Executive Compensation, DOJ Compliance, Corporate Ethics: Corporate Law and Governance Update March 2017

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Executive Compensation Developments

The general counsel should anticipate questions from the board and its executive compensation committee from recent media coverage of executive compensation (especially in the nonprofit sector). This increased focus has concentrated on issues relating to reasonableness of compensation, and the use of compensation to reward particular organization and individual success—and to hold executives accountable for shortfalls in leadership or performance.

Media attention to nonprofit executive compensation is nothing new, and data contained in Form 990 filings should always be expected to “see the light of day.” The general counsel can address related concerns by advising her internal board/committee clients to focus on the following critical factors: (a) the comprehensive nature of the board’s executive compensation approval process and the strength of the position on the "Rebuttable Presumption"; (b) familiarity with all individual components of an executive’s compensation package; (c) the increasing responsibilities of corporate executives given growth in organizational size and complexity; (d) the exercise of independent business judgment by the compensation committee; and (e) the continuing ability of the health system to operate in a manner consistent with its charitable purposes.

The compensation committee may also seek guidance on how compensation is being used more broadly by sophisticated enterprises to drive behavior, incentivize conduct and penalize performance that falls short of board expectations. The general counsel may wish to team with the chief human resources officer on a board briefing that anticipates these questions.

New DOJ Compliance Program Guidance

Health system audit and compliance committees will want to review the new compliance program guidance recently issued by the Fraud Section of the Department of Justice (DOJ). While not specific to the health industry, it nevertheless provides a practical set of benchmarks against which the audit and compliance committees, in consultation with the general counsel and the chief compliance officer, can evaluate the effectiveness of the health system’s compliance program.

The Guidance is presented in the form of a series of substantive compliance-focused questions that the DOJ frequently considers when evaluating a corporate compliance program. Questions particularly relevant to health care organizations include those that focus on the conduct of senior and middle management; the internal stature of the compliance function; the autonomy of the compliance function; program funding and resources; corporate response to expressed compliance concerns; the process for responding to investigative findings; consistency of disciplinary measures; and periodic updating of procedures and practices. Important questions focus on the board’s exercise of its compliance oversight duties—including whether relevant expertise is available on the board, and how compliance-related information is provided to the board.

The release of this Guidance is a significant development in terms of assuring the most effective corporate governance.
compliance plan possible. It is directly relevant to the fiduciary obligations of the board’s audit and compliance committee; to which the health system general counsel, in consultation with the compliance officer, may provide a briefing.

**M&A Strategic Planning**

The health system's M&A planning should closely consider the implications of the government's latest litigation victory in its challenge to a concentrated market hospital merger. The strategic planning committee would benefit from a briefing on the March 7 decision enjoining the proposed Advocate Healthcare Network/NorthShore University Health System merger in the Chicago area.

The District Court granted the Federal Trade Commission (FTC) and the State of Illinois a preliminary injunction blocking the merger from closing, pending an administrative trial on the merits before an FTC administrative law judge. Rather than continue to litigate, Advocate and NorthShore immediately announced their intention to abandon their proposed merger.

This is the second decision in a year in which the FTC has successfully challenged, by litigation, a concentrated hospital market merger (the other being the proposed Penn State Hershey/PinnacleHealth System merger in Pennsylvania). Both decisions adopted the FTC's approach to defining geographic markets by taking into account the views of payors and, specifically, what alternatives to the merging parties they believed they had in negotiations to form a provider network to market to employers and individuals.

It should also be noted that in both the Hershey and Advocate cases, the FTC voted unanimously for the filing of a complaint; there was no split among the FTC’s Republican and Democratic commissioners along political lines.

**The Corporate Ethics Officer**

One of the unanticipated side effects of the intensive focus on the President’s personal conflicts issues is increased interest in the creation of a new “chief ethics officer” position. Yet the wisdom and practicality of creating a separate executive position requires careful and dispassionate board-level review, in consultation with general counsel.

Some companies (e.g., the Trump Organization) may find assigning oversight of ethical obligations to a dedicated corporate executive or outside adviser to be an effective strategy for addressing business conduct. But there is no broadly accepted portfolio for the role of a separate ethics officer, nor understanding of how such a role might encroach on the existing duties of the general counsel or the chief compliance officer. In addition, there is no general agreement on the qualifications for such a position, even though the evaluation of conflicts of interest and interpretation of federal ethical guidelines usually requires legal training.

Boards should therefore pause before treating the related actions of the Trump Organization and of the White House as a governance corporate best practice, as meritorious as those actions may otherwise be.

**Corporate Officers as Corporate Agents**

In the current corporate accountability environment, the extent to which state law treats corporate officers (but not directors) as agents of the corporation may have increasingly important implications. This treatment may affect how the general counsel advises corporate leadership in certain situations.

A new scholarly article provides a helpful discussion of the distinctive fiduciary relationship of officers to the corporation. It confirms those duties that officers and directors share (e.g., the loyalty triad), and those that may be peculiar to officers (e.g., performance-related duties that include both a duty to comply with reasonable instructions and a duty to share material information with the board ). These unique agency-related duties form the basis of the corporation's authority to exercise control over officer conduct.

Depending upon specific state law, the characterization of corporate officers as agents may affect the legal analysis applied to the evaluation of such matters as an officer’s performance, standard of conduct, reliance, scope of authority, and indemnification and advancement rights, and the interpretation of employment contracts. This is a topic of increasing academic debate. The general counsel should thus note the potential that fiduciary and other laws may apply differently to officers than they do directors.

"Long Stay" Directors

Issues regarding director tenure continue to be a board challenge. A recent The Wall Street Journal article speaks to concerns of institutional investors with the "long stay director"; i.e., a director who has been on the board for more than 12 years.
The article cites data suggesting that only a small percentage of S&P companies have term limits and that independent directors at more than 100 such companies have served for 25 years or more. Thus, an increasing number of investor groups are either (a) opposing the re-election of long stay directors; or (b) requesting that the performance of such directors be vigorously reviewed and/or they be classified as non-independent.

These questions of tenure and compromised independence are absolutely relevant to nonprofit health system boards, many of which greatly value the unique experience of long stay directors. In the absence of best practices, governance committees should remain engaged on this issue.

### Meaningful Committee Service

A **recent article from the Chronicle of Higher Education** identifies steps that can be taken to make committee service more meaningful to its members and the board. Many of these steps are relevant to committees of nonprofit health system boards.

The article recognizes a number of concerns, including (i) a large number of committees and a small (board) pool from which to draw members; (ii) lack of recognition from committee service; and (iii) limited staff support for the committee's agenda.

It also prompts consideration of a number of proactive solutions, including updating the committee charter; making the work of the committee more visible to the full board; including non-directors as committee members, as law allows; monitoring the work load between committees; and assuring dedicated executive team resources to support the committee's work.

Given the heavy reliance the health system board places on the role of committees, the governance committee may want to consider **ways of enhancing** the value and materiality of committee service.

### Risk Oversight Duties

There is an increasing acceptance that risk management, in all of its permutations, transcends the duties of management to become a prominent responsibility of the board. The general counsel is well advised to brief the board on the elements of this responsibility.

Several new best practices compilations are available to help clarify for the board its responsibilities with respect to the oversight of a health system's risks. These include those published by The Business Roundtable, the National Association of Corporate Directors (NACD) and The Conference Board.

As most general counsel are aware, the historical judicial threshold in most states for breach of the risk oversight obligation is very high. However, in a **recent publication**, a prominent governance authority warns of the potential for egregious fact patterns to drive unfavorable outcomes, particularly in jurisdictions outside of Delaware.

For this and other reasons, the general counsel may want to encourage the board to revisit its approach to oversight of risk management; using state case law and these best practices compilations as benchmarks. The value of such an exercise exists regardless of whether the health system has an existing enterprise risk management program.

### The Relevance of Jobs Data

There are **increasing indications** that jobs-related data may be a valuable evaluation resource for several key committees of the health system board. Such data would include, but would not be limited to, information provided by the Department of Labor and other sources with respect to trends in hiring, jobs creation, the employment rate and the consumer price index.

A critical, but often overlooked, aspect of the duty of care is the obligation to monitor economic conditions (both national and global) and their implications for both the health care industry in general, and the individual health system the board serves. Part of that monitoring can focus on the pulse of the job market, and what employment trends are suggesting. Such data can offer important indications as to general and industry specific financial conditions; about what sectors and business lines are creating the most jobs (e.g. ambulatory care and home health); access to a pool of qualified employees, and the implications of job loss indicators and workforce reductions.

Such data can be useful to the board, particularly as it relates to strategic planning, human resources and talent development oversight responsibilities. The general counsel can help identify how this data can be effectively incorporated into the committee agenda and interpreted by its members.
Evolving Cybersecurity Duties

There are probably few topics that health system directors are more tired of hearing about than cybersecurity oversight obligations. But general counsel may need to return to that topic one more time, given the release of a new "best practices" compilation.

Recently, the National Association of Corporate Directors (NACD) issued its new resource, “NACD Director's Handbook on Cyber Risk Oversight.” Key topics covered include (i) the proper allocation of cyber risk responsibilities at the board level; (ii) the legal implications related to cybersecurity; (iii) board-to-management expectations on cybersecurity processes; and (iv) improving dialogue between the board and management on cybersecurity matters.

The release of the newest NACD guidelines is a reminder of how quickly and significantly the technological, regulatory enforcement and fiduciary duty landscape is changing in the area of cybersecurity—especially in health care. The general counsel (perhaps teaming with the chief information officer) might use the release as a prompt to revisit the continued effectiveness of current board cyber risk oversight processes.

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