

The following developments from the past month offer guidance on corporate law and governance law as they may be applied to nonprofit health care organizations:

1. CORPORATE OPPORTUNITY AND “IP”

A new federal district court ruling serves as a reminder of the scope of, and risks of violating, the prohibition against corporate opportunity that arises under the fiduciary duty of loyalty. *AngioScore, Inc. v. TriReme Med, Inc.* involved breach of fiduciary duty claims of a medical device company against a former director, alleging that the former director developed a new device that competed with its leading product (a specialty balloon catheter) while still a board member of the medical device company. The principal defendant had been a co-founder, officer and chief scientist of AngioScore. He developed a competing catheter after he had left AngioScore’s employment but while he remained on its board. The District Court ruled that the corporate opportunity doctrine applies to inventor/directors; that the defendant should have offered AngioScore the opportunity to acquire the rights to the new catheter. “The fact of inventorship does not absolve a director of his fiduciary obligations with respect to inventions he may develop that compete with the corporation he serves”. The Court also held the defendant’s new corporate employer liable for “aiding and abetting” the breach. The *AngioScore* decision is particularly relevant to health systems that pursue, directly or through affiliate investments, the support of innovative technologies.

2. NACD NONPROFIT GOVERNANCE SURVEY

Health system governance committees should note the results of the newly released “Nonprofit Governance Survey”, published by the National Association of Corporate Directors. **The NACD Survey** results contain five primary highlights: (i) a need for improvement in the information flow to the board on critical issues (e.g., strategy and nonfinancial risk, especially cybersecurity and IT risk); (ii) a need for significant improvement in board knowledge of cybersecurity risks; (iii) the annual time commitment of nonprofit directors is increasing; (iv) nonprofit boards continue to experience high turnover rates; and (v) substantial value is seen in formal, written CEO executive succession plans. The Survey also provides useful input on board structure and composition; director “refreshment” practices, and allocation of risk oversight responsibilities. While only 20% of Survey respondents came from the health care sector, the NACD survey results could nevertheless be useful fodder for governance committee discussion on a variety of important governance considerations.

3. DOJ FOCUS ON COMPLIANCE PROGRAM

The Department of Justice has **announced its intention** to hire compliance counsel, the specific role of which will be to help determine whether corporations under investigation maintain a good faith compliance program. The DOJ’s “Principles of Federal Prosecution of Business Organizations” make it clear that the existence and effectiveness of a corporation’s pre-existing compliance program is a factor DOJ will take into consideration when making a prosecution decision. This position has been underscored by a series of recent speeches by DOJ Criminal Division leaders. The new compliance counsel is expected to (a) help prosecutors distinguish between an effective compliance plan and a “paper” plan, and (b) provide businesses with guidance on program elements that may be appropriate for the particular industry. This more formal emphasis on compliance plan effectiveness should prompt health system leadership to increase the extent it monitors the design, application and comprehensiveness of the system’s compliance program. The general counsel may wish to discuss the implications of this initiative with the Audit & Compliance Committee.

4. ADVICE OF COUNSEL DEFENSE

An important aspect of the recent Court of Appeals decision in *Tuomey* was the Court’s rejection of the health system’s “advice of counsel” defense. The Court found that, by not providing outside counsel the facts of the implicated contracts and also the views of other counsel, **the hospital failed to meet the basic requirements of the defense**. The defense was further undermined by what the Court suggested was the appearance of “opinion shopping”; i.e., pursuing additional opinions that would approve of the core employment agreements while “ignoring negative assessments”. This ruling is notable given that health care systems not infrequently seek more than one legal opinion on issues that involve complex application of health care laws. The general counsel may wish to brief the full board on the foundational principles of the advice of counsel defense, the limitations of the advice of

counsel defense identified in the *Tuomey* decision, and on protocols the board could adopt to strengthen its claim to advice of counsel defense when necessary to do so.

CLICK HERE to access McDermott's full analysis of the governance and Stark implications of the *Tuomey* decision.

5. OVERSIGHT OF SIGNIFICANT LITIGATION

A recent article posted in the [Harvard Law School](#) Forum on Corporate Governance and Financial Regulation underscores the important, yet sometimes under-recognized role of the board of directors in monitoring significant litigation, government investigations and enforcement actions to which the corporation may be subject. The article provides a five-point framework from which boards may exercise oversight of critical litigation and related matters: (i) exercise of the duty of care; (ii) focus on the most appropriate cases; (iii) receive regular reports from management; (iv) prepare to ask appropriate questions; and (v) monitor the application of corporate liability insurance policies. Such a framework is especially relevant given the regulatory controversies and complex litigation that health systems may confront. By reference, the False Claims Act litigation involving Tuomey Healthcare System, and the creditors' rights action involving Lemington Homes, both took over ten years before resolution. Evidence that the governing board appropriately monitors such controversies and litigation will help support a position that it exercised informed oversight and decision-making in this regard.

6. "RISK GOVERNANCE"

A [new Delaware Chancery Court decision](#) provides helpful guidance to governing boards with respect to both their obligation to assess corporate risks, and to act to prevent loss. The decision, *In re General Motors Company Derivative Litigation*, confirms the high evidentiary standard required by Delaware law to establish a breach of the board's risk management duties (i.e., "conscious disregard"). The ruling illustrates certain elements of conduct to which boards may strive in order to support effective board level risk oversight. It also provides examples of issues boards should monitor in order to reduce their risk oversight-related personal liability profile. Yet, these and similar decisions upholding board risk governance practices should not give rise to governance complacency. Rather, they serve as a reminder of the importance of periodically reviewing the effectiveness of risk management and compliance programs, and the manner in which program leaders report to the board and its key committees. This is particularly with respect to jurisdictions that may not readily apply the Delaware standard for establishing risk oversight liability (especially in the nonprofit context).

7. BOARD CYBERSECURITY OVERSIGHT

[Several recent surveys](#) confirm the continuing discomfort of governing boards with their ability to adequately perform their cybersecurity oversight obligations. This is particularly notable given the steady drum-beat of health industry cyber-breaches. To address these continuing concerns, the health system general counsel may wish to team with the chief information officer in advising the board as to both the scope of their oversight obligations, and the types of questions board members may ask of executive leadership with respect to organization's cybersecurity measures. As to the [former, recent commentary suggests](#) that board attention should be focused on the presence of (a) organizational risk mitigation activity that is intended to prevent, or materially reduce, the impact of cyber attacks; and (b) a specially designed crisis management protocol that can be instituted in the event of a breach. As to the latter, a new NACD publication provides guidance on questions that directors might productively raise with management in order to enhance board/management coordination on security measures. A general counsel/CIO-led dialogue may be particularly useful given the absence of any judicial opinions offering direction on the specific application of oversight principles to cybersecurity matters.

8. D&O ADVANCEMENT RIGHTS

A [new decision of the Delaware Chancery Court](#) serves to clarify the rights under Delaware law of a former director and officer to receive mandatory advancement of defense costs under the organizational charter. This case addressed the subsequent ability of a company to condition its charter-based indemnification and advancement commitment upon receipt of the officer's representation that he had not acted unlawfully. In the instant matter, a natural resources company ceased advancing defense costs to its former CEO and Chairman upon his subsequent indictment. In a decision strongly in support of indemnification and advancement rights, the Court ruled that the only limitation that can be placed upon a company's otherwise mandatory agreement to fully indemnify and advance defense costs to an officer or director is a requirement to repay the advanced funds if the officer/director's conduct is subsequently determined to be un-indemnifiable. While this case did not arise from the health care sector, it involves a high-profile regulatory enforcement action. It thus might offer a good platform from which the general counsel can review with leadership the indemnification and advancement commitments made to the health system officers and directors.

For additional information on any of the developments referenced above, please contact Michael at +1 312 984 6933 or at mperegrine@mwe.com; or visit his publications library at www.mwe.com/peregrinepubs.

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