

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. APPEARANCE OF CONFLICT

A recent feature story in [The New York Times](#) analyzing governance of the nonprofit U.S. Tennis Association provides a useful example of how the “appearance of conflict” can lead to negative media coverage and organizational challenges. The focus of the feature was on the various business and financial dealings of certain USTA board members, and the potential conflicts they allegedly created. Among the identified dealings were business transactions between board members (and their companies) and USTA, and a series of grants provided by USTA to various tennis-associated organizations with connections to USTA board members. The feature included a half-page illustration purporting to illustrate the various interwoven relationships between USTA leadership and outside organizations. (A similar approach was used in an article last year about the [Clinton Foundation](#).) Regardless of the accuracy of the feature, it provides a powerful example of the reputational and other risks assumed by a nonprofit organization when officers and directors are *perceived* as conducting business transactions that present conflict of interest issues. It may also serve as an incentive for more vigorous internal conflicts protocols and disclosure questionnaires.

2. BENEFITS OF SMALLER BOARDS

A recent article in [The Wall Street Journal](#) reports on a new survey concluding that companies with smaller governing boards tend to outperform their peers. Among the cited benefits were quicker decision making and more effective supervision of management. For example, the survey concluded that among companies with a high market capitalization, those with the smallest boards (e.g., 8-10) typically produced better shareholder returns. Proper board size is a vexing challenge for large health systems, particularly given the use of board seats as “currency” in affiliation transactions and the interest in having board representation from key constituencies. Clearly, large (e.g., above 30 members) boards can present particular governance challenges. This is especially the case when the large size prompts the board to govern by executive committee. Yet, the benefits of a small board must be balanced against the need to assure that the board is large enough to adequately address the day-to-day responsibilities of governance—including informed decision-making and monitoring—and to include directors with needed competencies to assure effective oversight.

3. THE BUSINESS JUDGMENT RULE

Nonprofit health system boards place great reliance on the protections afforded by the Business Judgment Rule, and their general counsel are often called to advise on the application of the Rule to various board actions taken, or proposed to be taken. Thus, judicial decisions interpreting the Rule, such as a [recent ruling](#) by the [Georgia Supreme Court](#), can serve as useful guidance. The Georgia ruling (not involving a health care system) affirmed the common law doctrine that allegations of simple negligence against corporate officers and directors are foreclosed by the Rule when the issue is limited to “the wisdom of their judgment.” However, the Court declined to interpret the Rule as foreclosing *all* ordinary negligence allegations; i.e. held that officers and directors can be subject to allegations based on the *process* by which their decisions were based. While limited to Georgia law, this ruling is an important reminder of the Rule’s complexity, and its limitations with respect to particular actions of the board. It may provide the general counsel with additional support from which to enhance board decision-making processes.

4. EXPANDED FIDUCIARY DUTIES?

The question of whether directors of highly regulated companies should be held to [more stringent fiduciary duties](#) has been raised again, this time in the context of the banking industry. A recent speech by a [Federal Reserve Board Governor](#) raised the issue of whether the fiduciary duties owed by boards of financial firms should be increased, given the “systemic risks” in the banking and finance sector. The speech referenced an academic paper proposing that bank directors be held liable for losses attributed to breach of their risk management oversight duties. While the reaction to this proposal has been mostly negative, it

does serve as a reminder of the perspective in some regulatory and academic quarters, that societal interests in certain types of highly regulated companies (health care?) require higher oversight standards from their directors. This is especially the case as it relates to institutional risk-taking. It is also consistent with concerns expressed by some (particularly in the academic community) that the corporate and exempt organization tax laws are insufficient to effectively regulate the emerging “class” of very large, financially sophisticated and operationally diverse nonprofit organizations, such as health systems.

5. DIRECTOR COMPENSATION

Proposed Amendments to the Model Nonprofit Corporation Act could support efforts of nonprofit health system boards to approve their own director compensation plans. Existing Section 8.11 (“Compensation of Directors”) overrules the common law doctrine that prohibited directors from approving their own compensation. The proposed Amendments would help affirm—in a challenging policy environment—the board’s right to (i) set the compensation of directors for serving as directors, and the compensation of directors who serve as officers or in some other capacity; and (ii) pay reasonable compensation and reimburse directors for expenses. MCNA Sections 6.41 and 8.11 recognize that such compensation may be appropriate as a result of several factors, including the time and effort needed to serve as a director, the responsibilities undertaken by the director, and other relevant factors. This development may have favorable policy implications for health systems considering director compensation plans—particularly in states where the nonprofit code tracks the MNCA. A **related** development is the recent decision by a Florida judge to award \$24.6 million in compensation to the trustees of a charitable foundation, in recognition for their “exemplary job” in administering the trust.

6. CYBERSECURITY AND THE BOARD

The evidence continues to develop in favor of formalized board oversight of cybersecurity as a governance best practice. Among the most recent developments pointing to such a position is a new **Resolution by the American Bar Association** encouraging all private and public sector organizations to develop, implement and maintain an appropriate cybersecurity program. More directly applicable to health care systems are (i) the recent **FBI alert** that healthcare industry companies are being targeted by hackers; and (ii) the widely publicized **cyberattack on a large national proprietary hospital company**, that resulted in the theft of millions of patient records. These developments follow the recent publication of the **NACD “Director’s Handbook”** on cybersecurity oversight. In our August **article for the American Health Lawyers Association**, we propose some basic elements of a health care board’s cybersecurity oversight program.

7. GOVERNANCE RECOMMENDATIONS FROM HIGHER EDUCATION

The governance committees of nonprofit health system boards may wish to read the new report, “**Governance for a NEW ERA: A Blueprint for Higher Education Trustees**”. This controversial report was the byproduct of a summit convened by the American Council of Trustees and Alumni (“ACTA”) and was released in August. The report serves to challenge the perceived status quo that university trustees, as a practical matter, must “share” governance responsibilities with the faculty. It submits that the shared governance model is inadequate to address the array of challenges currently confronting colleges and universities, and recommends that boards of trustees be “reinvigorated” in order to be taken more seriously. The report makes a series of recommendations intended to clarify specific areas of trustee responsibility. These recommendations, and the report’s focus on the need for a new approach to governance structures, make it a provocative yet interesting read for board members of large nonprofit health systems.

8. BOARD OVERSIGHT OF COMPLIANCE

A series of recent public speeches and published articles by knowledgeable observers continue to address the important oversight role of the health care board as it relates to the system’s legal and compliance functions. These speeches and articles focus on the **continued enforcement initiatives** of the federal government in the health care sector, **the need for boards to become more engaged in compliance oversight** without “micromanaging” compliance activities, and the continuing conflict between the roles of the general counsel and compliance officer—particularly to the extent that it addresses the ability of the health care system to preserve the attorney-client privilege. **One such article** calls for a significant change in the respective roles of the chief compliance officer and the general counsel, towards a more formal peer-level arrangement. We discuss the board’s compliance oversight obligations as they relate to the GC/CCO relationship (and the risks inherent in aggressive expansion of the COO role) in recent articles for **BNA’s Health Law Reporter** and the **Harvard Law School Forum on Corporate Governance and Financial Regulation**.

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