston. This program had been soliciting funds from the public and portrayed itself as a charitable endeavor. However, there were rumors that its funds were being used for investments in such businesses as nightclubs. During the six month investigation, the author of this bill was unable to determine how the program's funds were being used because the records were inadequate. *A major recommendation from the study was that Texas law should be amended to require non-profit organizations soliciting funds from the public to keep adequate records showing how the funds were actually being used.*

Senate Comm. on Bus. and Indus., Bill Analysis, Tex. S.B. 857, 65th Leg., R.S. (1977)

(emphasis added). The bill analysis also reveals the purpose of the bill: "S.B. 857 amends current law to require non-profit corporations *soliciting funds from the public* to keep certain financial records." *Id.* (emphasis added).

In the primary interpreting case, *Texas Appellate Practice and Education Resource Center v. Patterson*, 902 S.W.2d 686 (Tex. App.—Austin 1995, writ denied), the court held that the exemption found in Tex. Rev. Civ. Stat. Ann. Art. Article 1396-2.23A(E)(2) applied to funds solicited from the general public and not grant funding or donations of in-kind services (as was the situation in *Patterson*).

In its interpretation, the court developed an accountability test:

The purpose, legislative history, and circumstances under which S.B. 857 was enacted reveal that the statute was narrowly drawn to remedy a specific problem: lack of accountability. The legislature designed Article 1396–2.23A as a mechanism for making nonprofit corporations accountable for donations solicited from the public. In the absence of a problem, there is no need for a remedy. Thus, organizations for whom lack of accountability is not an issue do not fall within the scope of Article 1396–2.23A.

*Id.* at 689.

The test reveals that the court limits the application of Article 1396-2.23A to

entities that are not held accountable to their donors in other ways. Because the language of Article 1396-2.23A(C) was adopted almost identically into § 22.355(2), the accountability test developed by the court in *Patterson* should also apply to interpretations of § 22.355(2).

In the present case, KMC claims that it should be exempt from producing the requested financial records under § 22.355(2). Unlike *Patterson*, however, accountability here *is* otherwise lacking. KMCF exists solely to support KMC. If KMC's financial records are not required to be maintained and available to the public under §§ 22.352 and 22.353, the purpose of the statute, "to require non-profit organizations soliciting funds from the public to keep adequate records showing how the funds were actually being used," is frustrated. Senate Comm. on Bus. and Indus., Bill Analysis, Tex.S.B. 857, 65th Leg., R.S. (1977). Since KMC receives far in excess of the \$10,000 per year threshold of funds solicited from the public, it should be required to keep adequate financial records and make those records available to the public.

**B. The Knapp Medical Center Foundation is a sham corporate entity which exists solely for the purpose of funding the Knapp Medical Center.**

KMC solicits contributions from the public. It does so through KMCF. The only reason KMCF exists is to solicit donations from the public on behalf of KMC. Indeed, KMCF's Articles of Incorporation state that KMCF "is organized for the sole benefit of, and the specific purpose of supporting the activities and purposes and fostering the well-being of Knapp Medical Center of Weslaco, Hidalgo County, Texas..." (See Appendix "4"). The registered agent for both KMC and KMCF is James A. Summersett III, CEO of

KMC (See Appendices “5” and “6”). James A. Summersett III<sup>1</sup> is also the Administrator of KMCF’s Board of Directors. (<http://www.knappmedfoundation.org>) In fact, the legislatively crafted exemption at issue in this case became effective in 1980. Interestingly, the KMCF was formed in 1981 (See Appendix “1”).

When members of the public are solicited by KMCF, and decide to contribute money, they are actually contributing to KMC. This isn’t a secret. The public knows they are actually contributing to KMC. According to KMCF’s website<sup>2</sup>, “[m]ore than \$6 million” in public donations have been given to KMC by KMCF. In 2011 alone, KMCF was able to give KMC more than \$700,000. *Id.* The KMCF webpage used to note that “private donations are vitally important to Knapp Medical Center,” but that language has been removed since TMA’s original amicus curiae brief was filed with the district court. KMCF only exists because KMC believes that it can avoid accountability by having KMCF solicit contributions from the public.

Sections 22.352 and 22.353 would be rendered meaningless if non-profit corporations could simply create sham (dummy) entities to hide behind. Texas law has frequently disregarded corporate entities when the purpose of creating a corporate entity is to limit the liability of the shareholders, otherwise known as “piercing the corporate veil.” *Castleberry v. Branscum* explains when a court should disregard the corporate fiction, including: where a corporation is organized and operated as a mere tool or

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<sup>1</sup> James A. Summersett III is also the Chairman of HOSPAC (Texas Hospital Association’s Political Action Committee) in 2012-2013. (See Appendix “8”) The Texas Hospital Association has filed an amicus curiae brief supporting KMC in the present case.

<sup>2</sup> At the time TMA filed an amicus curiae brief at the district court level, KMCF’s webpage was located on KMC’s website. At some point after that brief was filed, KMCF created a separate website. The new website may still be accessed by using the url address of the old webpage on KMC’s website (<http://www.knappmed.org/about/knapp-foundation>).

business conduit of another corporation; where the corporate fiction is resorted to as a means of evading an existing, legal obligation; and where the corporate fiction is used to circumvent a statute. 721 S.W.2d 270 (Tex. 1986).

KMC makes the bizarre argument that: “If Grass’ unproved allegation is correct that the hospital and the Foundation are the same, then the resolution of this appeal is simple. The hospital would clearly fall within the exemption in Section 22.355(2), and Grass would not be entitled to any documents.” (Brief for Appellant page 13, footnote 4) KMC goes on to repeat the argument that: “the hospital would not be subject to the statute at all if the hospital and the Foundation were “one and the same,” because the contribution would not come from an outside source.” (Reply Brief for Appellant page 8, footnote 2). This logic conveniently ignores the fact that the origin of the funds was donations from the public. Were that not the case, KMC would never have thought it had to create KMCF in the first place.

When the purpose, or result, of creating a related entity is to prevent the parent entity from being held accountable to the public it relies on for financial support, the parent entity should be estopped from asserting an exemption from laws requiring financial disclosure. To allow such an exemption, under these facts, would be completely inconsistent with the public policy behind the requirements for disclosure and accountability.

## **II. Public policy requires accountability for hospitals that rely on donations.**

### **A. Texas public policy is established by the Texas legislature, not by the non-profit entities it regulates.**

KMC states in its reply brief that “(t)he federal government obviously believes that (IRS form 990) is sufficient for purposes of transparency, especially after it was amended a couple years ago.” (Reply Brief for Appellant page 8) This argument<sup>3</sup> ignores the fact that sections 22.353 and 22.355 (and their predecessor statutes) were enacted *after* IRS form 990 was promulgated. Grass’ request was based on state law. To borrow KMC’s logic, the State of Texas obviously believes that the IRS form 990 is insufficient to bring transparency and accountability to certain corporations. IRS forms 990 must also be filed by corporations which do not solicit and received donations from the public in amounts exceeding \$10,000 in a year, and therefore do not have the same concerns with accountability.

KMC suggests repeatedly (Brief for Appellant pages 11, 12, 20) that if this Court decides to enforce the statute based on public policy, it should limit the records, books and reports to be made available to only those which trace the donor’s funds. Section 22.353, however, is not so limiting. No purpose would be served by requiring those who solicit donations from the public to only be transparent in regards to those donations. No one questions that KMC spends some money wisely. The concern is that KMC receives donations from the public and, in the absence of transparency and accountability, is freed up to do things the public would consider foolish with the money it would have otherwise had to spend. If you think there is a rat in your attic, you point the flashlight in every corner. You don’t point it in one corner and then conclude you are rat free because didn’t happen to see one there. It is one thing for the public to donate \$100,000 so that the

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<sup>3</sup> Which was echoed by every other amicus curiae brief filed on Appellant’s behalf.



hospital can purchase a new piece of equipment. It is quite another for that same donation to be made, the hospital to purchase that same piece of equipment and then give the CEO a \$100,000 raise. What donor would have given the same gift if they knew that to be the circumstance?

This situation is not unique. A recent article in Health Affairs discusses the same problem, as it relates to Freestanding Children's Hospitals (FCHs). "FCHs are reporting record profits and paying their executives millions, all while soliciting for community donations. (See Appendix "9"). In 2009, Senators investigating the matter noted that a nearly \$1 million salary and benefit package for a non-profit executive is "not only questionable on its face but also raises questions about how the organization manages its finances in other areas." *Id.* Such a compensation packages seems to be at odds with the non-profit mission to provide a public service. "Just trust us" is not a policy this law sought to protect.

Another potential situation in which access by the public to a non-profit hospital's records, books and reports under section 22.353(b) would be beneficial is if the hospital were trying to ripen itself for sale. Perhaps the public would not be so willing to donate to a non-profit hospital if it knew the hospital were about to be sold to a for-profit system. In fact, amicus Texas Hospital Association previously supported legislation which would have strengthened the standards for non-profit to for-profit conversions of hospitals. Texas Hospital Association testified in favor of Tex. H.B. 1331, 75th Leg., R.S. (1997) which addressed issues of notice, public participation, preservation of the non-profit entity's assets for charitable purposes and independent oversight of those assets. (See

Appendix “10”).

KMC expresses concerns that hospitals (“economic competitors”<sup>4</sup>) will gain an “unfair competitive advantage” if KMC is forced to make these records, books and reports available. “Economic competitors” is a strange way for a non-profit hospital to refer to other hospitals. Amici would argue that being able to accept over \$700,000 in one year from public donors, all while operating in tax-exempt status, without being held accountable is the real competitive advantage. In any event, concerns over economic competition should be secondary to accountability and transparency of non-profit hospitals to the public which they rely upon for donations and exist to serve.

Amici Curiae Christus Health, Memorial Hermann Healthcare System, The Methodist Hospitals System, Texas Children’s Hospital and Texas Health Resources do not believe that corporations who solicit and actually receive contributions from the public should have accountability to that same public. They argue that “it is the Attorney General, as the representative of the people of the State of Texas, and not the general public, that is vested with broad power to examine corporate books and records.” (brief at page 10). TEX. BUS. ORG. CODE § 12.151 allows the Attorney General to examine books and records, but not at the expense of other authorized parties. Further, the plain language of the statute at issue here addresses that notion: “A corporation commits an offense if the corporation fails to maintain a financial record, prepare an annual report, or make the record or report available *to the public* in the manner required by Section 22.353.” TEX. BUS. ORG. CODE § 22.354 (emphasis added).

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<sup>4</sup> Brief for Appellant page 16.

**B. Public policy demands an even higher burden of accountability for hospitals.**

Even if this Court believes that parent entities should not be accountable for the donations they solicit through related entities, this Court should recognize a higher burden of accountability among non-profit hospitals entrusted with patients' health and well-being.

Hospitals exist to serve the health, safety and well-being of the individuals in their communities. As a product of this purpose, hospitals ensure that the citizenry are able to both contribute to and enjoy the benefits of community. Hospital medical staff physicians practicing at a facility have a special interest in hospital operations and in its prudent use of resources. TMA and AMA member physicians practicing at non-profit Texas hospitals, such as KMC, should be able to require an accounting as provided for under Texas law.

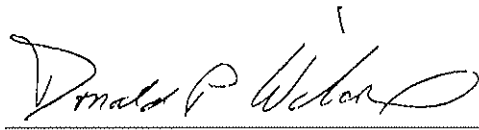
Non-profit hospitals receive various tax-exemptions from federal, state and local governments with the expectation that, in return, they will provide benefits to the community. These important functions and benefits are precisely why TMA, AMA, Rep. Martinez and the O.W.L.S. strongly support the transparency of financial records for non-profit hospitals that rely on the public for funding. This transparency promotes quality patient care and accountability. Every employee of and patient treated at a hospital is affected by the financial decisions made by those in charge. Financial misdeeds by hospital leadership are paid for by patients and employees. Patient safety is compromised

when hospitals do not use their financial resources to further quality of care.<sup>5</sup>

### CONCLUSION AND PRAYER

The district court's orders were consistent with the legislative intent of the statute and sound public policy. Therefore, this Court should affirm the judgment.

Respectfully submitted,

By: 

DONALD P. WILCOX  
State Bar Number 21449000  
JEFFREY S. GDULA  
State Bar Number 24056729  
TEXAS MEDICAL ASSOCIATION  
401 WEST 15TH STREET  
AUSTIN, TEXAS, 78701  
Phone: (512) 370-1300  
Fax: (512) 370-1636

**ATTORNEYS FOR AMICI CURIAE  
TEXAS MEDICAL ASSOCIATION,  
AMERICAN MEDICAL  
ASSOCIATION, REP. ARMANDO  
MARTINEZ AND THE O.W.L.S.**

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<sup>5</sup> Amici Curiae Texas Hospital Association, Texas Association of Voluntary Hospitals, Texas Organization of Rural & Community Hospitals agree with this sentiment in page 4 of their brief. "(M)any nonprofit organizations have limited financial resources and imposing additional requirements and costs on these organizations will take funds away from their mission and programs." Amici Curiae Christus Health, Memorial Hermann Healthcare System, The Methodist Hospitals System, Texas Children's Hospital and Texas Health Resources also express concern that "valuable and significant resources will be diverted from care of Texas patients." (page 1) Fortunately for them, the statute explicitly provides that corporations "may charge a reasonable fee for preparing a copy of a record or report." TEX. BUS. ORG. CODE § 22.353(b). Managing records and records requests would seem to be part of a hospitals core business. If the hospitals and other corporations are still concerned, there is nothing in the law that requires them to solicit and actually receive donations from the public.