Avoiding Liability:
A Hospital Board Member Primer

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Disclaimer

This presentation is intended to convey general information only and does not provide legal advice. The contents should not be construed as, and should not be relied upon for, legal advice.

Laws and regulations change. Contact your attorney for advice on your specific circumstances and legal issues.
Objectives

- Learn the legal duties of board members
- Learn the responsibilities of board members
- Discuss the consequences of noncompliance
- Examine how to avoid liability
Legal Duties of Board Members
Legal Duties of Board Members

Overview

• Board members are legally required to be informed and active participants in corporate governance.

• Failing to fulfill these obligations may have serious consequences to the individual, as well as to organization.

• If board member breaches any of these duties or otherwise harms the nonprofit or its stakeholders, he may be personally liable for failing to comply.
Legal Duties

Duty of Loyalty

- Directors of non-profit organizations owe allegiance to the organization’s stakeholders.
- Director must act in stakeholders’ best interest rather than for personal gain, or the benefit of other organizations, groups and individuals.
Legal Duties

Duty of Loyalty

• Stakeholders = the group the organization is designed to benefit, and whose interests must be protected/advanced.

• Stakeholders are typically vaguely defined in the organization’s charter, bylaws (e.g., for a hospital, “the community”).

• Stakeholder groups of nonprofit organizations may want very different things that often conflict with one another.
Legal Duties

Take out a sheet of paper and list your organization’s most important stakeholders.
Legal Duties

Duty of Loyalty

Do you know clearly who your stakeholders are?
Do you know the groups the board must represent?
Do you know to whom the board is accountable?
Legal Duties

Duty of Loyalty

To avoid liability:

– Know definitively the parties the board represents; and

– Know what benefits these parties want from, and expect of, the organization.
Duty of Loyalty

• Director’s actions have good faith intentions when:
  – they manifest a genuine desire to discharge their responsibility to advance and protect stakeholder interests; and
  – They behave in ways that demonstrate reasonable belief that their decisions, actions are in stakeholders’ best interest.
Legal Duties

Duty of Loyalty

Examples of breach of loyalty:

– A material conflict of interest influences director’s decisions;

– Director discloses confidential information that could have a detrimental effect on organization;

– Director seizes a business opportunity for himself or other parties that legitimately belongs to organization;

– Director votes for, or allows, an unlawful distribution of organization’s assets (which subverts its charitable purpose or results in private inurement).
Legal Duties

Duty of Care

- Directors must take “due care” in performing their duties. They must be:
  - Reasonable,
  - Diligent,
  - Prudent; and
  - Able to demonstrate sound judgment equal to that of an ordinarily competent person in similar circumstances.
Legal Duties

**Duty of Care**

- Duty of care focuses on the process of acting and deciding, not results.
- The test is not: Was the result optimal, satisfactory or even tolerable?
Legal Duties

Duty of Care

Tip: directors can assume that information, analyses and recommendations provided by others (organizational executives/staff and consultants) are accurate, truthful, and informed if there are no compelling reasons to believe otherwise.
Legal Duties

Duty of Care

- This duty does not require that directors be overly cautious, avoiding all risks.
- Courts are hesitant to substitute their business judgment, after the fact, for boards that did not have the benefit of hindsight.
- Courts will look at whether directors acted carefully, with common sense and reasonable, informed judgment.
Legal Duties

Duty of Care

Examples of breach of duty:

• Coming to board and committee meetings unprepared, not reviewing agenda materials, proposals, recommendations up for vote;
• Failing to regularly attend meetings;
• Not asking for additional information and clarification when an issue is not understood;
• Failing to demand an adequate amount of time is spent on important issues;
• Not asking the “tough questions”
Legal Duties

*Duty of Care*  
Avoid liability: Contribute!

- Speak up;
- Share your ideas, perspectives, experiences and values.
- Be prepared to express a dissenting opinion and vote “no”.
Legal Duties

Duty of Obedience

- Courts apply the duty of obedience to require non-profit directors to ensure compliance with the non-profit’s mission, donative restrictions, and tax requirements.
- Requires directors to avoid *ultra vires* acts (acts beyond the legal authority of the board as articulated by federal/state laws, court decisions and regulations in addition to those specified in the board’s own articles of incorporation, charter, bylaws and policies).
Duty of Obedience

- The duty tracks and reinforces the non-profit’s mission
- The duty also requires directors to ensure the non-profit complies with external legal regimes (i.e., federal and state tax laws, civil rights statutes, and antitrust laws).
Duty of Obedience

- The consequences of non-compliance by non-profit directors may be even more onerous than for their for-profit counterparts:
  - A non-profit fiduciary can be held responsible if an organization violates the law.
  - For example, a director is liable for a corporation’s failure to pay taxes if she meets the Internal Revenue Code’s definition of “responsible person” and the failure to pay has been “willful.”
Responsibilities of Board Members
Responsibilities

Do your board members clearly understand the difference between “governance” and “management”?

• Governance =
  – Ensures the mission and vision of the organization;
  – Legally responsible for the operation of the organization;
  – Leads the organization forward in carrying out its mission and vision.

• Management =
  – Carries out day-to-day tasks of running the hospital;
  – Guided, but not directed, by the governing board;
  – Leads the hospital’s staff in carrying out the mission and vision that has been developed and approved by the governing board.
Responsibilities

Board of Directors

- Hire, evaluate CEO
- Develop mission, strategic planning
- Ensuring high quality care
- Oversight of medical staff credentialing, privileging
- Board education, development, self-evaluation
- Financial oversight
Consequences of Noncompliance
Consequences of Noncompliance

But, I’m a volunteer

I can’t be held liable.

Right?
Consequences of Noncompliance

Who Is Going to Complain?

- Other members of the Board;
- Members of the corporation;
- Members of the community;
- State Attorney General;
- Internal Revenue Service;
- Third party payers (i.e., Medicare, commercial health insurers).
Consequences of Noncompliance

What Are They Going to Complain About?

- Anti-kickback Statute;
- Physician self-referral (Stark) law;
- False Claims Act;
- Medicare Conditions of Participation;
- Quality, incentive payment programs;
- Health Insurance Portability and Accountability Act;
- Federal tax exemption standards;
- Antitrust law; and
- Other legal compliance standards.
Consequences of Noncompliance

What Are the Potential Penalties?

- Requirement to repay any improperly received reimbursement amount with interest,
- Steep financial penalties,
- Civil liability;
- Criminal prosecution,
- Exclusion from participation in federal health care programs (i.e., Medicare, Medicaid);
- Loss of tax exempt status.
Consequences of Noncompliance

Personal liability

• Business judgment rule offers directors some protection.

• A director must be diligent and informed before making decisions:
  – The board must supervise: it must ensure that the organization’s management are qualified to perform their duties and are actually performing those duties.
  – The board must seek and follow independent expert advice where appropriate.
Consequences of Noncompliance

Personal liability

- $2.25 million jury verdict upheld against directors of a nonprofit nursing home, holding them personally liable for breach of duty of care.
- Directors failed to remove the nursing home’s administrator and CFO even after their mismanagement became apparent.
- While the court overturned a punitive damages verdict against five directors (the jury had found nine other directors liable for compensatory damages but not punitive damages), it upheld punitive damage awards of $1 million against the CFO and $750,000 against the Administrator.
- The decision, while unusual, illustrates that serving on a nonprofit board is not risk-free.
  - *In re Lemington Home for the Aged*, 777 F.3d 620 (3d Cir. 2015).
Consequences of Noncompliance

**Personal liability**

- Court held directors breached their fiduciary duties of care and loyalty by failing to supervise nonprofit’s finances and by approving transactions that involved self-dealing.
- The board’s finance and investment committees had not met for over a decade;
- The directors left management of the nonprofit to two officers who worked largely without supervision.
Consequences of Noncompliance

**Personal Liability**

- Volunteer directors of a Federal credit union were sued for $6.8 billion for failure to supervise credit union’s investment decisions.
- Credit union had invested heavily in mortgage-backed securities; when credit crisis hit, the Natl Credit Union Administration took over and sued the directors and officers.
- Court found that directors were protected by the business judgment rule.
- Officers did not fare as well; the business judgment rule did not protect them, officers had to pay money damages and suffered other sanctions.
Consequences of Noncompliance

Personal Liability

- A director was held personally liable for willful misconduct when his predominant motive was to prevent a creditor from collecting a debt
  
  - *IGL-Wisconsin Awning, Tent & Trailer Co. v. Milwaukee Air & Water Show, Inc.*, 185 Wis. 2d 864, 874, 520 N.W.2d 279 (Ct. App. 1994)
Consequences of Noncompliance

**Personal Liability**

- The lessons of these cases are:
  - You can be sued.
  - If you are sued, litigation can go on for years and be very expensive—even if ultimately you are vindicated.
  - Directors of nonprofits, despite usually being volunteers, can face personal liability for breach of their fiduciary duties and will be held to much the same standard of care as directors of for-profit corporations.
Avoiding Liability
Avoiding Liability

**ND nonprofit corporation immunity**

- A director shall discharge his duties:
  - in good faith,
  - in a manner the director reasonably believes to be in the best interests of the corporation, and
  - with the care an ordinarily prudent person in a like position would exercise under similar circumstances.

- A person who so performs those duties is not liable by reason of being or having been a director.

- A director is expressly **not** considered a “trustee”

  - *NDCC § 10-33-45*
Avoiding Liability – Tip One

Establish Appropriate Policies

- For example, conflict of interest policy, gift acceptance policy, whistleblower protection policy, record retention, etc.
- Boards should adopt and follow a written conflict-of-interest policy that prohibits members from engaging in either business or financial transactions with anyone directly connected to the organization.
- Alternatively, the policy should clearly state the conditions under which it would be acceptable to conduct business with an organization with which there is a conflict.
- Have board members sign a conflict of interest statement annually that defines potential conflicts and requires disclosure.
Avoiding Liability – Tip Two

Establish Appropriate Committees

• Board should consider establishing committees that will allow a detailed review of that time would not allow during a board meeting.

• Consider:
  – Executive committee that can act between regularly scheduled board meetings;
  – Audit committee;
  – Finance committee;
  – Nominating committee
Avoiding Liability – Tip Three

Establish Board Performance Measures

• Board should schedule strategic planning and mission evaluation on a regular basis.

• Consider conducting a self-evaluation, evaluation of Board Chair

• Survey the organization’s staff, stakeholders about metrics to measure success and the best use of resources.

• Board should track compliance with quality of care metrics, compliance with Medicare Conditions of Participation, accrediting body standards, etc.
Avoiding Liability – Tip Four

*Inventory Board Members’ Knowledge of Mission*

- Annually review the organization’s corporate structure, mission, and stakeholders;
- Discuss why the organization exists; what its purpose is, the “Why”;
- Maintain evidence of competence of all individuals who have significant responsibilities within the organization;
Avoiding Liability – Tip Five

Actively Engage

- Regularly attend board and committee meetings;
- Be prepared - review all written reports and recommendations on which the board bases its decision;
- Ask pointed questions;
- When appropriate, voice any concerns or objections to the organization’s activities;
- Insist that any disapproval be recorded in the minutes;
Establish Plan to Oversee Compliance

- Ensure that a corporate information and reporting system exists;
- Ensure that reporting system will adequately, timely and as a matter of course communicate to the board all appropriate information relating to compliance with applicable laws.
Avoiding Liability – Tip Seven

Mitigate Risk

• When appropriate, require that the organization’s board consult legal counsel or other experts;
• Ensure that the organization maintains adequate insurance coverage types and amounts.
QUESTIONS?
Thank You.

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