

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. JVS AND DUALITIES OF INTEREST

Judicial decisions and **governance discourse** are increasingly focused on the dualities of interest that are almost certain to arise when health system representatives (e.g., management) are serving as board members of joint ventures in which the health system is a direct or indirect investor. This is particularly the case given the proliferation of health care joint ventures and the tendency to fill JV boards with representatives of the principal investors. An ever-present risk in those situations is that the “dual loyalty director” will learn information in the JV boardroom that will advance the JV’s interests, but that will also be helpful to the more widely diverse interests of the health system. While the “dual loyalty director” may believe that she owes loyalty to the health system (which placed her on the JV board), the traditional response of the law is that her sole duty is to the venture itself. The health system general counsel is well-suited to work with health system designees to JV boards to help them understand their fiduciary responsibilities, and related options, in those situations.

2. STATE AG ENFORCEMENT ACTION

A recent **complaint** filed by Massachusetts Attorney General Martha Coakley seeks repayment by the former president of Falmouth College of excessive compensation that he allegedly used to purchase luxury cars and vacation homes. The AG also **charged** that the former president gave himself a bonus for “superior performance”, and created false board meeting minutes to document the board’s alleged decision to provide him with that bonus. In a **separate court ruling**, the Attorney General reached agreement with the school’s current governing board on actions that a newly appointed board must achieve in order to forestall dissolution of the corporation. That agreement includes the specific allegations of the Attorney General concerning the board’s breach of its oversight duties with respect to the former president. It also includes an acknowledgement by the present board that there is evidence to support certain of the Attorney General’s breach of duty allegations (to which the board neither admits nor denies). The Falmouth College incident reflects the willingness of the state Attorney General to pursue enforcement actions against nonprofit corporations and their officers and directors for alleged breaches of duty related to lack of oversight and payment of excessive compensation.

3. STATE AG INVESTIGATION

Another notable state attorney general matter involves the **Pennsylvania investigation** of potential misapplication of funds by the nonprofit National Museum of Industrial History, in Bethlehem. The Attorney General’s investigation follows allegations made by a county grand jury that the nonprofit misspent approximately \$17 million in donations and grants over 17 years towards the development of a still-unopened facility. According to media reports, the grand jury found no criminal wrongdoing, but was critical of the museum’s board for what it called “almost blind confidence” in the former CEO of the nonprofit. (The organization is reportedly still several million dollars short of what is necessary to begin construction). This type of AG investigation is consistent with the broad authority of the state to protect charitable donations from waste and improper use, and to monitor the financial stewardship of nonprofit directors.

4. DIRECTOR NOMINATION PROCESS

A **new proposal** arising from the public company sector has interesting implications for the process by which nonprofit board members are nominated. Recently, the Council of Institutional Investors proposed that the Securities and Exchange Commission revise its disclosure requirements with respect to compensation arrangements for directors or director nominees in proxy contests. The focus of such proposed additional disclosure would be on the existence and terms of compensation arrangements between director nominees and the party that nominated the individual. This proposal could have merit in the nonprofit nomination process, as there would be value in disclosing the existence of an existing compensation or similar

financial relationship between a director nominee and the board member who nominated (or seconded the nomination of) the candidate—as well as with any other board member. Such a disclosure would be consistent with the questions presented in the Form 990, Part VI-A-2, focusing on whether any officer, director, trustee, or key employee has a family relationship or a business relationship with any other officer, director, trustee, or key employee.

5. CEO DIVORCE

Are some executive issues too personal, even for corporate governance purposes? Maybe not, according to an **important new survey on the board level implications of CEO divorce**, conducted by Stanford Professor David F. Larker. Professor Larker's survey is directed to the corporate governance of public companies, but his analysis of survey results offers a number of important issues worthy of nonprofit board-level consideration. For example, divorced CEOs (even those who are long-tenured) tend to leave the organization shortly after their divorce. Untimely resignations can indeed be prompted by divorce. In addition, the circumstances involving divorce can be highly distracting for the CEO and—potentially—for the corporation. Unexpected risks can be presented. Thus, it is conceivable that, depending upon the circumstances, there may be value in requiring the CEO (and perhaps other senior executives) to make disclosure to the board. Ultimately, as Professor Larker notes, “what goes on in the personal lives of executives can matter to the company”.

6. D&O COVERAGE

A valuable **new article** from NACD's “**Directorship**” publication identifies a number of potential issues which may serve to limit the scope of coverage available under traditional “Officers & Directors” insurance policies. These potential limiting topics include, but are not limited to, the following: the difference in being a “target” as opposed to a “subject” of a governmental investigation; the full extent of conduct or actions—or claims—that might fall within the “prior or pending” exclusion from coverage; interpretation risks of “exhaustion of underlying coverage” clauses; whether coverage begins with the filing—or service of—a civil complaint; a myriad of issues relating to the willingness of the insurer to accept the insured's choice of counsel and its rate structure; the insurer's use of billing guidelines not included in the actual terms of coverage; and the definition of “covered defense costs”. As such, the NACD article offers an important checklist of key D&O coverage issues for the general counsel to review with the board—and ultimately with the D&O carrier.

7. SUSTAINABILITY

Nonprofit health system governance should note the gradually increasing focus on board oversight of “sustainability” issues. According to a newly released report, **Board Oversight of Sustainability Issues**, prepared by the Sustainable Investments Institute, more than half of the S&P 500 companies provide some level of board oversight of sustainability concerns; e.g., issues relating to the environment, climate change, social issues, human rights, health & safety, diversity and political spending, among other similar concerns. For a third of the surveyed companies, the oversight is provided at the board level, while for the remainder, the oversight is assigned within the charter of a board level committee (e.g., audit committee). While the report suggests that healthcare is among the several industry groups most likely to have board oversight of sustainability concerns, it does not articulate any particular guidelines for the types of sustainability-related topics that should be addressed by a nonprofit health care system. For that reason, health system boards may choose to monitor the broader governance dialogue on this issue before taking specific action.

8. HE'S BAACK!

Senator Charles Grassley (R-Iowa) has **requested** that the IRS provide information on the status of a series of IRC Section 501(r) related requirements for tax exempt status adopted in conjunction with the Patient Protection and Affordable Care Act. Senator Grassley's particular concerns relate to what he perceives as the incomplete status of legal guidance required to be prepared by the government to implement the new 501(r) controls, and of the information collection necessary to generate the required annual reports to Congress regarding the extent to which nonprofit hospitals have implemented the 501(r) requirements. Sen. Grassley's letter shows that he continues to be a vigorous advocate of the IRC Sec. 501(r) reforms he originally championed, as a means of providing more oversight of nonprofit hospitals and the extent of their charitable activities. In a **separate development**, an IRS official indicated the agency's expectation that the final Section 501(r) regulations will be released by the end of 2014. The underlying message is that organizational compliance with the Section 501(r) final regulations will be an important oversight obligation of the health system board (and of its compliance committee).

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