

*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. NEW DOJ ANTI-FRAUD EMPHASIS

The Audit & Compliance Committee should be briefed on the dramatically **increasing emphasis of the Department of Justice on health care fraud enforcement**, and on related issues of corporate cooperation and individual accountability. Over the last several months, the DOJ's Criminal Division has been engaged in a very focused public discussion of its commitment to health care fraud enforcement, and the process DOJ applies when making a decision with respect to corporate prosecutions. Noteworthy aspects of this discussion are the circumstances under which a corporation may receive "credit" for cooperating with a government investigation; incentives to disclose evidence relating to allegedly culpable executives and other employees; and what DOJ perceives to be elements of an effective compliance plan. A coordinated way to present these issues to the attention of governance could be through the general counsel teaming with the compliance officer and outside "white collar" counsel.

## 2. AG MULTI-STATE INVESTIGATION

The FTC and all 50 attorney generals announced on **May 19 the filing of a joint complaint** against four allegedly "phony" cancer charities and several related individuals. The allegedly illegal conduct included fraudulent activities intended to solicit donations from individuals to support allegedly non-existent disease prevention related activities--in violation several federal telemarketing and related rules, and state laws on charitable solicitation and reporting. Several of the corporate and individual defendants have already agreed to settlements including financial penalties, dissolution of the charities and, for the individuals, a ban on further work in the nonprofit sector. (This—further service ban—is an increasingly popular enforcement tool.) This unique complaint reflects the ability of the state attorney generals to work together with each other, and with the federal government, to enforce nonprofit and charitable solicitation laws. As such, it should be of particular interest to health systems operating in multiple states.

## 3. THE "ZONE OF INSOLVENCY"

A new Delaware Chancery Court decision offers important guidance on the liability exposure of board members of financially weak or insolvent corporations. The May 4 decision in ***Quadrant Structured Products Co., Ltd. v. Vertin*** provides substantial clarity on the rights of a creditor to institute a breach of fiduciary duty action, as those rights have evolved in recent years. Notably, the Court ruled that (a) Delaware law does not recognize a "zone of insolvency" for purposes of creditor breach-of duty claims; (b) similarly, Delaware law does not recognize the liability theory of "deepening insolvency" (but see the recent ***Lemington Homes*** decision to the contrary, applying Pennsylvania law); (c) directors of a financially insolvent entity do not owe special duties to creditors (apart from the duties they owe to the corporation); and (d) creditors can assert fiduciary duty claims derivatively and not through direct action. The *Quadrant* decision has been described as "seminal" for its clarification on the ability of creditors to pursue claims against directors of insolvent companies, and is worthy of note by the finance committee of a financially distressed health system.

## 4. "ON BOARDING" PROCESS

The nominating and governance committee may wish to revisit its director training/orientation process in response to **new guidance from the National Association of Corporate Directors ("NACD")**. This process (now often referred to as "Onboarding") is an increasingly critical aspect of the governance process given the potentially steep learning curve new health care system board members must confront. It may also be a very important component of pre-closing boardmember training for "to-be-merged" hospitals and systems. The NACD guidance is focused on ensuring that new board members are quickly integrated into the activity of the board. Among the leading recommendations of the NACD are (a) to begin the "Onboarding" activity during the recruitment process; (b) "Onboarding" is likely to require much more time in the current environment than in the past, for obvious reasons associated with the complexity of corporate operations; (c) the CEO or his/her delegate should participate closely with the nominating and governance committee in "Onboarding" efforts; and (d) an effective "Onboarding" process will also address "soft" issues like organizational culture. Given the relationship between director effectiveness, liability

profile and the commitment to new director orientation, the general counsel may wish to emphasize a closer look at existing “Onboarding” practices.

## 5. EMPHASIS ON CEO SUCCESSION

Two separate publications released in May combine to emphasize the value of a focused, formal board CEO succession process. Both publications refer to recent surveys indicating that a significant majority of U.S. companies lack formal CEO succession plans (and, according to one of the surveys, only a third of those that do are satisfied with what they have in place). An article in [The Harvard Business Review](#) (“Why Boards Get C-Suite Succession So Wrong”) posits that greater involvement of board members (particularly those experienced in evaluating executive talent) in the vetting process is critical to effective succession practices. Similarly, a [McKinsey commentary published by NACD](#) recommends that succession planning should take the form of a multi-year structured process directly linked to leadership development; i.e., succession becomes a product of incentives designed to actively develop potential candidates. The McKinsey commentary also recommends preventing certain pre-existing biases (e.g., “more of me”, “sabotage” and “herding”) from “creeping into” the succession process, with the result of appointing a specific candidate. Given the critical importance of succession and emergency succession practices to organizational sustainability, the general counsel may appropriately encourage the board to assure the adoption of a formal strategy in this regard.

## 6. QUESTIONING MANAGEMENT

“Constructive skepticism” is a phrase, coined in the aftermath of the Enron era, which refers to that level of director engagement which is generally more active, assertive and independent with respect to management. While “constructive skepticism” is not intended to create a confrontational climate in the boardroom, leading **governance observers believe** it is necessary to prevent a culture of passivity to senior executive officers, in which those officers are not subject to meaningful oversight. Evidence of constructive skepticism can also serve as a significant prophylactic to allegations of director liability. The benefits—and challenges associated with—the exercise of constructive skepticism were explored in a [recent NACD article](#), which article identified the following traits of a “skeptical but amicable and objective” board approach: (a) set expectations for management in areas where it is reasonable to do so; (b) start discussions with a focus on areas of common ground; (c) be sensitive to changes in speech pattern and body language during difficult discussions; (d) refrain from structuring questions in the form of an accusation or a demand; (e) maintain composure during contentious discussions; and (e) avoid a posture of constant confrontation; “choose your battles” in terms of identifying those actions or recommendations of management that merit questioning.

## 7. ATTORNEY-CLIENT PRIVILEGE

Health system general counsel will want to “flag” for further review the pending decision of the D.C. Circuit Court of Appeals in the complex, and controversial FCA/whistleblower case, [In re Kellogg Brown & Root, Inc.](#) (oral arguments held on May 11, 2015). The appeal deals with the District Court’s decision that KBR waived its attorney client privilege for particular reports developed in the context of an internal investigation into possible kickback arrangements, because of certain litigation tactics it adopted (e.g., having a KBR inside counsel testify concerning the documents in the context of a deposition). A particular concern is that should the District Court’s ruling be upheld, corporate compliance activities such as internal investigations may be impeded due to concerns associated with whether evidence of potential misconduct identified in the context of such investigations would be privileged. The KBR case is a leading example of the increasing extent to which attorney-client privilege issues, particularly those involving the office of general counsel, are becoming controversial.

## 8. STRATEGIC PLANNING

The crucial nature of the strategic planning process continues to be a focus of intense public policy dialogue. In that regard, the board’s strategic planning committee should note the [recommendations generated from a recent meeting of the NACD Nominating and Governance Committee Chair Advisory Council](#). These recommendations addressed actions that can be taken by nominating and governance committee chairs to support efforts intended to generate greater board-level involvement in strategy development: (a) developing nominations with a view towards a board composition well equipped to question, where appropriate, management’s strategic assumptions; (b) considering new ways in which to engage with management on strategic issues (e.g., additional executive sessions and requesting the provision of different types of information to the board); (c) balancing the need for a collegial boardroom atmosphere with increasing exercise of constructive skepticism on strategic matters; and (d) revisiting the scope of existing committee structures and charters to provide for expanded strategic-related responsibilities.

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).

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