

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. STRATEGIC DEVELOPMENTS

Several new reimbursement and quality of care developments may merit the attention of key board committees. For example, the finance and strategic planning committees may wish to note the **January 26 announcement by HHS Secretary Burwell** that Medicare would substantially revise its fee-for-service program. Secretary Burwell's plan would shift half of program spending not allocated to managed care (approximately \$362 billion) into accountable care, bundled payments and other arrangements that offer rewards (or penalties) tied to quality performance and cost control. Separately, the board's Quality Committee should be made aware of the **January 30 submission by the National Quality Forum** of 190 performance measures for HHS consideration. Both Quality and Compliance committees may benefit from a briefing on the Quality and Safety provisions of **OIG's 2015 Work Plan**.

2. DIRECTOR AND OFFICER LIABILITY

The **U.S. Court of Appeals has upheld** a jury verdict of approximately \$2.3 million in compensatory damages against the officers and directors of a nonprofit home for the aged, for breach of fiduciary duty and contribution to deepening insolvency. The breach of duty award was based on the board's failure to remove the home's executives following evidence of incompetent management. In addition, the board's decision to conceal the closing of the home for a period of time, and its failure to follow the advice of bankruptcy counsel, were determined to have contributed to the deepening insolvency of the home. The Court overturned a prior award of punitive damages against individual officers and directors. The Court's analysis provides useful baseline references to board conduct that may violate the duty of care; may trigger a punitive damages award, and may contribute to the "deepening insolvency of the organization".

3. INDIVIDUAL ACCOUNTABILITY AND CORPORATE COOPERATION

Senior Department of Justice officials continue to emphasize in public comments the Department's focus on individual accountability, corporate cooperation and self-disclosure. There is a consistent theme in these public comments that the government is willing to pursue the prosecution of corporate executives when the facts indicate the executives are responsible for corporate fraud. In addition, the DOJ officials have stressed that an important element of true corporate cooperation is efforts by the corporation to identify the individuals criminally responsible for the misconduct. Conversely, DOJ does not view voluntary disclosure as true "cooperation" if the corporation avoids identifying the responsible individuals. The audit committee should be briefed on the government's focus on accountability and cooperation. Board leadership may have particular interest in the DOJ's focus on corporate cooperation and its potential impact on executive suite culture.

Click [HERE](#) for Michael's recent article summarizing board-noteworthy DOJ criminal enforcement trends.

4. BOARD COMPOSITION

The Nominating and Governance Committee should review the new publication from the **National Association of Corporate Directors, "Board Composition"**, that evaluates trends in board composition and evaluation. Among NACD's key findings were that: (a) nearly two-thirds of surveyed boards had replaced at least one director in the last two years; (b) the typical board horizon for director recruitment was one to three years; (c) the vast majority of boards conduct both full-board and committee level evaluations; and (d) for a majority of surveyed corporations, committee composition changes "every few years". In addition, the matter of specialized skills and competencies (e.g., financial, industry-specific) continues to be a prominent factor in the nomination process. The publication also recommends the evaluation of board tenure-limiting policies to assure effectiveness.

5. GENDER DIVERSITY

There continues to be broad based emphasis on increasing the number of women serving on corporate boards. The most recent statements supporting this increase come from such diverse groups as the **International Labor Organization, Lehigh**

and [Syracuse Universities](#) and the [nonprofit research group Catalyst](#). While the data suggests that there is a general increase in the number of women directors, there remains substantial public/policy pressure for increased participation. *Material* gender diversity should be embraced by the health system board's nominating and governance committee. Boards that fail to do so may soon likely be considered as "outliers".

6. GRASSLEY'S BACK!

[Recent public comments by Senator Charles E. Grassley](#) (R-Iowa) speak to the importance of assuring compliance by the health system with IRC Sec. 501(r) tax exemption requirements. Senator Grassley recently presented by letter a Midwestern nonprofit health system with eight specific 501(r)-related compliance questions, following public reports by NPR and other media outlets on the health system's billing and collection practices. The Senator's written inquiry, closely following the release of final Sec. 501(r) regulations, may offer some guidance on the types of practices that may attract IRS enforcement scrutiny. As such, the letter offers a template for board/audit committee oversight of the organization's compliance with the new regulations.

[Click HERE](#) for MWE's Analysis of the Recent, Final Sec. 501(r) Regulations.

7. IRS "EO" OVERSIGHT

A recently released [GAO report on the IRS Exempt Organizations Division](#) commented on a variety of matters impacting the Division's oversight of the tax-exempt sector. For example, as the overall IRS budget has declined, so has the number of FTEs in the EO Division—leading to a notable decrease in the number of examinations. In addition, the GAO observed that Division lacks quantitative measures of compliance for hospitals (among other industry sectors) and for certain aspects of non-compliance (e.g., private inurement and political activity). These and other factors (according to the GAO) restrict the Division's ability to set goals to increase compliance. The GAO Report notwithstanding, compliance with the exempt organization tax laws remains a critically important legal responsibility of the organization. Representations with respect to such compliance continue to be requested in major transactions and venture agreements. The health system general counsel's challenge is to continue to promote organizational EO tax compliance despite a lack of overt examples of IRS enforcement activity in the hospitals and health system sector.

8. WHO IS THE GC'S CLIENT?

A [new state court decision](#) brings into sharp focus the question of who—or what—is the general counsel's client, particularly in the case of a legal proceeding or investigation that requires interaction with officers and directors. The decision arose in the midst of an ongoing criminal investigation against several executives of a prominent educational organization. The general counsel had appeared on behalf of the institution and the executives in the grand jury proceeding. The executives were subsequently charged with perjury in connection with their grand jury testimony. They brought a separate action to quash the grand jury presentment on the grounds that they had been denied the right to effective and conflicts-free counsel (*i.e.*, their perception that the general counsel was representing them individually). The court denied the requested relief, concluding that the evidence failed to establish that the general counsel represented them individually and that the general counsel was unaware of facts that would have created a conflict (e.g., the executives' potential exposure to perjury charges).

See the February 6, 2015 edition of [AHLA Weekly](#) for an article Michael co-authored, analyzing this case.

9. CHARITABLE/TAX EXEMPT STATUS

Two recent developments combine to attract board attention to the increasing importance of maintaining clear mission focus for the health care system—especially as it expands in scope and sophistication. These include [prominent state court litigation](#) challenging the property tax status of a large nonprofit health system's flagship hospital, and a [legislative proposal of the Maine governor](#) to require large nonprofits (including hospitals) to pay property taxes. As greater focus is placed by state and federal legislators and regulators on the charitable, tax exempt status of nonprofit health systems, it will be increasingly important for leadership to clarify (through both the strategic plan and in the rationale for individual major decisions) how the system differs in focus and purpose from comparable, for-profit, proprietary systems.

[Click HERE](#) for Michael's new article, "[Business Judgment and the Health System Board](#)", published in the January 2015 edition of AHLA's [Connections](#).

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.