

*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. NONPROFIT/TAX EXEMPT CHALLENGES

Large health systems should monitor challenges to nonprofit corporate and tax exempt status that are emerging in other industries, and in Congress. The most prominent recent example is the [decision of the California Franchise Tax Board](#) to revoke the tax exempt status of Blue Shield of California. While the FTB did not publicly cite any reason for the revocation, media reports focused on allegations of excessive compensation, rate increases and very large financial reserves. Another recent example is the [House Oversight and Governmental Reform Committee's ongoing review](#) of professional sports teams organized as tax exempt entities. The Committee has requested information from the sports leagues with respect to their respective organization's IRC Sec. 501(c)(6) status; some of which focuses on the organization's tax liability were it not tax exempt. Also noteworthy is the possibility that [proposals to cap executive compensation](#) at tax exempt charities may soon surface in Congress. A common thread applied by opponents of the nonprofit, tax exempt status of targeted organizations is that their operations too closely mirror those of for-profit organizations. Boards should assume that similar issues may arise for large nonprofit health systems.

## 2. GOVERNANCE AND TECHNOLOGY

Boards in all industry sectors are facing increasing scrutiny concerning their ability to address matters of technology strategy and vulnerability. [Recent media reports](#) indicate a movement towards greater board/CIO interaction, whether through a new "technology" committee, or other means. [A new survey](#) reflects significant board dissatisfaction with the technology strategy data they receive. There is also an [increasing recruitment focus](#) on director candidates with demonstrable technology expertise, and who are aware of the broader trends in technology development and thus able to apply them to operations. It is important to recognize that for health system boards, the matter of effective "tech governance" transcends issues of performance metrics, PHI and data security, and includes the full array of technology-based business issues. The broader goal of a "technology committee" includes evaluating internal technology operations; monitoring emerging technologies, reviewing IT expenditures and staffing levels, and applying dashboards to help monitor health system specific technology performance metrics; among many other topics. It's just not limited to cybersecurity matters.

## 3. JUDICIAL OBSERVATIONS ON MINUTE TAKING

[In recent public comments](#), Chief Justice Leo G. Strine of the Delaware Supreme Court offered a number of valuable insights on the minute taking process that are certainly applicable to health systems. Among the Chief Justice's main comments were: (a) an incoherent approach to minute taking can create opportunities for mischief by regulators and third parties; (b) shifting from a "short form" to a "long form" minute taking approach for purposes of review and approval of a specific transaction should be accompanied by a statement on why the change is being made; (c) there is a difference between attributing statements or concerns to particular directors [which some counsel understandably oppose] and capturing the full range of factors the board considered in its deliberations [typically preferred]; and (d) documenting the range of factors the board considered may still result in directors having somewhat different recollections of what was the most important factor of those discussed in the meeting, but it will serve to provide a more reliable memory aid that can reduce the risk of subsequent material disputes as to what the board did, and why. The general counsel may wish to share these observations with the CEO and Board Chair.

## 4. BOARD/CFO INTERACTION

A recent [article in The Wall Street Journal](#) discusses how governing boards are playing a more direct role in the process by which the CFO is selected—and removed. This increased emphasis is a direct consequence of both (a) the post Sarbanes/Dodd-Frank environment and the value attributed to retaining competent and ethical financial officers; and (b) heightened expectations of board oversight of financial affairs. In addition, directors are increasingly aware of the complexity associated with the CFO position due to changes in regulation, compliance and technology. This new role is also consistent with the broader governance

trend whereby boards are increasingly involved in matters of executive talent development. This involvement includes greater board attention to CEO and executive leadership succession planning; providing the board with greater exposure to the non-CEO members of the executive leadership team (and their respective credentials); and structuring the compensation committee agenda to include the recruitment, retention and development of executive talent, beyond that of the CEO.

## 5. LESSONS FROM INVESTOR VOTING GUIDELINES

There may be value for health system governance committees to periodically consider the perspectives of shareholder groups and (perhaps more specifically, asset managers) as they relate to director performance at companies within their investment portfolio. Despite the basic differences between the roles and relationships of for-profit and nonprofit governance, some performance and effectiveness themes are constant. For example, the asset management firm **BlackRock's new voting guidelines** identify a number of performance and re-election factors that are notably relevant to large nonprofit health systems. These include director skills necessary to effectively oversee management; the process for identifying qualified director candidates; circumstances of excessive director tenure/entrenchment; insufficient attention to matters of board diversity in terms of gender, race, age and experience; poor short term attendance records; significant corporate bylaw changes; the failure to promote adequate board succession planning; and the board evaluation process and its significant outcomes. The health system general counsel can be particularly helpful in identifying investor group perspectives particularly relevant to the governance of sophisticated nonprofit health systems.

## 6. LATEST SURVEYS ON AREAS OF DIRECTOR FOCUS

Recent surveys generated by **Corporate Board Member** magazine, and jointly by **NYSE Governance Surveys and Spencer Stuart**, provide insight on leading trends that are occupying the interest of corporate directors across industry sectors. Both surveys identify topics such as risk management/risk appetite/board oversight of risk; cybersecurity, strategic plan effectiveness, application of social media and board tenure. Other health system-relevant topics referenced by at least one of the surveys include the emergence of new board committees (e.g., strategy, risk, environment, technology, innovation and social responsibility); the growth of advisory boards; greater focus on executive succession; review of the effectiveness of capital spending and—particularly interesting—matters of director ineffectiveness. The NYSE/Spencer Stuart survey also endorsed the (increasingly widely held) perspective of the general counsel as a valued legal AND strategic partner to the board and the management team. These surveys can provide a useful reference point on the items that might be included in a health system board's strategic agenda.

## 7. THE ROLE OF THE ATTORNEY GENERAL

A **recent feature article** in *The Washington Post* ("State Attorney Generals Are More and More Powerful. Is That A Problem?") provides an excellent opportunity to more fully inform the senior leadership and the board on the role, function and authority of the state attorney general. This is particularly important given the broad jurisdiction invested in the attorney general to regulate nonprofit corporations, enforce provisions of state nonprofit corporate and charitable trust laws, and address alleged breaches of fiduciary duty by nonprofit directors. In addition, the attorney general's authority to protect consumer interests may have a direct (and potentially sweeping) application to health care providers (e.g., patient health information breaches). These broad powers, and the similarly broad scope of enforcement mechanisms available to the attorney general, are a principal legal feasibility consideration in many major health system transactions. The corporate compliance programs of such systems should similarly be geared in part to the public policy concerns and enforcement interests of the attorney general. Of special interest to health systems operating in multiple states is what the *Post's* author describes as "the increasing, and increasingly national, political activism of state attorneys general" (and the willingness of "like minded" attorneys general to work together on matters).

## 8. THE BOARD AND POST-MERGER INTEGRATION

An **important new report** issued by Deloitte concludes that the success of many mergers and acquisitions is dependent upon the quality of an effective post-closing integration strategy. This is particularly noteworthy given the significant level of M&A activity involving health systems. According to the survey, effective "pre-emptive" (i.e., pre-closing) steps include planning for a swift, phased integration; a rigorous process to select an integration planning team; a clear, shared understanding of the goals expected from the merger; the involvement of senior leadership from both merging parties in integration planning; assuring that the integration plan optimizes resources, budget and timing factors; and developing a transparent and consistent post-closing employee communication plan. Health system boards are typically sensitive to their oversight obligations with respect to M&A planning and the negotiation process. This new survey can help alert directors to their equally important obligations with respect to assuring an effective post-closing merger implementation plan that is consistent with antitrust guidelines.

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