

*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 PLANNING

A **new report** published by the National Association of Corporate Directors (“NACD”) underscores the significant importance attributed to the board’s role in the development of the company’s strategic vision. The NACD report makes a number of progressive recommendations with respect to board involvement in strategy development, with an emphasis on the expectation of greater accountability by the board with respect to the strategic planning process. The NACD recommendations are particularly important given the often-sensitive distinctions between the roles of executive management, outside consultants and the board in the preparation, implementation and monitoring of strategic plans and related initiatives. In particular, the NACD calls on boards to recognize that board engagement on strategy must be continuous, not episodic (e.g., not just every few years). Issues related to strategy should make frequent appearances on the board meeting agenda. The general counsel may wish to share the NACD report with board and executive leadership and facilitate a discussion regarding the relevance of its recommendations.

## 2. EXECUTIVE SUCCESSION PRACTICES

Two developments in the for-profit sector provide prominent reference points for the executive succession practices of nonprofit health systems. **One development** was the exceedingly swift process by which the French oil company Total SA replaced its chairman/chief executive officer, who had tragically died in an aircraft accident. Two days after the accident, a board meeting was held in which a new chairman and a new chief executive officer were appointed. Total’s action underscores the fundamental value of a board level emergency succession protocol. The **second** development was a report in [The Wall Street Journal](#) addressing the growing corporate practice of implementing long term succession plans for the chief financial officer position. The [Journal](#) described this practice as reflecting the increasing complexity associated with the CFO position, a greater interest by the board in executive succession matters, and the value of reassuring corporate constituencies during an executive transition process.

## 3. RETIRED CEO CONSULTING ARRANGEMENTS

Many nonprofit health systems enter into valid and appropriate consulting agreements with former senior executives to retain the benefit of their expertise for a period of time following their retirement or similar separation from the system. These arrangements must be carefully structured as they can, in certain circumstances, lead to controversy and regulatory scrutiny. For example, **recent media reports** focus on the decision by a former hospital CEO to repay over \$800,000 in compensation received from the hospital under a post-retirement consulting arrangement. A dispute had arisen with respect to the reasonableness of the compensation given the nature of the services, and that payments received by the former executive had been reported as excess benefit transactions on the hospital’s Form 990 for three consecutive years. This development confirms the importance of general counsel participation in structuring such consulting arrangements to assure their propriety from legal, tax and reputational perspectives.

## 4. GC/CCO RELATIONSHIP

The general counsel may wish to discuss with the compliance committee and the chief compliance officer **recent public comments** from a senior Department of Justice official concerning compliance officer independence (*i.e.*, where the CCO is a separate position, and does not report to the general counsel). According to this official, while independence/separation from the GC is preferred by the government, it is not a proscribed arrangement. Rather, the DOJ’s focus is on whether the compliance program is well designed, applied in good faith and works effectively. A CCO-to-general counsel reporting relationship may indeed be acceptable where the CCO has “futility bypass” options in the event of conflict; e.g., a direct line of communication to the board, or to the audit/compliance committee. **Clearly**, issues relating to compliance officer independence remain controversial and subject to differing interpretations. Yet, the DOJ’s perspective may be informative as the board, its committees, the GC and the CCO all work collaboratively to assure effective coordination on compliance and other risk management matters, and reporting to the board.

## 5. CEO-BOARD COMMUNICATION

The vital importance attributed to effective CEO-to-board communication is evidenced by the **recent decision** by a large international pharmaceutical company to fire its CEO for failure to keep the board informed. A principal contributing factor was the board's perception that it was not advised in advance of a major strategic corporate decision. This development underscores the fiduciary pressures on the board to exercise informed oversight and decision-making. It also suggests the risks to the board-CEO dynamic when the board's expectations concerning communications are not met; *i.e.*, when the CEO displays an uncommunicative management style. From a governance perspective, knowledge is a critical prerequisite for directors to satisfy their oversight and decision-making functions. This development may thus provide an opportunity for the board to confirm with management the timing and content of information flow, as well as the "lines of authority" between the CEO and the board.

## 6. OVERSIGHT OF SUSTAINABILITY

The general counsel may wish to alert the board to the emergence of "sustainability oversight" as a board responsibility. According to a **new National Association of Corporate Directors handbook**, the concept of "sustainability" includes not only environmental concerns, but other issues relating to "the company's social license to operate" (*e.g.*, social, demographic, climate, population growth). NACD's perspective is that the link between environmental and social issues to core business operations and [especially] reputational concerns are becoming increasingly material. Thus, while these issues may not present immediate risks to the health system, "sustainability" is likely to increase as a governance concern – and may be worthy of a boardroom briefing at some point.

## 7. DIRECTOR CYBERSECURITY LIABILITY

A **new federal decision** may provide comfort to directors uncertain as to potential liability exposure for cyber breaches. Applying business judgment rule principles, the district court dismissed with prejudice a shareholder derivative action alleging that Wyndham Worldwide's officers and directors breached their duties by failing to prevent and react to a series of data breaches. The district court determined that after the breaches occurred, the board took a series of responsive actions, *e.g.*, multiple board meetings (including the audit committee) on Cybersecurity matters, engaging an outside technology company to investigate the breaches and adopting the company's recommendations.

## 8. SINGLE BIDDER SALE STRATEGY

A **recent Illinois decision** is the latest in a series of cases applying business judgment rule protection to a board's decision to negotiate a sale with a single bidder—rather than through an auction or other broad-based sale process. This body of caselaw serves to protect disinterested boards when they determine on an appropriate record, and with thoughtful advice, that a discrete negotiation process served value maximization goals. Key to the court's ruling was a record reflecting reliance on qualified financial advisors, negotiation of a premium price and shareholder approval of the sale. Less clear are the circumstances by which a nonprofit organization can appropriately pursue a single bidder strategy in a proposed disposition, particularly given the absence of a "market factor" (*i.e.*, shareholder approval), and the presence of state approval protocols.

## 9. OVERSIGHT OF COMMITTEES

Two recent developments in the public company sector portend greater external auditor review of key board committees, to a degree that may ultimately prove relevant to large nonprofit health systems. The **first development** is the recommendation of the "Investor Advisory Group" of the Public Company Accounting Oversight Board that a company's external auditors review the effectiveness of board's audit committee. The rationale is that closer review of the committee's practices—including the transparency of its work and its evaluation of the auditor's work—could enhance the effectiveness of the audit committee and provide greater comfort to investors and other constituents. The **second development** is the SEC's approval of an auditing standard adopted by the PCAOB that requires increased auditor scrutiny of executive compensation arrangements. Auditing Standard No. 18, Related Parties, strengthens auditor performance requirements in related party transactions, significant unusual transactions and a company's financial relationships with its executive officers. While neither of these new developments are directly applicable, their underlying principles are readily relevant to the audit, executive compensation and compliance practices of boards of large nonprofit health systems. The implications of the new developments may thus be worthy of board discussion.

**NOTE: Michael Peregrine's October 6, 2014 presentation (slide deck) to the National Association of Attorneys General/National Association of State Charity Officials can be accessed [HERE](#).**

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