

CAUSE NO. C-1-PB-15-001085

ATTORNEY GENERAL KEN PAXTON,	§	IN THE PROBATE COURT
ON BEHALF OF THE PUBLIC INTEREST	§	
IN CHARITY,	§	
<i>Plaintiff</i>	§	
	§	
v.	§	
	§	NO. 1 OF
D. KEITH PERRY, GREG WILLIAMS,	§	
TERRY MYERS, RANDAL CROSSWHITE,	§	
KENNETH FINCHER, GORDON SHOGER,	§	
CAROL DENTON, LARRY DODSON,	§	
STEVE EXTER, VANCE GODDARD,	§	
DAVID LYNN, RICK RHODES, and DR.	§	
JEFFREY A. SMITH, individually, and in their	§	
representative capacities as former directors	§	
and officers of SEARS METHODIST	§	
RETIREMENT SYSTEM, INC.,	§	
<i>Defendants</i>	§	TRAVIS COUNTY, TEXAS

**ATTORNEY GENERAL'S ORIGINAL PETITION**

COMES NOW, Attorney General KEN PAXTON, on behalf of the public interest in charity, by and through his authorized representatives (the "Attorney General"), complaining of D. KEITH PERRY, GREG WILLIAMS, TERRY MYERS, RANDAL CROSSWHITE, KENNETH FINCHER, GORDON SHOGER, CAROL DENTON, LARRY DODSON, STEVE EXTER, VANCE GODDARD, DAVID LYNN, RICK RHODES, and DR. JEFFREY A. SMITH, individually and in their representative capacities as former officers and directors of SEARS METHODIST RETIREMENT SYSTEM, INC. ("SMRS") and its affiliated nonprofit entities, all of which are subject to the Plan of Confirmation in Case No. 14-32821-11, United States Bankruptcy Court, Northern District of Texas, Dallas Division ("Bankruptcy Case" and "Bankruptcy Court"), which was approved on March 6, 2015,<sup>1</sup> and for the reasons stated below,

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<sup>1</sup> The Bankruptcy Case is a jointly administered proceeding involving the following entities controlled by the Sears Methodist Retirement System: Sears Methodist Retirement System, Inc., Canyons Senior Living, L.P., Odessa Methodist Housing, Inc., Sears Brazos Retirement Corporation, Sears Caprock Retirement Corporation, Sears Methodist Centers, Inc., Sears Methodist Foundation, Sears Panhandle Retirement Corporation, Sears Permian Retirement Corporation, Sears Tyler Methodist Retirement Corporation, and Senior Dimensions, Inc.

files this Original Petition.

### **I. DISCOVERY CONTROL PLAN**

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

### **II. AUTHORITY OF ATTORNEY GENERAL**

2. This suit is brought by the Attorney General acting within the scope of his duty to protect the public interest in charity, and pursuant to the authority granted him under Chapter 123 of the Texas Property Code, the Texas Business Organizations Code, and the Constitution and common law of the State of Texas.

### **III. STATEMENT OF RELIEF**

3. The Attorney General seeks damages for losses to the public interest in charity of at least \$1.4 million due to the mismanagement of donor-restricted charitable gifts, due to the failure to sufficiently operate as a charitable entity, and due to other breaches of fiduciary duty and violations of statutory responsibilities. The Attorney General further seeks reasonable attorneys' fees and costs as are equitable and just, as well as any other equitable relief that the Court may find appropriate to vindicate the public interest in charity.

### **IV. JURISDICTION AND VENUE**

4. Jurisdiction in this Court is proper under §115.001 of the Texas Property (Trust) Code and §32.007 of the Texas Estates Code. Venue is proper in Travis County under §123.005(a) of the Texas Property (Trust) Code.

### **V. PARTIES**

5. Ken Paxton, 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 15<sup>th</sup> Street, Austin, Texas 78701.

6. Defendant D. Keith Perry is an individual residing in the state of Montana, who may be served with process at his last known address of 369 La Brant Rd., Kalispell, Montana 59901. Mr. Perry was President and Chief Executive Officer of SMRS during the period 1993 to 2013.

7. Defendant Greg Williams is an individual residing in the state of Texas, who may be served with process at his last known address of 107 Salinas Cove, Austin, Texas 78738. Mr. Williams was President and Chief Executive Officer of SMRS during the period 2013 to 2014.

8. Defendant Terry Myers is an individual residing in the state of Tennessee, who may be served with process at his last known address of 1602 Glenellen Way, Brentwood, Tennessee 37027. Mr. Myers was Senior Vice-President and Chief Financial Officer of SMRS during the period 2009 to 2014.

9. Defendant Randal Crosswhite is an individual residing in the state of Texas, who may be served with process at his last known address of 2434 Spyglass Hill Ct., #7966, Abilene, Texas 79606. Mr. Crosswhite was Vice-President and Controller of SMRS during the period 2010 to 2014 and Interim Chief Financial Officer of SMRS during 2014.

10. Defendant Kenneth Fincher is an individual residing in the state of Texas, who may be served with process at his last known address of 1900 Stevens Drive #423, Richland, Washington 99354. Mr. Fincher was Senior Vice-President and Director of Sears Methodist Foundation during the period 2011 to 2013.

11. Defendant Gordon Shoger is an individual residing in the state of Texas, who may be served with process at his last known address of 625 Wimberley Oaks Dr., Wimberley, Texas 78676. Mr. Shoger was Vice-President of Financial Operations of SMRS during the period 2010

to 2014.

12. Defendant Carol Denton is an individual residing in the state of Texas, who may be served with process at her last known address of 10320 Jennys Jump Dr., #2304, Austin, Texas 78733. Ms. Denton was a member of the Board of Trustees of SMRS during the period 2008 to 2015 and Secretary of the Board of Trustees of SMRS during the period 2013 to 2015.

13. Defendant Larry Dodson is an individual residing in the state of Texas, who may be served with process at his last known address of 17 Autumn Oaks Dr., The Hills, Texas 78738. Mr. Dodson was a member of the Board of Trustees of SMRS during the period 2010 to 2015 and Chairman of the Board of Trustees of SMRS during the period 2013 to 2015.

14. Defendant Steve Exter is an individual residing in the state of Texas, who may be served with process at his last known address of 5602 Norfolk Ave., Lubbock, Texas 79413. Mr. Exter was a member of the Board of Trustees of SMRS during the period 2003 to 2012 and Treasurer of the Board of Trustees of SMRS during the period 2008 to 2012.

15. Defendant Vance Goddard is an individual residing in the state of Texas, who may be served with process at his last known address of 2 Kings Cross St., Abilene, Texas 79602. Mr. Goddard was a member of the Board of Trustees of SMRS during the period 2001 to 2012 and Secretary of the Board of Trustees of SMRS during the period 2008 to 2012.

16. Defendant David Lynn is an individual residing in the state of Texas, who may be served with process at his last known address of 2101 Crestline Dr., Abilene, Texas 79602. Mr. Lynn was a member of the Board of Trustees of SMRS during the period 2011 to 2012 and Treasurer of the Board of Trustees of SMRS during the period 2013 to 2015.

17. Defendant Rick Rhodes is an individual residing in the state of Texas, who may be served with process at his last known address of 112 Desert Forest Ct., Austin, Texas 78738. Mr.

Rhodes was a member of the Board of Trustees of SMRS during the period 2008 to 2015 and Vice-Chairman of the Board of Trustees of SMRS during the period 2010 to 2015.

18. Defendant Dr. Jeffrey A. Smith is an individual residing in the state of Texas, who may be served with process at his last known address of 30220 Oak Tree Dr., Georgetown, Texas 78628. Dr. Smith was a member of the Board of Trustees of SMRS during the period 2003 to 2012 and Chairman of the Board of Trustees of SMRS during the period 2008 to 2012.

## **VI. STATEMENT OF FACTS**

### ***The SMRS System - Governance and Organization***

19. SMRS, a tax-exempt, charitable nonprofit Texas corporation based in Abilene, is the umbrella organization for a system of mostly nonprofit entities in the senior living industry in Texas. SMRS's origins date back over 40 years to the establishment of the Sears Memorial Methodist Center (later Sears Methodist Centers, Inc.) in Abilene in 1966. The purpose of this original affiliate was to aid older adults.

20. SMRS itself was formed as a Texas nonprofit corporation in 1993. According to its Articles of Incorporation, SMRS's primary charitable purpose was to "develop, support, and promote charitable and educational undertakings for the needs of the elderly in the Northwest Texas Annual Conference of The United Methodist Church" and to "establish, maintain, operate, and manage, directly and/or through one or more subsidiaries, one or more nursing homes, retirement centers, congregate living facilities, health care facilities, or other homes or facilities for older adults within the bounds of the Northwest Texas Annual Conference of The United Methodist Church."

21. Between the time SMRS formed in 1993 and June 10, 2014, when it filed its petition in bankruptcy, the system grew to control, either directly or indirectly, the activities and business affairs of an affiliated group of 15 nonprofit and for profit entities.

22. SMRS's affiliated nonprofits included the following nine (9) entities, all of which filed petitions in bankruptcy simultaneously with SMRS: 1. Odessa Methodist Housing, Inc.; 2. Sears Brazos Retirement Corporation; 3. Sears Caprock Retirement Corporation; 4. Sears Methodist Centers, Inc.; 5. Sears Methodist Foundation; 6. Sears Panhandle Retirement Corporation; 7. Sears Permian Retirement Corporation; 8. Sears Plains Retirement Corporation; and 9. Sears Tyler Methodist Retirement Corporation (together with SMRS, collectively referred to as "SMRS and its affiliated nonprofits").<sup>2</sup>

23. SMRS and its affiliated nonprofits were each Texas nonprofit corporations and were each recognized as tax-exempt charitable organizations under §501(c)(3) of the Internal Revenue Code.

24. At the time SMRS and its affiliated nonprofits, as well as two (2) of its six (6) affiliated for profits - Canyons Senior Living, L.P. and Senior Dimensions, Inc. - filed their petitions in bankruptcy, the SMRS system included eight (8) senior living communities in five (5) Texas communities as follows: 1. Parks Methodist Retirement Community (Odessa); 2. Wesley Court Methodist Retirement Community (Abilene); 3. Craig Retirement Community (Amarillo); 4. The Mildred and Shirley L. Garrison Geriatric Education and Care Center (Lubbock); 5. Meadow Lake Retirement Community (Tyler); 6. Mesa Springs Retirement Village (Abilene); 7.

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<sup>2</sup> The other six (6) of the 15 entities affiliated with SMRS included: Canyons Senior Living, L.P., Senior Dimensions, Inc., Sears Methodist Senior Housing, LLC, Texas Senior Management, Inc., Southwest Assurance Co., Ltd., and Senior Living Assurance, Inc. Of these, only Canyons Senior Living, L.P. and Senior Dimensions, Inc. filed petitions in bankruptcy.

Desert Haven Retirement Community (Odessa); and 8. Canyons Retirement Community (Amarillo). In addition, an SMRS affiliate managed three (3) veteran's homes in El Paso, McAllen, and Big Spring.

25. Though consisting of many entities, SMRS and its affiliated entities operated in many ways as a single system. SMRS was managed by a board of trustees, which also controlled the appointment of the boards of directors for each affiliated entity, most of which held property for the benefit of SMRS.

26. The executive committee of the SMRS board of trustees acted as the board of directors of all of the affiliated nonprofit corporations, and the officers of SMRS acted as officers of all the affiliated nonprofits. SMRS's affiliated nonprofits, including the Sears Methodist Foundation, were led by staff serving as executive or community directors for those affiliates only.

27. Defendants include the executive committee of SMRS, which also acted as board members for the affiliated nonprofits for the period 2010 to 2014. Defendants also include the chief executive officers and other officers of SMRS with primary responsibility for the financial operations of SMRS for the same period.

28. The SMRS cash management system reflected the system's coordinated administration. While each facility maintained at least one operating account,<sup>3</sup> the operating accounts of several of the entities (the "Obligated Group" as defined below) were swept nightly into a "sweep account" in the name of Sears Methodist Centers, Inc. and then "swept" back into the individual operating accounts of each affiliated entity to cover expenses.

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<sup>3</sup> In all, the SMRS-related debtors in the Bankruptcy Case maintained at least 40 bank accounts at the time of the filing of the petitions in bankruptcy in June 2014.

***Management of Charitable Donor Gifts by SMRS and its Affiliated Nonprofits***

29. The Attorney General sought documents regarding SMRS and its affiliated nonprofits pursuant to his investigative authority under the Texas Business Organizations Code, through informal request and via subpoena in the Bankruptcy Case. The focus of the Attorney General's review has been on the management of charitable funds. The Attorney General has reviewed documents including minutes of the meetings of the Board of Trustees and the Executive Committee, donor gift instruments, financial statements, bank records and other materials.

30. SMRS and its nonprofit affiliates, as tax-exempt charitable organizations, solicited, obtained, managed, and invested charitable gifts from individual and organizational donors seeking to support SMRS's charitable mission and that of its affiliated nonprofit facilities in the five (5) cities across Texas. SMRS and its nonprofit affiliates received gifts from its residents or former residents, residents' families, foundations, and even its own employees through sources including direct donations, testamentary bequests, and charitable annuities. Some donors intended that their gifts be maintained permanently as endowments. Others made gifts for a specific purpose, such as improvements, or for benevolent care at a particular senior-living facility.

31. The Sears Methodist Foundation (the "Foundation") played a pivotal role in the SMRS system with respect to charitable donations. Incorporated in 1996, the Foundation's purpose was to receive, manage, invest and distribute gifts, including endowment gifts, for the benefit of SMRS and its affiliated nonprofits.

32. Among the solicitation activities the Foundation undertook in the years leading up to the bankruptcy were: sponsoring fundraising events, such as concerts, to benefit a particular facility; soliciting charitable gift annuities for the benefit of SMRS and its related nonprofit affiliates; and coordinating capital campaigns to fund facility growth, including one to make



improvements at the Craig facility in Amarillo. The Foundation coordinated a “Heart to Heart” campaign to encourage employees to donate to a fund to be used for resident care when a resident was unable to pay fully for their care. In addition, as further outlined below, the Foundation was involved in the campaign to raise funds for an expansion project at the Garrison Geriatric Education and Care Center (“GGECC”) in Lubbock.

33. Although the Foundation’s purpose was solely to manage gifts for the charitable purposes of SMRS and its affiliated nonprofits, the officers and directors of the Foundation included it as a member of the Obligated Group on debt issued to SMRS and several nonprofit affiliates in 1998. The Foundation continued as part of the Obligated Group, jointly and severally liable for an increased obligation in 2013, when the SMRS debt was restructured and refinanced.

34. At least until April 2014, the SMRS cash management and gift management systems appears to have operated such that charitable gifts to SMRS and its affiliated nonprofits, including restricted gifts, were not segregated but were commingled with operating funds. For affiliated nonprofits in the Obligated Group, including the Foundation, charitable gifts were subject to a nightly “sweep” of accounts into a single account.

35. Charitable gifts, including restricted gifts, were accounted for primarily on the books of the Foundation, which was responsible for recordkeeping related to donor gifts to SMRS and its affiliated nonprofits.

36. The recordkeeping system of SMRS and its affiliated nonprofits, including the Foundation, did not enable the SMRS system to monitor the extent to which donor gifts were expended for their intended purpose.

37. In April 2014, the Board of Trustees of SMRS adopted a new cash management system that, for the first time, distinguished treatment of restricted funds. The April 2014 cash

management policy provided for the segregation of all restricted funds, including donations to the Foundation or to another system entity for a restricted purpose. At the same time, the Board of Trustees of SMRS adopted a new charitable gift management policy.

38. There is no record in the minutes of the meetings of the Board of Trustees of SMRS and its affiliated nonprofits during all of 2011, 2012, 2013 and half of 2014 of any discussion regarding the oversight or management of charitable funds: no inquiry was recorded in the minutes regarding the amount of funds available, for what purposes they were intended, or whether or how donor intent was being honored.

39. SRMS did segregate and has set aside as unavailable to pay creditors in the Bankruptcy Case \$1.7 million in two accounts at the Texas Methodist Foundation (“TMF”). On its most recent audited financial statement, for the year ended December 31, 2012, SMRS reflects that it held \$1.7 million in permanently restricted endowment funds, comprised of four (4) donor gifts: the Parks Endowment, the Holbert Endowment, the Garrison Endowment, and the Benevolent Endowment. The Attorney General is requesting the Court to distribute these assets to pursuant to the doctrine of *cy pres*, which provides that when the purposes of a charitable trust have become impossible to fulfill, a court may distribute the trust funds for a purpose that most closely conforms to the donor’s intent.

#### ***Charitable Fundraising for the Garrison Project***

40. SMRS initiated a special fundraising project for the construction of a new private therapy and rehabilitation wing at the Mildred and Shirley L. Garrison Geriatric Education and Care Center (“GGECC” and the “Garrison Project”). GGECC was a unique facility on the campus of Texas Tech University Health Sciences Center in Lubbock, which provided teaching opportunities for students in geriatrics. The fundraising project for this new wing, called the “Gear

Up the Garrison Project,” was initiated in 2012.

41. Between December 31, 2012 and February 2, 2014, a total of \$832,056.67 was donated to SMRS specifically restricted for use related to the Garrison Project. The funds for this project were deposited into an operating account for Sears Plains Retirement Corporation, the SMRS nonprofit affiliate that operated GGECC.

42. SMRS expended just over \$49,000 on expenses related to start-up of the Garrison Project. However, the private therapy and rehabilitation wing was never constructed. SMRS either expended or commingled (or both) the remaining \$783,009.67 in restricted funds such that they could not be identified as restricted charitable funds at the time of the filing of the Bankruptcy Case.

***Additional Restricted and Endowed Gifts to SMRS and its Affiliated Nonprofits***

43. The books and records of SMRS and its affiliated nonprofits indicate that donors made additional charitable gifts restricted to a particular use or intended to be held permanently as endowments.

44. For example, as noted, SMRS engaged in a fundraising campaign to support an expansion project at its Parks facility. Unlike the Garrison Project, this construction did occur. However, there appear to be no records to show that the over \$1.8 million in funds raised for the project were fully expended on the project.

45. In addition, the books and records of SMRS and its affiliated nonprofits show donations totaling \$2.4 million for a fund entitled the Charitable Assistance Endowment and another \$507,000 for a fund entitled the Permanent Endowment. The names of these funds signal donor intent that the funds remain in perpetuity. However, no records have been made available to the Attorney General to date to evidence the origins, purposes or uses of these funds.

46. The books and records of SMRS and its affiliated nonprofits also indicate that donors made other gifts which were intended to be held in perpetuity and/or for a particular purpose. For example, in 2002, SMRS received a \$500,000 matching grant for Alzheimer's research. The books and records of SMRS and its affiliated nonprofits made available to the Attorney General to date do not reflect expenditures for this purpose.

47. In addition, in several annuity contracts with donors, SMRS and its affiliated nonprofits agree to hold the residual gift as a perpetual endowment. Again, the books and records of the charities do not reflect how these funds were maintained or used, and it appears that they were expended prior to the bankruptcy or commingled with available resources such that they were indistinguishable from general funds and were, therefore, included in the bankruptcy estate.

48. In 2011, SMRS reclassified four (4) donor gifts totaling approximately \$650,000 from donor-restricted to board-restricted, thus making them eligible for expenditure for operations on a current basis. Gift instruments for at least three (3) of these gifts, totaling approximately \$530,000, reflect donor intent that they be held in perpetuity, as endowments, for charitable purposes related to SMRS and its affiliated nonprofits, making such "reclassification" improper.

49. To the extent that SMRS and its affiliated nonprofits held permanent endowment funds or funds for a restricted purpose that had not been fulfilled at the time of the filing of the petition in bankruptcy, these funds should have been available at the time of the filing of the Bankruptcy Case. Because SMRS and its affiliated nonprofits are liquidating, the proper treatment of such funds is to invoke the equity powers of a court of competent jurisdiction to distribute them for a charitable purpose that conforms as closely as possible to the intent of the donor(s). In this way, a donor's intent to benefit charitable purposes is honored to the greatest extent possible.

50. SMRS and its affiliated nonprofits, including the Foundation, were subject to both

statutory and common-law fiduciary duties with respect to charitable gifts and were required to manage, invest and expend these gifts pursuant to donor intent, in good faith and in a prudent manner, pursuant to, *inter alia*, Chapter 163, Texas Property Code, the Texas Uniform Prudent Management of Institutional Funds Act (“TUPMIFA”).

51. At all times during their respective terms as directors and officers of SMRS, Defendants, in their capacities as employees, officers, directors, and managerial agents of SMRS and its affiliated nonprofits, including the Foundation, were subject to these statutory requirements and fiduciary duties related to the proper management, investment and expenditure of charitable gifts.

***Property Tax Liability of Sears Tyler Methodist Retirement Corporation***

52. Sears Tyler Methodist Retirement Corporation (“Sears Tyler”), which constructed and operated the Meadow Lake facility in Tyler, was a charitable nonprofit corporation with federal tax-exempt status. As such it was required to be organized and operated for charitable purposes. Sears Tyler was unable to demonstrate to local taxing authorities that it provided at least a threshold amount of charity care at its facility. As a result, it became liable for up to \$1 million in property tax payments. Sears Tyler settled the liability with taxing authorities, paying \$200,000 for 2011, 2012, and 2013. The corporation may also owe taxes for 2014.

***Financial Struggles of SMRS and its Affiliated Nonprofits Leading to Bankruptcy***

53. SMRS and its facilities were heavily debt-financed. SMRS, the Sears Methodist Foundation, Sears Brazos Retirement System, Sears Methodist Centers, Inc., Sears Panhandle Retirement Corporation, and Sears Permian Retirement Corporation (collectively, the “Obligated Group”) secured approximately \$73.1 million in financing through a series of bond offerings by the Abilene Health Facilities Development Corporation between 1998 and 2003.

54. Additional capital sources for other SMRS affiliates (collectively, the “Non-Obligated Group”) included a Sears Plains Retirement Corporation bank loan of \$9 million (2011); bonds issued by Sears Tyler totaling approximately \$49 million (2009 and 2011); bonds issued by Sears Caprock Retirement Corporation totaling approximately \$8 million (2008); and a 2010 HUD loan to Canyons Senior Living, L.P. (balance as of May 2014 was \$3.5 million).<sup>4</sup>

55. By 2011, SMRS’s Board of Trustees knew or should have known that the SMRS system was struggling financially. In a report to the Board of Trustees dated May 8, 2012, SMRS’s auditors expressed “substantial doubt about the System’s ability to continue as a going concern” based on their review of SMRS’s financial statements for the years ending December 31, 2010 and December 31, 2011. SMRS’s auditors noted losses from operations, lack of liquidity to cover operations and debt service, as well as default by the Obligated Group and certain entities in the Non-Obligated Group, including Sears Tyler, on bond payments and on financial covenants included in its long-term debt agreements. As of December 31, 2011, liabilities of the SMRS system exceeded assets by over \$14 million.

56. During 2013, the Obligated Group restructured and refinanced its existing \$73.1 million in debt, pursuant to an April 2013 Offer to Tender and Exchange, after which the Obligated Group emerged with approximately \$95.6 million in Retirement Facility Revenue Bonds governed by a restated Master Trust Indenture. As part of the restructuring, the Obligated Group also borrowed \$3.5 million from the Texas Methodist Foundation (“TMF” and the “TMF loan”). Thus, after the 2013 restructuring, the Obligated Group, which included the Sears Methodist Foundation,

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<sup>4</sup> Note that Canyons Senior Living, L.P. was not a non-profit charitable corporation.  
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was jointly and severally liable for payment and performance on approximately \$99.1 million in debt obligations.

57. In November 2013, in the wake of default on its bond payment and agreements, Sears Tyler, a Non-Obligated Group member, entered into a forbearance agreement with certain holders of its bonds. An additional forbearance agreement was entered into in April 2014.

58. Also in 2013, SMRS transferred some of its management functions to Life Care Services, LLC (“LCS”) pursuant to certain management agreements. Under the terms of those agreements, LCS reviewed and proposed policies and procedures for SMRS and its affiliated nonprofits and advised SMRS regarding the operations of the senior-living facilities.

59. Greg Williams, an employee of LCS, served as the chief executive officer of SMRS during this time.

60. The relationship between SMRS and LCS deteriorated, with SMRS alleging that Mr. Williams’s loyalties were conflicted because he remained an LCS employee while serving as SMRS’s chief executive. In April 2014, two months before filing for bankruptcy, Mr. Williams left SMRS and LCS terminated the management agreement. The SMRS Board of Trustees then hired Susan Whittle as interim chief executive officer.

61. In the meantime, beginning in January 2014, SMRS had begun to draw on a reserve fund that had been set up in connection with the 2013 restructuring.

62. SMRS and its affiliated nonprofits and the other debtors in the Bankruptcy Case, filed their petition in bankruptcy on June 19, 2014, citing declines in occupancy resulting from changes in housing and equity markets that made it difficult for potential residents to move to SMRS facilities.

63. The Bankruptcy Case was filed pursuant to Bankruptcy Code Chapter 11, as a reorganization. However, SMRS and its affiliated nonprofit debtors were unable to reorganize and, instead, with the exception of the Sears Methodist Foundation, sold their assets to various for profit purchasers. Pursuant to the Plan of Confirmation, the Sears Methodist Foundation's assets, except for the approximately \$1.7 million in permanent endowment funds discussed above, became part of the bankruptcy estate, available to pay creditors of the Obligated Group.

## **VII. CAUSES OF ACTION**

### ***A. Breach of Fiduciary Duty under the Common Law and/or the Texas Business Organizations Code (Texas Non-Profit Corporation Law)***

64. The Attorney General reasserts the factual allegations contained in paragraphs 19-63, above.

65. At all times while serving as a director or officer of SMRS and its affiliated nonprofits, Defendants owed fiduciary duties to the nonprofit charitable corporations they served. In addition, because the assets of a nonprofit corporation are held for the charitable purposes for which the organization is dedicated, Defendants at all times while serving as officers and directors of SMRS and any of its affiliated nonprofits owed fiduciary duties to the public interest in charity. Defendants were required to operate and manage the nonprofit, charitable corporations in good faith, with ordinary care, and in the best interest of the corporations and the public interest in charity. Defendants further had the duty of using corporate assets solely for the purposes of the corporations.

66. Defendants, at all times while serving as directors and officers of SMRS and its affiliated nonprofit corporations had duties under the Texas Business Organizations Code, requiring that they discharge their duties in good faith, with ordinary care, and in the manner the



director or officer reasonably believes to be in the best interest of the corporation. *See* Tex. Bus. Org. Code §§22.221, 22.235.

67. Defendants failed to exercise reasonable business judgment and use ordinary care in the management of restricted donor gifts, commingling donor-restricted and endowment funds with general corporate assets, expending restricted assets to meet cash flow needs, and then, at times, attempting to “replace” expended restricted gifts; employing a cash management system that did not preserve endowed or restricted funds; and failing to establish any method to ensure that donor gifts were used for their intended purposes. Directors did not inquire about or discuss restricted or endowed gifts, and officers failed to inform directors of significant actions, like the reclassification of permanently endowed gifts. Defendants improperly treated the donor-restricted gifts of residents, families, employees and foundations as ordinary corporate income, not as protected assets of the charitable corporation they served.

68. Defendants also failed to exercise reasonable business judgment or act with the ordinary care of a prudent person with responsibilities as an officer or director to a charitable corporation with respect to general financial management. Defendants managed SMRS and its affiliated nonprofits in such manner that was tantamount to a lack of good faith and failure to exercise ordinary care, which was not in the best interest of SMRS and its affiliated nonprofits. Defendants failed to protect the mission of SMRS in violation of the reasonable standards of conduct attendant to their stewardship. Defendants led SMRS in undertaking unreasonable growth and voluntary debt acquisition that left it struggling to service its debt, and, eventually, unable to serve its charitable mission. Defendants unreasonably responded to unfavorable financial news by acquiring additional debt, and managed Sears Tyler in such a way that it was not considered by local taxing authorities to be operating as a charity.

69. Defendants serving in 2013 further exercised unreasonable business judgment and failed to use ordinary care by entering into a management agreement with apparent issues of conflicting loyalties, thereby jeopardizing the nonprofit corporations and their charitable purposes, and unreasonably risking the loss of charitable assets.

70. In addition, Defendants further exercised unreasonable business judgment by continuing to encumber the assets of the Foundation, whose sole purpose was to manage charitable assets for a charitable purpose.

71. In breaching their fiduciary duties, Defendants caused damages to the public interest in charity. Defendants are, thus, liable for such losses, including those resulting from inadequate recordkeeping as required by Tex. Bus. Org. Code §22.352 and/or misappropriation of restricted or endowed gifts as well as losses to the public interest in charity for failing to operated Sears Tyler as a charity, consistent with its mission and its legal requirements.

### ***B. Negligence***

72. The Attorney General reasserts the factual allegations contained in paragraphs 19-63 above.

73. At all times while serving as a director or officer of SMRS and its affiliated nonprofits, Defendants had a duty to use ordinary care in managing the affairs of the corporations.

74. Defendants failed to use ordinary care in managing the restricted funds for the Garrison Project, commingling these funds with operating funds at Sears Plains, and, because there was no method of ensuring that restricted dollars were spent for their intended purposes, misappropriating those dollars or so losing track of them that they were eventually included as payments to creditors in the Bankruptcy Case. In the case of the Garrison Project, Defendants' negligence resulted in the loss of over \$700,000 to the public interest in charity.

75. Defendants failed to use ordinary care to ensure that Sears Tyler was operating as a charity, thus subjecting the entity to property tax liability. Defendants' negligence in ensuring Sears Tyler operated for a charitable purpose resulted in damages of at least \$200,000 to the public interest in charity.

76. Defendants failed to oversee the management of SMRS and its related nonprofits in a prudent and reasonable manner, breaching the duty of care imposed upon them in their capacities as fiduciaries. They failed to exercise their fiduciary duties in such a negligent manner that their lack of diligence caused harm to the public. For such harm, their breaches of fiduciary duty subject them to damages as a result of their negligence.

***C. Statutory Violations of the Texas Uniform Prudent Management of Institutional Funds Act (TUPMIFA)***

77. The Attorney General reasserts the factual allegations contained in paragraphs 19-63 above.

78. Pursuant to TUPMIFA, Defendants were required to manage restricted and endowed gifts consistent with donor intent as expressed in a gift instrument, and to manage and invest restricted and endowed charitable gifts in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances. *See* Tex. Prop. Code ch. 163.

79. Defendants failed to prudently manage, invest and expend institutional and endowment funds pursuant to the requirements of TUPMIFA. They failed to exercise good faith, unreasonably and imprudently managed donor gifts in a manner that placed them at great risk, and expended restricted and endowment funds in violation of donor intent.

80. Defendants' practices with respect to the handling of charitable gifts, by their very nature, jeopardized charitable assets because such methods only worked if unrestricted cash was

plentiful. Defendants' "method" of ensuring conformity with donor intent depended heavily on hope, luck, and the availability of excess cash. Defendants' method of management of restricted funds was to note "on the books" that such funds should be there, then hope that sufficient cash would actually be there, somewhere in the SMRS system, if those dollars for restricted purposes were needed.

81. Defendants failed to take their roles as stewards of charitable funds seriously and failed to exercise the care required of stewards of charitable funds. If they had properly safeguarded these charitable assets, including the gifts for the Garrison Project and the permanent endowments that were reclassified and expended, the funds would still be available for charitable purposes, to be used in a manner consistent with donor intent.

#### **VIII. ADDITIONAL DEFENDANTS AND CAUSES OF ACTION**

82. The Attorney General specifically reserves the rights to name additional defendants and allege additional causes of action following discovery conducted in this proceeding.

#### **IX. TRIAL BY JURY**

83. The Attorney General herein requests a jury trial. Pursuant to Tex. Civ. Prac. & Rem. Code § 6.001, the state is not required to pay fees or give any other security for the costs in advance.

#### **X. ATTORNEYS' FEES**

84. Due to the acts of Defendants, the Attorney General has found it necessary to investigate and prosecute this action on behalf of the public interest in charity. Consequently, the Attorney General requests that this Court adjudge against Defendants, all attorneys' fees, investigators' fees and costs of court pursuant to Tex. Prop. Code §§123.006.

## PRAYER

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

1. To issue citation to Defendants D. Keith Perry, Greg Williams, Terry Myers, Randal Crosswhite, Kenneth Fincher, Gordon Shoger, Carol Denton, Larry Dodson, Steve Exter, Vance Goddard, David Lynn, Rick Rhodes, and Dr. Jeffrey A. Smith to appear and answer;
2. To award the Attorney General, on behalf of the public interest in charity, an amount to compensate the public for the failure of Defendants to safeguard charitable assets in the manner intended by the donors of restricted and permanently endowed gifts, such damages to be redistributed by the Court, pursuant to the Court's authority under the *cy pres* doctrine, to a Texas nonprofit charitable corporation with the same or similar purpose as SMRS and its affiliated nonprofits.
3. To award the Attorney General his costs of court, including his reasonable attorneys' fees and investigators' expenses; and
4. To award such other relief, whether legal or equitable, as may be necessary to vindicate the public's interest in charity.

Respectfully submitted,

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Attorney General of Texas

CHARLES E. ROY  
First Assistant Attorney General

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Deputy Attorney General for Civil Litigation

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/s/ Leslie J. Friedlander

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***On Behalf of the Public Interest in Charity***