



The “Appearance” of Conflict: New Challenges for Board Review

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We’ve all heard the old refrain: “If something looks bad, it probably is.” Often times, it’s probably true. But in the context of director conflicts of interest, it’s not always that simple.

The rapid growth of health systems; the equally rapid diversification of their business and investment portfolios, and the expanding diversity of background in board membership increasingly complicate the conflict-of-interest review process.¹ And, as the political headlines regularly remind us, there is much uncertainty on how to address relationships that constitute an actual conflict of interest, as well as those that create only the appearance of a conflict. All of this combines to make the job of the board’s governance committee much harder.

The question is whether most hospital and health system conflict-of-interest policies are sufficient to address these challenges. The traditional approach is to focus on business, financial, investment, and employment relationships involving officers and directors. Some organizations expand the scope of review to include family and intimate social relationships, and certain kinds of non-financial business relationships such as board or similar positions with competitors. Others apply rigorous attention to the disclosure process.

Regardless, the ultimate inquiry under this approach is whether an actual conflict exists between the interests of the individual, and the interests of the organization. Only if the governance committee concludes in the affirmative is a corrective response or management plan triggered.

Yet that approach leaves unresolved the organizational impact of relationships and arrangements that create the appearance, rather than the actuality, of conflict. The recent presidential campaign

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What are we talking about? Examples might fall into at least three distinct categories. The first category involves arrangements that are approved in a manner consistent with board conflicts review protocol and/or state rebuttable presumption processes. This might include a business arrangement between the health system and the relative of a senior executive, where the relative was the low bidder. That the arrangement was approved in strict accordance with board process offers little



comfort when it was widely (and critically) reported in local and national media.

The second category involves the seemingly benign use of relationships to achieve indirect, non-financial benefit. This might include a director asking the organization’s CFO for assistance in procuring an unpaid summer internship from a corporate vendor for the director’s son. It might also include a director arranging an introduction of a personal business contact to the system CEO when the contact had just made a significant contribution to the system’s charitable foundation.

A third category involves the proverbial “wrong place, wrong time, wrong persons” scenario. One example might be social interaction between a director and an actual or potential health system vendor, especially during an RFP-type process. Another example might be the public association (e.g., a meeting, endorsement, contribution) between a director and a political organization or public figure known to be in a position to affect the interests of the health system and its mission.

None of these, and other, similar, circumstances present an actual conflict of interest as defined by the traditional conflicts review processes. None involves direct, personal, substantial pecuniary interest to the director. Yet each one presents a sense of discomfort with the propriety of the

1 See, e.g., Andrea Fuller and Melanie Evans, “Dilemma for Nonprofit Hospitals”, *The Wall Street Journal*, August 22, 2016.

circumstances; a discomfort that can serve to undermine the credibility of the health system's commitment to ethical business and governance practices. And the source of that discomfort may be something that prompts the curiosity of a state or federal charities official.

There is no "easy fix" to these situations. They involve matters of judgment, perspective, and principle; indeed, the first category of examples is essentially condoned by state law. Yet each category involves circumstances that may make the health system "look bad" when exposed to public view. But to subject directors to uncompromising discipline for arrangements that create the appearance of conflict injects an infeasible level of uncertainty to the conflicts review process. It would certainly make board service less attractive.

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Perhaps the better approach is to clarify matters "upfront." Make it clear in the onboarding process that a director's duty is to avoid circumstances that can create both a conflict of interest and the appearance of conflict as well. Disclosure of such appearances (as known to the director)

would be required, and the conflicts review committee could evaluate the possible remediation of the "appearance situation" on a case by case basis. Director removal would be limited to situations determined by the committee to have arisen in conscious disregard for the interests of the health system.

Such an approach is imperfect. Asking directors to disclose circumstances that may be perceived to create an appearance of conflict may be impractical without context. Unless presented properly, it can almost be requesting an admission against interest. The approach must be presented with a series of understandable examples of appearance of conflict, to provide a useful frame of reference. Directors may consult, in a confidential manner, the general counsel with particular questions.

The ultimate concern is not what, upon considering the circumstances, a "reasonable person" might believe about the director's *impartiality*, but rather whether that a "reasonable person" might *question* the director's *partiality*.²

This approach is grounded in fiduciary principles. The reputation of the corporation is increasingly recognized as an enterprise asset that directors are obligated to protect and preserve as part of their loyalty



and care duties. The obligation to avoid circumstances that create the appearance of conflict (and risk to the corporate reputation) is consistent with those duties.

It may thus be a productive exercise for the health system to leverage the echoes of the recent political campaign (and the related transition) into a discussion on how best to address circumstances that trigger the "appearance of conflict" on the part of a director. For it may be that heightened sensitivity to "appearance" concerns will become a loyalty-based precondition for board service.

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² See Monroe H. Freedman and Abbe Smith, *Understanding Lawyers' Ethics*, (252 Lexus-Nexus 2010).