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Board Termination of the "Unethical CEO"

An important new study concludes that CEO terminations for ethical lapses (as a percentage of overall CEO successions) has dramatically increased over the last five years. The study also reflects the willingness of boards to reclaim compensation from so called "unethical CEOs."

The survey results are suggestive of a growing climate of accountability in corporate boardrooms across the globe. Boards are now more willing to terminate CEOs for conduct they regard as unethical or otherwise inconsistent with corporate values. This is a notable consideration for both the board, and its executive compensation and search/succession committees, and the standards they apply to monitor and evaluate senior executives. This, as boards seek to balance appropriate levels of executive accountability with the benefits of maintaining a close relationship with the CEO, and collaborate with the CEO to encourage entrepreneurship and informed risk-taking.

The general counsel can play an important role in guiding corporate leadership's response to the study (*e.g.*, by evaluating its implications in the particular context of the company, the health care regulatory environment, and the company's existing compliance, ethics and other oversight mechanisms). The general counsel can also assist the board in its consideration of related recommendations presented by the National Association of Corporate Directors.

DOJ Enforcement Update for the Audit Committee

A May 18 speech by a senior Department of Justice Criminal Division official provides health lawyers with an easy and efficient way to brief their clients' audit and compliance committees on the status of health care fraud enforcement in the Trump Administration.

This speech was given by Acting Assistant Attorney General Kenneth A. Blanco, to the American Bar Association's 27th Annual Institute on Health Care Fraud. The thrust of the speech was that health care fraud enforcement remains a priority for the Department of Justice (DOJ). Within that context, Mr. Blanco offered a comprehensive overview of the focus of the DOJ, its enforcement efforts generally, and areas in which those efforts are having, in his view, a significant impact.

What may be particularly informative to board and committee members is Mr. Blanco's discussion of the "why" piece—the reasons why the DOJ is so vigorous in its pursuit of health care fraud. In a sense, the Blanco speech serves as one-stop-shopping for basic director education on the status of the DOJ's health care fraud enforcement efforts. It may also serve to sharpen the attentiveness of those corporate leaders who may have harbored doubts about the intensity of the DOJ's enforcement commitment in the new Administration.

Fiduciary Duties of Corporate Officers

The general counsel is well advised to monitor the growing academic discourse concerning the extent to which state laws fully articulate the fiduciary duties of executive corporate officers (as opposed to directors).

The issue has most recently focused on the perceived silence of Delaware law about the various legal issues that relate to executive corporate officers--but it could just as easily extend to the corporate law of other states as well. As a leading corporate scholar notes, Delaware has yet to provide guidance on such key issues as whether the business judgment rule applies to these officers; what is the applicable standard of care for officers; whether officers are considered agents of the corporation; and the nature and scope of officer disclosure and oversight duties.

This is an important concern for the general counsel, given her need to advise both the board and the CEO, respectively, on matters of executive conduct. It may prompt the general counsel to review the health system's applicable state corporate law to confirm the extent to which these duties are codified, or are—or should be—addressed in other ways (*e.g*., employment and severance agreements).

Executive Compensation Committee Issue

"Executive Pay: the Race to the Top," featured in the Sunday business section of the May 28 *The New York Times*, offers substantial fodder for the executive compensation committees of health care companies, and their advisors.

The theme of the article is that the combination of significant 2016 pay gains for chief executives and President Trump's plan to deregulate (*e.g.*, roll back key Dodd Frank provisions) and to reduce corporate tax rates, "sets the stage for perhaps the most consequential moment for corporate governance since the financial crisis of 2008." The reporter refers to the widening pay gap between senior executives and most employees.

The relative magnitude of the governance consequence can be debated. The impact of pay ratio rules and related issues may vary depending on the nature of the health system's size, and its form of ownership or control. But the broader implications of income equality, as they relate to the responsibilities of the executive compensation committee, will likely not vary significantly. Investing in human capital will continue to be a major board pressure point. In this regard, it is an example of how social concerns can migrate to become governance concerns.

Latest Challenge to RCOD Fails

Health industry general counsel who monitor application of the Responsible Corporate Officer Doctrine (RCOD) will be disappointed to learn that on May 22, the Supreme Court of the United States denied a petition for a *writ of certiorari* with respect to *U.S. v DeCoster*, which is widely considered to be one of the most consequential RCOD cases in many years.

RCOD is a Supreme Court-grounded strict liability theory, interpreted by the government as permitting (in certain circumstances) the prosecution of officers and directors for misdemeanor criminal offenses—without the need to establish their intent or personal involvement in wrongful conduct. RCOD prosecutions have, until recently, been concentrated in the pharmaceutical and medical device industries, pursuant to the federal Food, Drug and Cosmetic Act (FDCA).

A divided Eighth Circuit panel had upheld the criminal conviction of two members of the DeCoster family, which operated an egg company, for allowing the introduction of tainted eggs into interstate commerce, even though they did not know of the contamination. Given the potential for expansion of the RCOD into other public welfare related areas, the health industry general counsel may wish to review its scope with executive officers who hold supervisory responsibilities.

Charity Regulators Remain Active

The health system general counsel should remain mindful of the continued willingness of state and federal charity regulators to investigate prominent nonprofits, as demonstrated by two recent developments.

The Minnesota Attorney General recently completed an extensive compliance review of the charitable solicitation activities of a well-known national vehicle donation program. The review focused on what it concluded was a substantial gap between funds raised by the program from Minnesota donors, and charitable expenditures of the program for Minnesota residents. It was also critical of the extent to which donations were used on fundraising and overhead expenses, (as opposed to charitable programming) and a lack of program transparency concerning its main charitable mission.

On May 24, Senator Charles Grassley released the results of his year-long review of the Wounded Warrior Project, documenting problems he identified with the veterans charity such as its "exorbitant" spending on administrative matters, its portrayal of program expenses and misleading ads on long-term support programs. He commended the charity for its responsiveness to his inquiry and its corrective action, and included in his report the independent legal review conducted by the charity. With exhibits, the report was almost 500 pages in length.

Governance Lessons from "WannaCry"

The general counsel should be part of any briefing of the board's cybersecurity obligations following the recent **"**WannaCry" ransomware incident. This is in recognition of the potential for boards to be held to *Caremark*-like standards with respect to their oversight of organizational cybersecurity measures.

The primary focus of the briefing should be to provide a concise summary of what happened in this most recent attack: what was the nature of the particular vulnerability, the extent to which it affected the organization, and steps taken to resolve any related concerns. The effectiveness of internal risk reporting-to-board systems should be confirmed. As a recent article from National Association of Corporate Directors suggests, an important role of the general counsel is providing the board with the questions they should be asking the organization's technology advisors to assure themselves that the organization is protected.

From a broader focus, the general counsel and the CIO could use WannaCry as an opportunity to brief the board on a range of emerging cybersecurity developments (*e.g.*, the U.S. Department of

Health and Human Services' new National Cybersecurity and Communications Integration Center) and related prophylactic steps they may wish to consider. Especially in matters of technology, it is important that the board not micromanage the organization's cybersecurity program. But, consistent with *Caremark* principles, the board must take steps to assure itself of the continuing effectiveness of that program, particularly as it relates to known vulnerabilities. In that regard, the general counsel may encourage the board to consider whether the organization is prepared to respond to similar incidents.

New Challenges Confronting Compliance Officers

The health system's audit and compliance committee would benefit from a briefing on the series of recent developments that may affect the position security of the chief compliance officer, and the structure and funding of the compliance program. The general counsel, with her overall responsibility for risk management, may wish to team with the CCO for this briefing.

Prominent among those was the May 4 settlement between the federal government and the former chief compliance officer of MoneyGram International, Inc., of civil charges that he failed to stop specific money laundering activities. The settlement provided for a $250,000 fine and a three year ban on serving as a compliance officer for a money transmitter. In a similar matter, a federal appeals court recently denied the petition of former compliance executive to overturn a decision keeping him imprisoned before trial on charges he participated in alleged fraud by his employer.

Other relevant developments include a recent global survey of compliance officers that identified substantial compliance staffing concerns and funding deficits at companies of 10,000 or more employees. In addition, the influence of the DOJ's internal compliance consultant appears to have diminished, both by comments of a senior official of its Criminal Division, and by the public controversy prompted by that consultant's own tweets criticizing the Trump Administration.

Fascinating Nonprofit Derivative Action

The legal implications of internecine disputes in the nonprofit context are on display in an ongoing derivative action involving a large Pennsylvania charity and its affiliate. The action arose from allegations of executive financial mismanagement and an effort to reconstitute the boards of the two corporations.

The litigation involves a nonprofit historic preservation and education organization, with an endowment of approximately $100 million. The action was filed by the charity and several former trustees. The defendants are the CEO, and the current and former board chairs. According to news reports, the breach of duty-based litigation arose from concerns of board members with the financial stewardship of the CEO; his control over the organization; efforts to remove dissident directors and to dilute their influence; and a failure to implement recommendations of a governance task force.

The latest development relates to whether the attorney-client privilege applies to the work of the investigative committee. The litigation continues despite the recommendation of that committee that it not be pursued. As such, the litigation offers reminders of the potential for contentious internecine disputes arising from governance concerns, the intensity of those disputes, and the fact that some states allow such disputes to be pursued as derivative actions.

Board Diversity Developments

New studies by consulting groups and media organizations serve to provide informal but useful guidelines by which health system boards may evaluate their progress towards achieving ethnic, gender and perspective-related diversity goals.

For example, a new report from the EY Center for Board Matters concludes that women now represent almost 40 percent of new directors on the boards of Fortune 100 corporations. These new female directors are slightly younger (57) than their male new director counterparts (59). In addition, many of these new women directors have backgrounds apart from serving as a senior corporate executive (*e.g.*, scientists, educators, former government officials). A separate study by Deloitte of Fortune 500 companies showed similar, significant increases in the number of women and minorities being appointed to the board.

In contrast, a new study conducted by *The Chronicle of Philanthropy* suggests that at the largest charitable grant-making foundations, progress towards board diversity is a slower process. According to *The Chronicle*, control of these prominent foundations remains predominantly in the so-called "coastal elite." *The Chronicle* notes, however, that such conclusion may not be suggestive of the range of socioeconomic diversity or range of perspectives of the board of a particular foundation.

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