

*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. AUDIT/COMPLIANCE COMMITTEE

June was a very active month in terms of health care compliance and enforcement developments that merit Audit & Compliance Committee attention. These include the Fourth's Circuit's decision in *Tuomey*; OIG's announcement of the creation of its new specialized litigation team; the significant new Stark "Under Arrangements"/"Per Click" decision in *Council for Urological Interests v. Burwell*; the OIG Fraud Alert concerning medical director arrangements; Department of Justice guidance on effective internal investigations and on "corporate cooperation"; new Medicare Fraud Strike Force initiatives; and new surveys addressing the role and function of the chief compliance officer. Individually and collectively, these developments speak to the intensity of the health care fraud enforcement climate. They may prompt health system boards to reconsider the effectiveness of their current compliance oversight protocols, particularly with respect to proposals that materially implicate anti-fraud laws.

Information and analyses with respect to each of these developments can be accessed on the [McDermott Will & Emery Health Care Compliance and Defense Resource Center](#). (Click here)

## 2. TAX EXEMPTION CHALLENGES

The potential vulnerability of the large integrated delivery system to tax exemption challenge is evidenced by the recent decision of The New Jersey Tax Court in *Morristown Memorial Hospital v. the Town of Morristown*. The case involved the property tax exemption of a nonprofit hospital subsidiary of a large, diversified nonprofit health system. The 91 page decision focused on the relationship between tax exemption and "labyrinthine corporate structures intertwined with both nonprofit and for-profit subsidiaries". Particularly disconcerting elements of the decision related to what the judge described as a 'commingling' of hospital assets and activities with its for profit operations; with the impact of overlapping governing boards, and with matters of both physician and executive compensation. The *Morristown* decision comes on the heels of a [recent survey published in Health Affairs](#), concluding that the value of tax exemptions extended to hospitals has doubled over the past ten years. Property tax matters are inherently a matter of state law, and the *Morristown* decision may ultimately be overturned on appeal. Nevertheless, the decision—and the [Health Affairs](#) survey—serve as important reminders to the health system board as to the value of preserving and supporting the core nonprofit, tax exempt mission of the health system.

## 3. CHARITABLE TRUST ISSUES

A [decision of the Virginia Supreme Court](#) in the [controversial Sweet Briar College "closure" case](#) serves to revive the long dormant, but potentially unresolved question of the proper application of charitable trust laws to nonprofit corporations. The Supreme Court was responding to an order of a lower court that had granted an injunction, requested by the Commonwealth, restraining the College from closing. That order was based (at least in part) on the legal conclusion that trust law cannot apply to corporations. The Supreme Court found error in this regard, ruling, indeed, that the law of trusts can apply to a corporation (e.g., a charitable corporation can serve as the trustee of a charitable trust under state law). However, [as an observer notes](#), the Court did not conclude that a charitable corporation is necessarily governed by charitable trust law. In this regard, the *Sweet Briar* decision serves to remind nonprofit health systems to consider the possible application of charitable trust law to significant issues involving ownership, investment and transfer of charitable assets. Trust law in most states differs significantly from nonprofit corporation codes and can have unexpected consequences with respect to major health system actions and initiatives.

## 4. EXECUTIVE COMPENSATION COMMITTEE

The general counsel will certainly want to bring to the attention of the Executive Compensation Committee the highlights of the newly released Report of the [NACD Blue Ribbon Commission on the Compensation Committee](#). The Report specifically focuses on how the board can work with the executive compensation committee to develop an executive compensation philosophy supportive of the long term sustainability of the organization. While the Report is principally focused on public companies and other for profit entities, many of its recommendations have clear application to nonprofit health systems. These

include recommendations relating to (a) a broader scope for the Committee, that would include oversight of organizational talent development (especially at the leadership level); (b) including within the Committee composition members with a wide range of perspectives (including some members with compensation or human resources experience) and skill sets (e.g., personal traits such as courage to withstand external pressures, and communication skills); (c) more clearly identified duties for the Committee chair; and (d) Committee chair succession planning.

## 5. BOARD LIABILITY PROFILE

The benefits of an effective board-level risk management system are demonstrated in the new Delaware Chancery Court decision, *In Re General Motors Company Derivative Litigation*. This case involved allegations that inattentive supervision by the GM board contributed to the damage associated with the ignition switch controversy. Ruling for the GM Board, Judge Sam Glasscock found that the GM board "did not consciously fail to monitor" or oversee GM operations. As a result, Judge Glasscock could not find "substantial likelihood of personal liability on the part of a majority of the board". Specifically, Judge Glasscock found that GM had adequate risk-assessment systems in place and there were not obvious problems or "red flags" of which the board was aware yet ignored, nor was there evidence of bad faith on the part of the directors. Thus, while the standard for board liability in this type of action remains high, the decision also serves to underscore the critical importance of protocols and reporting systems that would provide the board with prompt warning of a real, specific problem.

## 6. CHIEF JUSTICE STRINE'S PRACTICAL BOARD GUIDANCE

The general counsel will enjoy sharing with the board the highly practical guidance provided by Chief Justice Leo E. Strine, Jr. in a [newly published article in The Business Lawyer](#). In his article, the Chief Justice identifies several actions advisors can recommend to improve the process by which boards review and approve major transactions. These include promoting more effective decision making, mitigating the potential for conflicts of interest and more accurately recording the exercise of board judgment – all for the purpose of reducing transaction exposure to regulatory scrutiny or litigation challenge. Of particular interest may be the Chief Justice's observations on the form of minute taking, the value of "red-lining" documents the board reviews, and the limitations of the electronic board portal—especially as a platform for reviewing documents. More broadly, these recommendations serve to underscore the various critical elements that support informed board decision-making and sustainable transactions. They are certainly applicable to the large, sophisticated nonprofit health system.

## 7. AGE LIMITATIONS ON BOARD SERVICE

A [recent article in The Wall Street Journal](#) on average director age is likely to further stimulate the debate on the merits of "director tenure" protocols such as term restrictions and age limitations. The [Journal](#) article analyzed a new survey by the compensation research firm Equilar, which reported that the average director age has increased to 64. According to the survey, the average age of directors has risen over the past several years (i.e., it was 61 in 2007). According to the [Journal](#), the oldest directors are found in the financial and utilities sectors, while the youngest directors are found in the technology and services sectors. From a board development perspective, "tenure" factors such as term restrictions and age limitations deal with different governance concerns (e.g., entrenchment v. ability to serve, and perspective). In addressing these issues, the board should be aware that there are no "best practices" in this area, and that there is conflicting data and analysis on the benefits of tenure limitations. Key factors that should be addressed when considering limitations are the extent to which they could affect the board's access to important expertise, and its ability to provide necessary oversight over management.

## 8. THE DIGITAL ADVISORY PANEL

As nonprofit health system boards seek access to advice on all applicable aspects of technology, a [recent The Wall Street Journal article](#) offers a unique possible option in this regard—the "digital advisory panel". According to the article, boards and management are increasingly accessing these "informal and smaller versions of a corporate board" in an effort to become more aware of trends in social media, "big data" and digital commerce—topics which are of great interest to health systems. These are not the traditional form of advisory boards, i.e., informal groups made up of large donors or retired directors. Rather, they are typically a small group of younger (i.e., under 50) experts who meet periodically with corporate leadership on matters of digital strategies, entrepreneurial proposals and executive and outside advisor hires. They can come from industries as diverse as gaming, digital communities and data visualization, and typically rotate off the panel after a year or two. This advisory panel is an alternative to recruiting younger experts in the digital sector for service as a full board member (which oftentimes proves challenging). One possible "catch" for the nonprofit health system is that in the typical instance, digital advisory panel members are compensated (e.g., in the form of an honorarium) for their service.

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

© 2015 McDermott Will & Emery LLP.