

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. JOINT VENTURES AND CONSTITUENT DIRECTORS

The role of “constituent directors” of joint ventures (e.g., directors appointed by venture owners) continues to attract the **attention of legal commentators (i, ii, iii)**, particularly with respect to the **potential for conflict of interest and confidentiality concerns** arising from their “dual duties” e.g., to the venture and to the investor/employer. This is a particularly important concern in the health care industry given the proliferation of joint venture investments made by health systems, and the business and operational issues arising as these ventures mature. The need of the constituent director to balance its duties between the venture and the investor/sponsor can prove intensely frustrating to the health system that appointed the director—particularly when the director is a management level employee of the system. The health system general counsel may wish to consider the value of amending existing venture agreements to incorporate policies and procedures intended to anticipate and address such potential conflicts.

2. GOVERNANCE LESSONS FROM THE UNC SCANDAL

The recent academic/athletic scandal at the University of North Carolina has broad-based governance relevance. The scandal involved the perpetuation of a “paper class” program that served to elevate student grades, and proliferated for over 19 years without full university awareness or response. Health care general counsel may find the **investigative report** on the scandal illustrative on several points: First, on how a major organizational controversy can arise from totally unexpected sources (e.g., from a student advisor, program chair and a university ethics counselor). Second, how cultural and behavioral proclivities can unintentionally perpetuate a scandal (e.g., the lack of any personal and financial motivation on behalf of those who perpetuated the paper class program; the historical unwillingness of university leadership to interfere in academic matters.) The **report’s lessons** on human nature, institutional loyalty, lax oversight, “willful blindness” and employee ethical consciousness have particular application to health system compliance programs and risk management efforts.

3. INTERSECTION OF CRIMINAL ENFORCEMENT AND FIDUCIARY DUTIES

The ability of health system directors to exercise effective judgment and oversight will be aided by an awareness of emerging white collar enforcement trends of the federal government. These trends are primarily reflected in a notable **series of speeches (i, ii, iii, iv)** and other public comments made this fall by senior officials of DOJ’s Criminal and Antitrust Divisions, as well as Attorney General Holder. The trends speak to such critical issues as corporate cooperation with the government, the application of compliance programs to growing corporations, practical elements of an effective compliance program, the continued importance of “tone at the top” and an interest in holding decision makers responsible for corporate malfeasance. Viewed as a whole, they reflect a serious federal commitment to enforcement of criminal laws as may be applied to corporations and their leadership. As such, these trends may help to inform boards with respect to transactional planning, risk evaluation and compliance oversight, among other critical matters. The general counsel is well suited to brief board members on these trends.

4. PROFESSIONAL RESPONSIBILITY

An important **new essay from Harvard Law School’s Center on the Legal Profession** comments on the key roles and responsibilities of lawyers, as both professionals and as citizens. Its authors include a former general counsel of a global corporation, a former managing partner of an international law firm, and a professor of the legal profession at a major law school. The essay seeks to define, and give content to, four ethical responsibilities the authors believe are critical to lawyers in their core roles as “expert technicians, wise counselors and effective leaders”—responsibilities owed to their clients and stakeholders; to the legal system as a whole; to their institutions; and to society at large. These responsibilities are examined through the lens of corporate law departments, law firms and law schools. As such, the essay is a valuable resource to health system general counsel on their technical roles and how those roles intersect with their professional duties. The themes of the

essay are particularly relevant given the need for senior management and the board to be sensitive to the professional responsibilities of their legal advisors, and the increasing efforts by the compliance officer industry to encroach on the traditional roles of corporate counsel.

5. EXECUTIVE SUCCESSION

An important fiduciary responsibility of the board is to adopt viable chief executive succession plans, to deal with both normal transition and with emergency situations. A notable [new essay prepared by the Rock Center for Corporate Governance](#) at Stanford University comments on how succession plans have moved away from the practice where the current CEO plays the dominant role in succession selection. Despite the CEO's detailed knowledge of needed leadership skills, the Stanford survey identifies several arguments against having the board delegate the selection decision to the CEO. Principal among them is the potential bias the CEO may exhibit in the selection process; either advocating for a favored candidate or opposing a disfavored candidate. Rather, the survey suggests a selection process that balances heavy board involvement in succession planning with meaningful input from the current CEO in the selection process. The general counsel is well-suited to advise the board on the fiduciary responsibilities associated with its succession planning responsibilities. The SVP-Human Resources should not be the sole or primary staff-to-board advisor on succession.

6. THE BOARD AND FINANCIAL REPORTING FRAUD

The health system general counsel may wish to inform the audit committee of the new report, "[The Fraud-Resistance Organization \(i, ii\)](#)", prepared by the "Anti-Fraud Collaboration" (the membership of which includes several leading financial, auditing and governance organizations). The report does not suggest that any organization can fully protect itself against financial reporting fraud—but rather, that it can materially reduce such threats through several steps—including greater engagement by the board as a whole and by the audit committee. Notably, the report identifies those board and audit committee traits that it believes are particularly supportive of the detection of fraud. These include the exercise of constructive skepticism, a thorough knowledge of the company they serve, and an understanding of the roles that factors such as pressure, opportunity and rationalization can play in the context of financial reporting fraud. More specific recommendations are offered with respect to audit committee oversight practices (e.g., greater ability to monitor the risk of management override of internal controls).

7. STATE CHARITY OVERSIGHT

A useful demonstration of the authority of the state attorney general over nonprofit, charitable organizations is provided by the [Minnesota Attorney General's recent compliance review](#) of the disclosure and related practices of a for profit thrift store chain that works with established charities to collect used items for resale. Among the principal concerns of the Attorney General was the accuracy of receipts provided by the for profit company to individuals (for tax reporting purposes), when they donate items to the company in the name of a particular charity. The Attorney General argued that the receipt process used by the company did not accurately account for the value of individual gifts, because many of the items donated by individuals were combined with the contributions of other donors. The Attorney General's compliance report on the process is over 53 pages. This particular review should be a reminder of the value of requiring health system foundation, fund raising and charitable solicitation programs to be reviewed by the general counsel before being approved.

8. SUPPORT OF FOR-PROFIT RESEARCH

A recent [The New York Times](#) story highlights the issues that may be presented when a nonprofit healthcare organization provides financial support to the drug development programs of a for-profit company. The Times' story focused on a disease prevention charity which, for a period of 15 years, financially supported the efforts of a biotechnology company to develop drugs intended to combat the specific disease. The dollar amount of the commitment was reported at \$150 million. From that commitment, the charity has announced that it will receive over \$3.3 billion in return for selling the rights to the royalties to the drugs; a sum that dwarfs the charity's budget. The Times' story deals with issues associated with the advantages (e.g., accelerating drug development) and disadvantages (potential risk to the charity, and possible conflict of interest arising from the high cost of the drug treatment) associated with a charity making such an investment. As such, the article is worthy reading for the general counsel of health systems and disease charities with interest in the support, development and eventual commercialization of intellectual property and drugs.

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.

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