



COLLABORATIVE TRANSFORMATION

FOCUS ON INNOVATION CENTERS

GOVERNING HEALTH



CO-INVESTMENT ARRANGEMENTS: KEY GOVERNANCE PLANNING CONSIDERATIONS

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As health systems continue to explore strategic investments and joint ventures—particularly in the areas of digital health and other technology innovation, “big data” strategies, and research—opportunities may arise for officers and directors to become co-investors with the health system as a means of furthering the health system’s venture-specific goals and objectives.

The mere opportunity to invest should not be legally problematic. However, several important legal standards are essential to consider at the earliest planning stages, including: (i) the common law duty of loyalty and the business judgment rule; (ii) private inurement and excess benefit considerations under the Internal Revenue Code; (iii) state nonprofit corporation and charitable trust laws; and (iv) laws and industry standards addressing management of potential conflicts of interest.

In addition, prudent management of legal issues, good intentions and honesty of purpose may not always be enough to manage the possibility that internal constituencies, regulators and the media may nevertheless judge a co-investment arrangement based largely on appearance and misperceptions.

There is no recognized “best practice” for evaluating co-investment opportunities, and applicable legal requirements can vary between and among current federal and state laws. Nonetheless, focusing on the following high-level planning considerations may guide health systems and their officers and directors navigating these legal issues:

- 1 The process by which the organization’s acquisition of the interest was reviewed and approved by the board (*e.g.*, involvement of only disinterested, non-conflicted directors/committee members; consideration of appropriate valuation findings and other relevant and appropriate data; reliance on credible legal and tax advice)

- 2 The extent to which any officer or director (not just one who seeks to invest along with the corporation) has a financial interest or material business or personal relationship with any potential co-investors or any external advisors with which the health system consults in the decision-making process
- 3 The performance of an appropriate level of due diligence in determining that the investment is consistent with the health system's charitable mission, vision and purposes, as well as its strategic plan and investment guidelines
- 4 The extent to which the investment opportunity is offered widely or on a selective/preferential basis and whether certain investors are offered preferential investor status or other more favorable terms than other investors
- 5 Whether an officer or director is being offered a special financial benefit because the health system is also investing in the same company (*i.e.*, the same opportunity would not be available if the officer or director was making the investment on his or her own initiative)
- 6 The mechanism by which the investment interest is managed on behalf of the health system, including the health system's consideration of expanding or withdrawing its investment (*e.g.*, oversight by disinterested, non-conflicted directors; consultation with outside experts; appropriate conflict management plans with interested directors/officers that are vigilantly enforced and periodically modified as necessary)
- 7 General consistency with the organization's own policies and procedures (*e.g.*, policies/procedures on conflicts of interest, investments, and relationships with industry)
- 8 The potential for bias arising from the governance, operational or strategic decisions made by the investment entity (*e.g.*, whether a health system's co-investing board member, who serves on the board or a committee of the investment entity, would need to make decisions for the entity that may conflict with the best interests of the health system; conversely, whether a health system's board member could be required to make decisions for the health system that may conflict with the best interests of the investment entity)
- 9 The potential that through his/her personal involvement in the operation of the investment entity (or affiliate thereof), a co-investing health system officer or director could learn of confidential information which, if known to the health system, would be material to the oversight of its investment interest
- 10 The potential that a co-investing officer's or director's decision to exit the investment could cause the investment entity to limit redemptions from other investors (thereby frustrating the health system's ability to redeem its own investment interest in a timely manner)

These factors are not intended to be prescriptive, mandatory or all-inclusive. In evaluating the appropriateness of a particular co investment with officers or directors, each organization should identify and assess the relevant factors based on its particular facts and circumstances and through an appropriate independent process.

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