

NONPROFIT CORPORATE GOVERNANCE IN THE HEALTHCARE WORLD

NEXT CHALLENGE. NEXT LEVEL.

NEXSEN | **PRUET**

SC BAR NONPROFIT CORPORATE UPDATE

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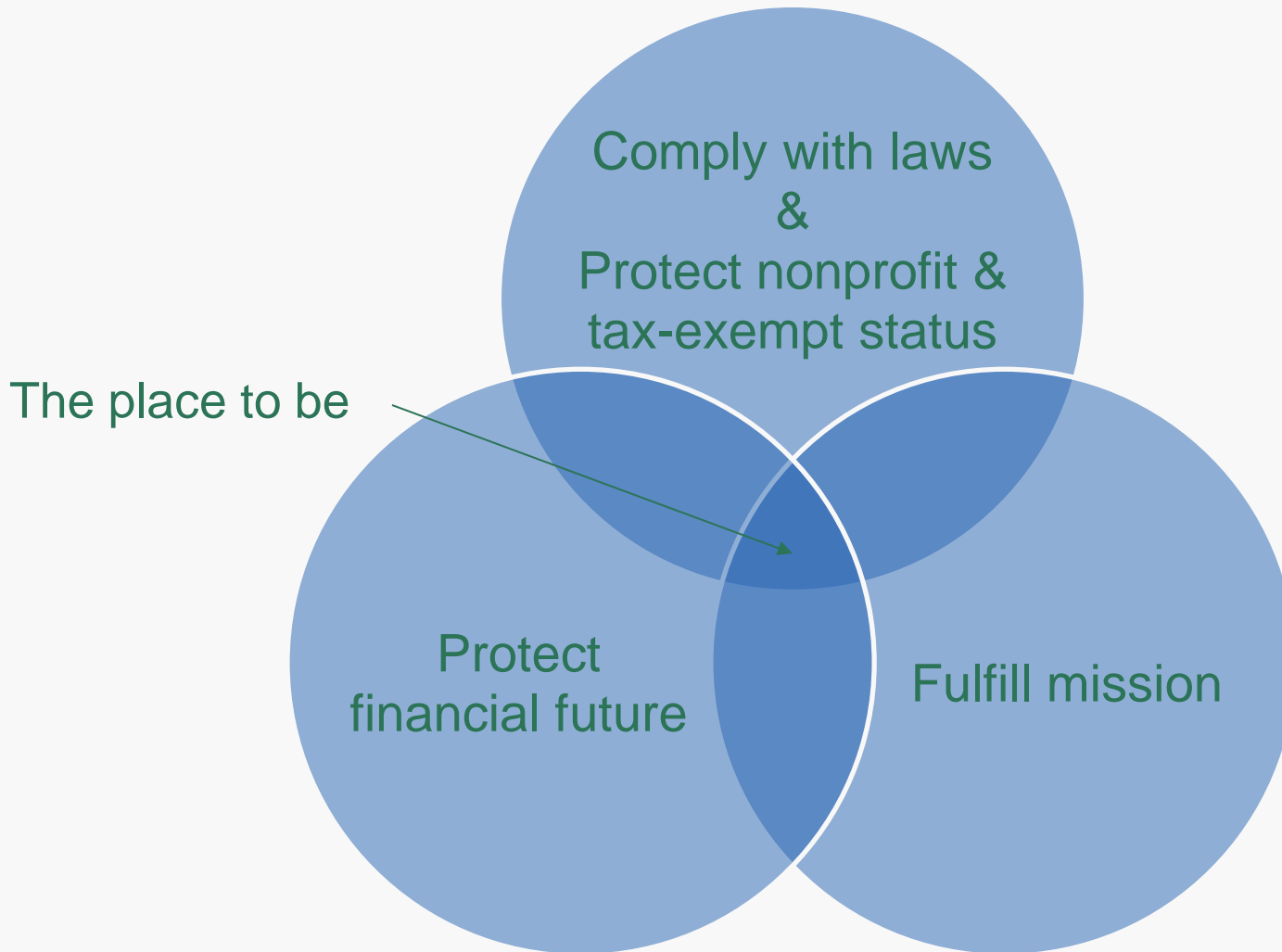
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Current Health Care Environment

- ▶ Health Care reform creating major change in industry
- ▶ More integration
- ▶ Increased scrutiny on compliance
- ▶ Increased scrutiny on quality
- ▶ More competition

Healthcare Providers Have Internal Competing Interests



Board of Directors

- ▶ All corporate powers must be exercised by or under the authority of and the affairs of the corporation managed under the direction of its board (except what is reserved in the Articles). S.C. Code Ann. § 33-31-801(a).
- ▶ Board's job:
 - ▶ Create policy; and
 - ▶ Select and evaluate a management team to carry out policy.

Corporate Officers Have Separate Duties, With Expectations To:

- ▶ Manage day-to-day operations
- ▶ Further the Facility's strategic directives
- ▶ Mitigate risks
- ▶ Control costs
- ▶ Understand the governing laws and the Facility's policies
- ▶ Educate the Board
- ▶ Forge strategic alliances
- ▶ Get the job done

Duties of Board Members to the Organization

- ▶ Focus on:
- ▶ Legal compliance
- ▶ Mission
- ▶ Financial performance
- ▶ Quality of care

Why Is This Important?

- ▶ Heightened governmental and public scrutiny
- ▶ Increased transparency
- ▶ Potential exposure and risks are increasing

LEGAL COMPLIANCE

- State law compliance
- Tax law compliance
- Health Care Compliance

State Law Compliance— Nonprofit Facilities

General Duties of Directors:

- ▶ Duty of care
- ▶ Duty of loyalty

Not just the right thing to do:

- ▶ Provides liability protection
- ▶ Protections under S.C. Nonprofit Corporation Act

Duty of Care & Duty of Loyalty

- ▶ General standards for directors.
 - ▶ (a) A director shall discharge his duties as a director, including his duties as a member of a committee:
 - ▶ (1) in good faith;
 - ▶ (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and
 - ▶ (3) in a manner the director reasonably believes to be in the best interests of the corporation.
- S.C. Code Ann. § 33-31-830(a)

Duty of Care & Duty of Loyalty

- ▶ (b) In discharging his or her duties, a director is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by:
 - ▶ (1) one or more officers or employees of the corporation who the director reasonably believes is reliable and competent in the matters presented;
 - ▶ (2) legal counsel, public accountants, or other persons as to matters the director reasonably believes are within the person's professional or expert competence;
 - ▶ (3) a committee of the board of which the director is not a member, as to matters within its jurisdiction, if the director reasonably believes the committee merits confidence; or
 - ▶ (4) in the case of religious corporations, religious authorities and ministers, priests, rabbis, or other persons whose position or duties in the religious organization the director believes justify reliance and confidence and who the director believes is reliable and competent in the matters presented. S.C. Code Ann. § 33-31-830(b).

Duty of Care & Duty of Loyalty: Good Faith Requirement

- ▶ (c) A director is not acting in good faith if the director has knowledge concerning the matter in question that makes reliance otherwise permitted by subsection (b) unwarranted. S.C. Code Ann. § 33-31-830(c).

Duty of Care

Business Judgment Rule

- “Under the business judgment rule, a court will not review the business judgment of a corporate governing board when it acts within its authority and it acts without corrupt motives and in good faith.” Dockside Assn. v. Detyens, 291 S.C. 214, 217, 352 S.E.2d 714, 716 (Ct. App. 1987).
- Plaintiffs must establish, by a preponderance of the evidence that a corporate governing board lacked good faith, was self dealing, acted corruptly or fraudulently in taking action. Id.

Duty of Care & Duty of Loyalty: Liability Protection

- ▶ (d) A director is not liable to the corporation, a member, or any other person for any action taken or not taken as a director, if the director acted in compliance with § 33-31-830.
- ▶ (f) An action against a director asserting the director's failure to act in compliance with this section and consequent liability must be commenced before the sooner of (i) three years after the failure complained of or (ii) two years after the harm complained of is, or reasonably should have been, discovered. This limitations period does not apply if the failure to act in compliance with this section has been fraudulently concealed. S.C. Code Ann. § 33-31-830(d) & (f).

Duty of Care

- ▶ An Officer or Director must act in good faith and with the care an ordinarily prudent person would take in a similar circumstance.
- ▶ Director must act within their authority:
 - ▶ S.C. Nonprofit Corporation Act;
 - ▶ Articles of Incorporation;
 - ▶ Bylaws;
 - ▶ Policies.

Duty of Care

- ▶ Directors must act on an informed basis.
- ▶ When making reasonable inquiry about an action, the director is entitled to rely on the opinions of:
 - knowledgeable officers, employees, etc.;
 - outside experts; or
 - appointed committees

where such reliance is in good faith.

Duty of Loyalty

- ▶ Acting in the best interests of the corporation.
- ▶ Self dealing is a breach of the duty of loyalty.
- ▶ A transaction in which self-dealing was involved may be voidable by the corporation and may expose the director to personal liability for breach of the duty of loyalty.

Risks Under State Law

- ▶ Claims for Breach of Fiduciary Duties—In re Caremark Int’l Inc. Derivative Litig, 698 A.2d 959 (Del. Ch. 1996);
 - ▶ First case where a court decided whether directors could be held liable for losses sustained by a company as a result of compliance program failures.
 - ▶ Held: Directors could be liable for breaching the duty of care if the directors:
 - ▶ Knew or should have known about legal violations and did nothing to stop them, resulting in harm to the company;
 - ▶ Failed to assure that the company implement an information and reporting system reasonably designed to prevent losses caused by compliance violations.
 - ▶ Found a sustained or systematic failure of the board to exercise oversight.

Risks Under State Law

- ▶ Stone v. Ritter, 911 A.2d 363, 370 (Del. 2006).
 - ▶ Held that a director's failure to implement and subsequently monitor or oversee a reporting and information system intended to ensure compliance could constitute a breach of the duty of loyalty.

Risks Under State Law

- ▶ Case in point: Official Comm. of Unsecured Creditors v. Baldwin (In re Lemington Home for the Aged), No. 13-2707, 2015 WL 305505, 60 Bankr. Ct. Dec. 138 (C.A.3 (Pa.) January 26, 2015)
- ▶ A nonprofit nursing home established in 1883 for the purpose of caring for African American seniors.
 - ▶ Administrator breached the duty of care: 1997-2004
 - ▶ The home was out of compliance with state and federal regs;
 - ▶ Cited for deficiencies at 3 x's the level of other Penn. Homes;
 - ▶ Failed to assure appropriate clinical documentation;
 - ▶ An investigation after the death of a resident showed that the Adm. Lacked the qualifications, the knowledge of the Penn. Regs and ability to direct staff to perform the services required.
 - ▶ Administrator breached the duty of loyalty: Adm. did not work full-time but collected a full-time salary while receiving short term disability benefits for more than 8 months.

Risks Under State Law

- ▶ CFO breached the duty of care:
 - ▶ Did not keep or create financial statements, annual audit or even maintain a general ledger for over a year;
 - ▶ Did not cooperate with the bankruptcy consultant or provide any requested documents;
 - ▶ Lied about keeping an “excel spreadsheet” containing a financial record;
 - ▶ Statements in Board minutes state that CFO provided all requested information to the consultant;
 - ▶ Failed to bill/collect >\$500K from Medicare.
- ▶ CFO breached the duty of loyalty:
 - ▶ Presented a proposal for the sale of the home to a church in which the CFO would assume the role of President and CEO.

Risks Under State Law

- ▶ Directors breached the duty of care: “Heads stuck in the sand”
 - ▶ Allowed the Adm to continue in the Adm role when:
 - ▶ Aware home had deficiencies 3 x’s other Penn. Homes;
 - ▶ Received a 2001 independent review of the home that due to the # of citations, the Adm. should be replaced with a more seasoned adm;
 - ▶ Sought and obtained a grant for \$178K from a foundation to fund an adm search, but did not use the funds for that purpose;
 - ▶ Allowed the Adm. to continue to receive a full-time salary while working part time; and
 - ▶ Allowed the CFO to continue in his role after being informed he was not keeping appropriate records.;
 - ▶ Did not disclose the Board’s January 2005 decision to close the home until April and delayed filing for bankruptcy.

Risks Under State Law

- ▶ Court maintained the punitive damage award for the officer defendants, but not the director defendants finding that the officer defendants engaged in self-dealing, but the director defendants did not.
- ▶ Court also found sufficient evidence for a “deepening insolvency” claim due to the mismanagement of the home, delay in filing bankruptcy and the undisclosed decision to close the home.

Take-Aways

- ▶ BE INFORMED;
- ▶ TAKE ACTIONS IN THE BEST INTERESTS OF THE CORPORATION;
- ▶ Board approval of the Code of Conduct and Compliance Plan;
- ▶ Regularly include compliance updates to the Board;
- ▶ Regularly evaluate/update all components of the Compliance Plan;
- ▶ Regularly review the adequacy of compliance resources;

TAKE-AWAYS

- ▶ ACT ON INFORMATION PROVIDED!!!
- ▶ DON'T STICK YOUR HEAD IN THE SAND.



Protections Under State Law: “Safe Harbors”

- ▶ Directors enjoy **immunity** from suit under S.C. Code § 33-31-834:
 - ▶ Stems from tax exempt status (501(c)(3), (c)(6), & (c)(12))
 - ▶ Immunity lost when director’s conduct amounts to willful, wanton, or gross negligence.
 - ▶ What is gross negligence? When the defendant has failed to exercise a slight degree of care. Osborn v. University Med. Assoc. of MUSC, 278 F.Supp.2d 720, 729-730 (D. S.C. 2003).
 - ▶ What is willful, wanton behavior? Whether a tort “is committed in such a manner or under such circumstances that a person of ordinary reason or prudence would then have been conscious of it as an invasion of the plaintiff’s rights.” Id. at 730.
 - ▶ Implies conscious wrongdoing by defendant.

Protections Under State Law: “Safe Harbors”

- ▶ Additional protections under S.C. Code Ann. § 33-31-202(b).
- ▶ Unless the articles provide otherwise, no director of the corporation is personally liable for monetary damages for breach of any duty to the corporation or members. However, this provision shall not eliminate or limit the liability of a director:
 - ▶ (1) for any breach of the director's duty of loyalty to the corporation or its members;
 - ▶ (2) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law;
 - ▶ (3) for any transaction from which a director derived an improper personal benefit; or
 - ▶ (4) under Sections 33-31-831(COI); 832(Loans); 833(Distributions).

Protections Under State Law

- ▶ Statutory Indemnification
 - ▶ Mandatory (S.C. Code § 33-31-852)
 - ▶ Director is a party to proceeding because of status as a director and has a successful defense on the merits.
 - ▶ Permissive (S.C. Code § 33-31-851)
 - ▶ Conditions must be met:
 - ▶ If a civil proceeding:
 - ▶ Conducted him/herself in good faith; &
 - ▶ Reasonably believed conduct was in the best interests of the corporation.
 - ▶ If a criminal proceeding, no reasonable cause to believe his/her conduct was unlawful.
 - ▶ Often times contained in bylaws
 - ▶ Must be approved by the Attorney General

Protections under D&O Policy

- ▶ Review Current D&O Policy
- ▶ Directors and Officers Liability Coverage
- ▶ Pays Loss
(damages/settlements/judgments/defense costs)
on behalf of the Insured Persons
- ▶ Maximum aggregate limit
- ▶ Applicable Deductible

Tax Law Compliance: Remember the Basis for Your Exempt Status

- ▶ Organized and operated exclusively for exempt purpose
- ▶ No private inurement
- ▶ No private benefit
- ▶ Restriction on political and substantial lobbying activities
- ▶ Compliance reported annually on the 990

Health Care Compliance

- ▶ Anti-kickback
- ▶ False claims
- ▶ Provider self-referral law (Stark)

Compliance Risk Areas

- ▶ Billing
- ▶ Coding
- ▶ Cost reports
- ▶ Financial relationships with physicians and other providers

Policies are Important

- ▶ Written policies help organizations:
 - ▶ Demonstrate compliance with applicable laws
 - ▶ Fulfill their directives
- ▶ But, they may hurt you if not followed

Practical Tip: Recommended Policies

- ▶ Conflict of interest
- ▶ Document retention & destruction
- ▶ Legal compliance: detect and prevent violations
 - ▶ Code of Conduct
 - ▶ Compliance officer/Compliance committee
 - ▶ Open lines of communication
 - ▶ Whistleblower
 - ▶ Auditing and Monitoring
 - ▶ Investigating alleged violations
 - ▶ Enforcement of disciplinary standards
 - ▶ Training and education

Practical Tip: Policy Management

- ▶ Know your organization's policies
- ▶ Review them periodically
- ▶ Adhere to them
- ▶ Simplify if necessary

Quality of Care: Key Objective

- ▶ The Board must understand and be able to articulate the Facility's strategic mission on quality
 - ▶ Tied in with general duties of the Board
 - ▶ LARGE on CMS's radar
 - ▶ Quality (or lack thereof) could also be linked to compliance risk

Attaining this Objective Through Board Education

- CMS's quality initiatives
 - Quality measures
 - Consumer information: Comparing your data to other facility's data
 - Moving from Pay for Reporting to Pay for Performance
 - Regulation and enforcement

Bottom Line on Quality

- ▶ Be informed about your facility's quality initiatives
- ▶ Know your facilities' performance record with quality measures
- ▶ Address quality issues – mistakes happen!
- ▶ Board will be held responsible

TAKE AWAYS

- ▶ Board members should be aware of and briefed on the following issues:
 - ▶ Quality
 - ▶ Compliance
 - ▶ Financial Performance
 - ▶ Mission

Questions?

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