

*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. FUNDRAISING ABUSES

The authority of the Attorney General to regulate fundraising activities by nonprofit organizations is well-demonstrated by the **June 30 settlement** between the New York Attorney General, a prominent veteran's charity and two of its direct mail vendors. The settlement requires the vendors to pay damages, forgive past due fees from the charity and reform certain of their respective business practices. It also requires the charity to end fundraising practices the state determined to be misleading, reorganize its board, appoint a committee to re-examine its business practices, terminate the direct mail vendors and discontinue certain national fundraising appeals, among other requirements. The breadth of the settlement, the extent to which it extends penalties to both the direct mail vendors and the charity (and its board), and the accountability it imposes on charity boards for their organization's fundraising efforts, are all notable to health systems with organized solicitation activities. The settlement is thus worthy of a discussion between the health system's general counsel and its fundraising leadership.

## 2. ATTORNEY GENERAL'S AUTHORITY

The state's authority to regulate nonprofit health care systems with respect to market share and insurance contracting practices has been demonstrated by the Massachusetts Attorney General's lengthy antitrust investigation of Partners HealthCare System. The investigation was reportedly prompted by the Attorney General's concern that Partners was forcing insurers to accept services provided at all of the Partners' facilities, and not just the particular component sought by insurers. Partners and the Attorney General entered into a **final agreement and settlement** on June 24, which included a series of stipulations concerning price increases and system expansion, among other matters. However, on the motion of competing hospitals and physicians, a **Superior Court judge** ruled on June 30 to hold the settlement agreement open for a public comment period until July 21, creating a degree of uncertainty with respect to the final resolution. This situation – and the "risks" of hospital mergers – was the focus of a **lead editorial** in the July 7 edition of The New York Times.

## 3. ROLE OF THE GENERAL COUNSEL

There continues to be substantial public attention paid to the role of the general counsel, and to the perspective that the general counsel of a sophisticated enterprise (such as a health system) has highly consequential responsibilities—which require a position of hierarchical importance within the organization. This comes in the form of **another new survey**—the third in recent months—and an **article in a prominent corporate governance publication**—both suggesting increasing commercial recognition of a broad legal/business portfolio for the general counsel. In addition, a **new article authored by a prominent corporate lawyer** argues persuasively for more direct involvement by the general counsel with the organization's corporate compliance program, in order to protect availability of the attorney-client privilege. This is an extremely controversial topic but one that serves as an important reminder of the board's obligation to assure clarity in the roles of the general counsel and the chief compliance officer.

**NOTE:** A copy of my presentation (with Anne M. Murphy) to the In House Counsel Program of the American Health Lawyers Association, on the subject of *The Indispensable Counsel*, can be accessed [here](#).

## 4. CORPORATE SEPARATENESS

Issues relating to "alter ego" treatment and maintaining the corporate separateness of subsidiary entities of a parent company are a continuing concern to health care systems. For that reason, system general counsel may want to note a recent, favorable **decision by the Pennsylvania Court of Common Pleas** in the context of a dispute over whether the University of Pennsylvania Medical Center owes payroll taxes to the City of Pittsburgh. In that matter, the City's complaint had asked the

Court to conclude that employees of UPMC's subsidiaries were, indeed, employees of UPMC for purposes of determining payroll tax liability. The Court dismissed the City's complaint, finding no basis for disregarding corporate formalities and the existence of UPMC's subsidiaries. Although this decision arose in the context of a local tax dispute, the decision offers some useful lessons on how to support corporate separateness arguments (particularly in connection with employment relationships) as they may relate to health system subsidiaries.

## 5. BOARD OVERSIGHT OF CYBERSECURITY

There is a continuous movement in corporate governance discourse concerning the need for a board-level committee with responsibility for oversight of cybersecurity-related matters. A recent feature [article in The Wall Street Journal](#) reported on how a series of high profile commercial data security breaches in 2014 has served to accelerate board efforts to improve the ability of governance—and the corporation—to protect against cyberthreats. This includes the recruitment of new directors with cybersecurity-related expertise. In addition, a recent major [speech by SEC Commissioner Luis Aguilar](#) emphasized the important role that board cybersecurity oversight plays in the organization's risk management profile. He also cited surveys indicating that many boards have yet to adopt basic oversight measures, e.g., reviewing annual budgets for privacy and information technology security, assigning internal responsibility for cyber preparedness, and requiring regular management reports on cybersecurity matters.

## 6. EMPLOYEE AS BOARD CHAIR

The New York legislature and the state Attorney General have recently agreed to [postpone the provision](#) of the new "Nonprofit Revitalization Act" that would have prohibited an employee of a nonprofit organization from serving as the organization's chair. The governance propriety of the "employee as chair" concept arises from time to time in the health care system sector, typically when either the chief executive officer, or a senior employed physician, is considered for the chair role. A primary governance issue often presented in such a situation is whether the nature of the particular employment relationship creates independence concerns at the board. The "employee as chair" concept also requires the board to more closely consider the specific roles and responsibilities of the board chair. Some nonprofit health systems have sought to address these and related governance concerns through the appointment of a separate, Sarbanes-like "Lead Independent Director", with powers traditionally associated with that position.

## 7. BOARD COMPOSITION

A recently released IRS [Private Letter Ruling](#) helps to illustrate the intersection between exempt organization tax law and nonprofit corporation law and governance, especially when it relates to board composition. The Ruling involved the plan of a tax exempt health care facility that is affiliated with a state university to restructure its governing board so that the health care facility's board would be identical to the university's board. The IRS analyzed the request in accordance with the 'community board' standards of Rev. Rul. 69-545 and concluded that the restructuring would not adversely affect the facility's Sec. 501(c)(3) status, because the university's board is a 'community board' by virtue of its representation of the state at large, and of certain geographic areas thereof. The Ruling is notable given the historical lack of guidance from the IRS on the definition of 'community board' outside of the most traditional settings. Note from a corporate governance perspective that, in certain jurisdictions, the use of overlapping boards between affiliated entities can create the potential for duality/conflict of interest.

## 8. THE BOARD'S M&A PROCESS

A recent [decision of the Delaware Court of Chancery](#) provides useful guidance on the basic steps a board must take in connection with evaluating a merger/acquisition offer in order to avoid a finding of "bad faith". The action arose from a breach of fiduciary duty claim asserted by shareholders of a company that sold its business without obtaining a fairness opinion. While noting that the board "did not conduct a perfect sales process", the Court found that bad faith did not exist where the board took a series of procedural steps relating to obtaining the best price for the shareholders, e.g., consulting with legal counsel; soliciting the informal advice of an investment banker on consideration; deciding not to obtain a fairness opinion due to the cost involved; and negotiating directly with the purchaser. While the case involved for-profit companies, the Court's ruling serves as a reminder to nonprofit health systems on the importance of even a minimal level of M&A evaluation procedures. The ruling also underscores the fact that the "fairness opinion", as a unique form of transactional advice, may not be necessary or required in all types M&A transactions (as opposed to some other, less expensive confirmation of FMV).

For additional information on any of the developments referenced above, please contact Michael at +1 312 984 6933 or at [mperegrine@mwe.com](mailto:mperegrine@mwe.com); or visit his publications library at [www.mwe.com/peregrinepubs](http://www.mwe.com/peregrinepubs).

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