New York Law Journal

SERVING THE BENCH AND BAR SINCE 1888

WWW.NYLJ.COM

An ALM Publication

VOLUME 256—NO. 61

TUESDAY, SEPTEMBER 27, 2016

Health Law

Expert Analysis

The Duties of Governing Board Members

Historically, the health care sector in New York has been largely the domain of not-for-profit (NFP) organizations. Most hospitals, about half of the nursing homes, many home health agencies and clinics, and even a number of major health insurers and managed care plans are NFP corporations. While membership on the board of trustees or board of directors of these NFP organizations has always carried important responsibilities, the challenges facing these governing boards in today's environment are almost unprecedented. In addition to adjusting to the ongoing implementation of the Affordable Care Act, there is heightened federal and state regulatory scrutiny, more and more Medicare and Medicaid payment audits and liabilities, increased competition, more consolidations among hospitals and other providers, and many other cross currents that these organizations have to navigate.

By
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While most of these organizations offer a thorough orientation and ongoing educational briefings on the responsibilities of governing board members, some unfortunately offer only cursory guidance, with the result that many new board members are left to learn as much as they can on their own as they begin their board service. This is perhaps an opportune time to review the basic legal duties of the members of any governing board: the duty of care, the duty of loyalty, and the duty of obedience.

The 'good faith' referred to in the law requires that governing board members always act honestly, openly and fairly in making decisions for their organizations.

Duty of Care

The duty of care relates to the competent performance of a director or trustee's responsibilities as a member of the governing board. New York has codified the duty of care in the Not-for-Profit Corporation Law §717(a):

> Directors and officers shall discharge the duties of their respective positions in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.

The "good faith" referred to in the law requires that governing board members always act honestly, openly and fairly in making decisions for their organizations. This means always acting objectively, and only in the best interests of the organization, not in their own personal interests, or in the interests of family members, friends, business associates, or other organizations. It means spending the time to become familiar with their organization's mission, strategic direction, operations, finances, quality of care, compliance, and other important aspects of governance. That includes but is not limited to attendance at and active participation in board and committee meetings, briefings, and understanding all

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materials and information presented to them.

The "prudent standard" referred to in the law means that governing board members are expected to exercise sound practical judgment in making decisions affecting the organization. They should ask questions and insist upon getting all relevant information so that they can make informed judgments. Members need not have individual expertise on each and every matter that is brought to the board, and need not always reach the right decision or even the best decision. But the duty of care does require that the decisions they make meet the standard of an ordinarily prudent person in a like position under similar circumstances. In other words, the member is expected to exercise the ordinary prudence of governing board members of similar organizations in similar circumstances. In summary, the duty of care encompasses diligence, inquisitiveness, objectivity, careful attention to the organization's needs, and active involvement.

Duty of Loyalty

The duty of loyalty demands that governing board members give their undivided allegiance to the organization and its mission at all times. This means that, in making decisions affecting the organization, governing board members must act exclusively for the organization's benefit and advancement, and not in the member's own interest, or in the interest of other persons or organizations. Governing board members may not use their positions, or information that they receive about the organization's operations, assets, plans, etc. in such a way as to benefit themselves or others. They must act at all times in the best interests of the organization and in furtherance of its mission.

The most frequent issue arising under the duty of loyalty is a conflict or a potential conflict of interest. Examples include business dealings between the organization and a board member, or the organization and an entity in which the board member (or family member) has a financial interest or a business relationship. In the case of hospitals, for example, New York's Health Code 10 NYCRR §610.4(a)(1) sets forth specific requirements for the board and the member involved:

> The duty of loyalty requires that when board members come into possession of information about the organization that may be valuable to the board member's business interests or to the business interests of others, the board member must keep such information confidential.

> No director of a nonprofit corporation operating a hospital shall vote, or be counted in determining the quorum for any vote, on any transaction between such hospital corporation and another corporation, firm, association or other entity in which that director is an officer or director or has a direct or indirect substantial financial interest. Any such quality of interest shall be disclosed to the other directors of the hospital corporation and made a matter of record. Such disclosure shall be made by the director involved or, in his absence, by another director having knowledge of the facts. In addition to refraining from voting, such director shall not participate in the deliberations nor use personal influence in the matter and any such transaction shall be at least as fair and reasonable to the hospital corporation as would otherwise then be obtainable by such corporation.

It is important to note that the duty of loyalty does not prohibit transactions between a NFP organization and its governing board members. There are many situations where a governing board member is in a position to help the organization in connection with a transaction. For example, a member who is an executive of a bank may be in a position to obtain loans or credit for the organization on more favorable terms than if the organization went out to the marketplace on its own. In that circumstance, the organization should seek out proposals, and if the proposal of the board member's bank is the most favorable, there is nothing wrong with selecting that bank.

The board member must not use his influence or board position to get his bank selected. At such time as the board takes up the proposal, the board member should have fully disclosed the potential conflict on the record, and then should not participate in any discussion or vote on the transaction. (It is advisable to have the interested board member leave the room when the discussion and vote occurs.) All of this should be reflected in the minutes of the board meeting at which the transaction is considered and acted upon.

Another troublesome matter implicating the duty of loyalty are loans by a NFP organization to a board member or an entity in which the board member has a substantial financial interest. Board members of NFP organizations in New York should be aware that Not-for-Profit Law §716 contains an outright prohibition on such loans:

> No loans, other than through the purchase of bonds, debentures, or similar obligations of the type customarily sold in public offerings, or through ordinary deposit of funds in a bank, shall be made by a corporation to its directors or officers, or to any other corporation, firm, association or other entity in which one or more of its directors or officers are directors or officers or hold a substantial financial interest, except a loan by one type B corporation to another type B corporation.

Section 716 not only prohibits such loans, but declares them to be "…a violation of the duty to the corporation of the directors and officers authorizing it or participating in it…." The law thus holds responsible not just the board member seeking the loan but any board member who votes to approve it.

Lastly, the duty of loyalty requires that when board members come into possession of information about the organization that may be valuable to the board member's business interests or to the business interests of others, the board member must keep such information confidential. For example, if a hospital has identified property that it plans to purchase to build a new off-site clinic or physician offices, it would be a violation of the duty of loyalty for a board member who learned of these plans to purchase the property with the intention of re-selling it to the hospital at a higher price, or to pass that information along to the property owner so he can raise the selling price.

Duty of Obedience

The duty of obedience, like the duties of care and loyalty, commits each board member to support the mission, objectives and operations of the organization. Board members are responsible for assuring that the organization is carrying out its purposes as stated in its certificate of incorporation, corporate bylaws, mission statement, and board directives. They are charged with making sure the organization is benefitting the community and/or population that the organization has undertaken to serve. The duty of obedience prohibits any board member from taking any action that undermines the organization's corporate purposes.

Members of the governing boards of hospitals in New York State should also be aware that 10 NYCRR §405.2 contains three pages of regulations setting forth detailed responsibilities for their board. These include oversight of the organization and operation of the hospital, including the quality of patient care services; compliance with federal, state and local laws; active supervision of the hospital's chief executive officer and medical staff; maintaining a properly staffed and equipped facility; and other requirements.

Conclusion

Trustees and directors of NFP organizations in the health care sector have serious responsibilities that involve diligence, active participation, honesty, objectivity, accountability, a significant amount of personal time, and a wholehearted commitment to support the mission and goals of the organization. Fortunately, most of the individuals who undertake serving on these boards accept and fulfill these commitments and help to assure the success and good reputation of their organizations and the communities and populations they serve. Board service has never been more important—or more challenging.