



# Governance & Leadership Issues in Today's Environment

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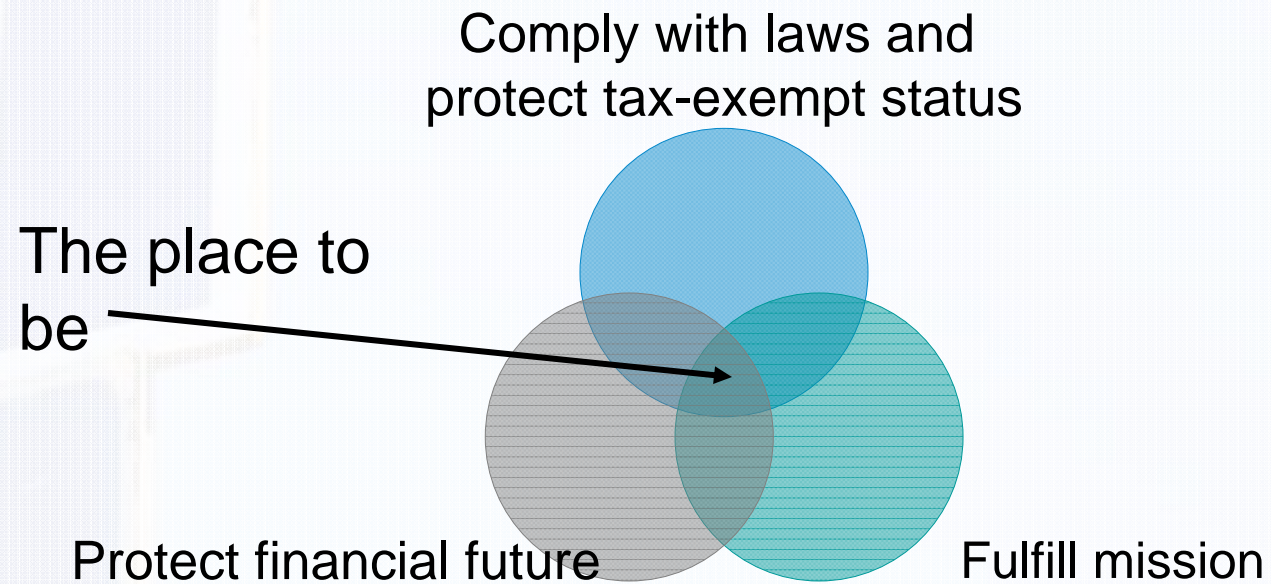
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# Current Health Care Environment



- Health Care reform creating major change in industry
- Increased scrutiny on compliance
- Increased scrutiny on quality
- More competition
- More integration between hospitals and physicians

# Hospitals Have Internal Competing Interests



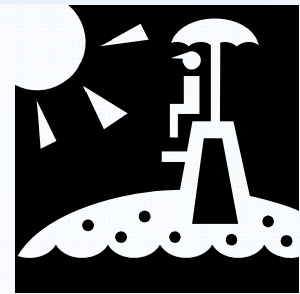
## Corporate Officers Have Separate Duties, With Expectations To:

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

# Duties of Executive Team and Board Members to the Organization

Focus on:

1. Compliance
2. Quality of care
3. Financial Status and Objectives
4. Mission



# Why Is This Important?

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

# COMPLIANCE

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

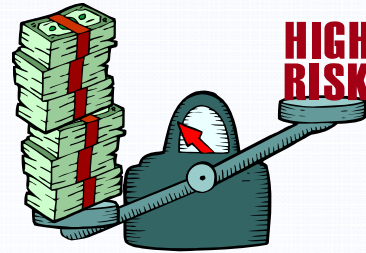



# Health Care Compliance

- Provider self-referral law (Stark)
- Anti-kickback statute
- False Claims Act
- Antitrust
- Health Care Reform changes

# Compliance Risk Areas

- Financial relationship with physicians
- Billing
- Coding
- Cost reports
- Internal Communications: board minutes, emails, etc.





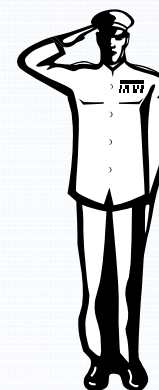
## Tax Law Compliance for Tax-Exempt Hospitals: Remember the Basis for Your Exempt Status

- Differences between private nonprofits and governmental hospitals which are tax exempt
- Organized and operated exclusively for exempt purpose
  - Community benefit
- No private inurement
- No private benefit
- Restriction on political and substantial lobbying activities

# State Law Compliance — Nonprofit Hospitals

## Duties of Officers and Directors:

- Duty of good faith
- Duty of care
- Duty of loyalty



Officers need to follow duties as outlined in bylaws and resolutions

- 33-31-841: Clear requirement to do so

Not just the right thing to do:

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

# State Law Compliance — Governmental Hospital

- Duties of Directors and Executives
  - S.C. Ethics, Governmental Accountability, and Campaign Reform Act—S.C. Code § 8-13-100, et seq.
- Liability Protection
  - Immunity under the South Carolina Tort Claims Act

# State Law Compliance — For-Profit Hospitals

- Same fiduciary duties as non-profit hospitals, but loyalty owed to shareholders as well
- Same protections as non-profit hospitals, but potentially more individuals have personal stake in operations which increases the risk of suit against officers

# Duty of Good Faith

- Directors / Officers must hold a good faith belief that their actions are in the best interests of the corporation and have no knowledge concerning the matter in question that would make reliance unwarranted
- Kansas City University of Medicine and Biosciences (2010):
  - Pay for executives out of line
  - Unauthorized executive expenditures, including travel and entertainment expenses

# Duty of Care

- Directors / Officers must act with common sense and informed judgment
- When making reasonable inquiry, the director is entitled to rely on the opinions of (1) knowledgeable officers, employees, etc.; (2) outside experts; or (3) appointed committees where such reliance is in good faith

# Duty of Loyalty

- The standard for determining whether a director / officer acted in a way that was believed to be in the best interests of the corporation is both subjective and objective
- A transaction in which self-dealing was involved may be voidable by the corporation and may expose the director / officer to personal liability for breach of the duty of loyalty

# Risks Under State Law

- Claims for Breach of Fiduciary Duties - Caremark and beyond
- Change of Control Transactions
  - Increased/Enhanced Duties
  - Following Charitable or Governmental Purpose of Corporation
  - Outlining Alternatives when making decisions
  - Use of Outside Financial Advisors



# Protections Under State Law



- “Safe Harbors”
  - Directors enjoy **immunity** from suit under S.C. Code § 33-31-834 and N.C.G.S. § 55A-8-60 and N.C.G.S. § 55A-2-02(b)(4); immunity lost when director’s conduct amounts to willful, wanton, or gross negligence. Officers enjoy no such protections, but have others
  - **Business Judgment Rule** is a common law defense to breach of the duty of care by ordinary negligence when there has been a good faith, informed business decision

# Protections Under State Law

- Director 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
    - Often times contained in bylaws
  - Officers have mandatory and permissive indemnification under SC Code § 33-31-256, but such indemnification can be limited by the Articles of Incorporation
  - Insurance
    - Can be purchased on behalf of officers and directors pursuant to SC Code § 33-31-857

# Case Study: Natchez Regional Medical Center

Natchez, Mississippi—12/7/2009

- Natchez files complaint against management company, CEO, and CFO based on mismanagement of the hospital
- Allegations included:
  - Falsely reported to board that hospital was profitable when hospital was losing money
  - Allowed hospital to enter into agreements in violation of Stark
  - Excessively staffed the hospital
  - Had conflicts of interest with vendors
  - Failed to increase medical services rates to reflect market conditions
- Causes of action included:
  - Breach of fiduciary duty
  - Breach of contract
  - Breach of duty on good faith and fair dealing
  - Negligence
  - Aiding and abetting breach of fiduciary duty

# 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: Policy Management

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

# Practical Tip: Recommended Policies

- Conflict of interest
- Whistleblower
- Document retention & destruction
- Joint venture evaluation



# Conflicts of Interest Policy

- Vital Component
- IRS model
- Presents unique issues in rural America
- Presents political challenges involving physician Board members
- Identifying potential relationships between the Board / Executive Team and hospital is the first step
  - Distribution and implementation of policy
  - Questionnaire



## Practical Tip: Conflicts of Interest

- Common sense should be your guide
- If you would hesitate to tell a third party about a business relationship or transaction, you may have a conflict issue to resolve

# Quality of Care: Key Objective



- Board members and officers must understand and be able to articulate the Hospital's strategic mission on quality
  - Tied in with general duties of the Board
  - LARGE on CMS's radar
  - Critical for Joint Commission Compliance
  - Quality (or lack thereof) could also be linked to compliance risk
  - Officers considered to be one of the top influences on quality

# Attaining this Objective Through Board and Officers Education

- CMS's hospital quality initiatives
  - Hospital quality measures and voluntary reporting
  - Regulation and enforcement
  - Consumer information: Comparing your data to other hospital's data
  - Moving from Pay for Reporting to Pay for Performance
  - Never Events

# Bottom Line on Quality

- Be informed about your hospital's quality initiatives
- Know your hospital's performance record with quality measures
- Address quality issues – mistakes happen!
- Board and Executive Team will be held responsible
- Executive officers need to encourage good exchange of dialogue on these types of issues



# Promotion of Quality of Care

- Quality issues and reports prominently placed on agenda of each meeting of officers and directors
- Put plans in place and frequently evaluate results
- Increase education for staff

# How CEOs / CFOs should deal with their Board

- Keep Board informed on all material events, situations and decisions
- Communicate with Board as a whole rather than rely on ad hoc communication with key members
- Request feedback on all aspects of Hospital's operations
- Document correspondence and act on decisions

# Financial Performance

- Annual Budget Approval
- Investment Policy
- Maintenance of Financial Records for Nonprofits with Members
- Performance of Employed or Contracted Physicians
- Maintenance of Accounting Records
  - Required by SC Code § 33-31-1601(b) and NCGS § 55A-16-01(b)
  - The more significant funds, the more detailed records required



# Case Study: Stevers Institute of Technology

Hoboken, NJ—9/17/2009

- New Jersey Attorney General brings suit seeking overhaul of leadership and operations following investigation of financial management
- Focus of allegations:
  - Borrowed money without board approval
  - Made excessive expenditures
  - Violated restrictions placed on gifts
- Results:
  - Power taken from executive committee and placed in hands of directors
  - Corporate governance documents, financials, and investments posted on hospital website
  - Required to, establish guidelines for accepting gifts

# Annual Budget Approval

- Board members should ask questions and engage hospital administration in dialogue regarding expenditures
- Board should not merely act as a rubber stamp for hospital administration





# Form 990: Focus on Governance

- Board size and structure
- Management of conflicts of interest
- Board independence
- Relationships among Board members
- Audit committees
- Written governance policies
- Role of Board with Form 990

# Practical Tips: Form 990 Encourages

- Board involvement and independence
- Policy development
- Management of private business use
- More rigid compensation procedures
- Maintenance of records
- Transparent operations



# Private Business Use

- An issue for tax-exempt financed facilities
- Requires coordination between operations and accounting departments
- Even contractual relationships that are required to fulfill your exempt purpose may present problems
- Potential risks are enormous



## Practical Tip: Private Business Use Compliance

- Review your existing contracts and measure your private business use
- Maintain records sufficient to monitor compliance
- Take advantage of the available IRS management contract safe harbors

# TAKE AWAYS



- As a hospital Board member or Executive Officer, you should be aware of and briefed on the following issues at your hospital:
  - Quality
  - Compliance
  - Financial Performance
  - Mission



# Questions?

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