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## Observations on Conflicts of Interest in Health Care

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The health care sector has experienced several significant and highly publicized conflicts of interest controversies in the last several months. These controversies have, in part, raised issues with the adequacy of relevant organizational conflicts policies, and awareness by officers and directors of their fiduciary obligations. They have implicated matters of individual and organizational reputation and suggested collateral self-dealing concerns.

Collectively, these controversies provide a useful opportunity to refresh the awareness of officers and directors on the subject of proper conflict of interest management; i.e., to review "what it's all about." Given that such issues involve to a large degree matters of law and ethics, the health system's chief legal officer is the logical corporate executive to lead such discourse, with support from the compliance officer and organizational psychology consultants.

To support the health care system chief legal officer in such educational efforts, the following observations on core legal principles are offered.

### Core Fiduciary Considerations

The duty of loyalty seeks to prevent those in a fiduciary relationship to the organization (i.e., an officer or director) from using his or her position (including but not limited to voting rights) for individual personal advantage. This principle is incorporated within statutory and common law guidance that obligates officers and directors to act in good faith and in a manner he or she reasonably believes to be in the best interests of the corporation, as opposed to his/her own interests.

### Scope of the Law

It is important to understand that corporate law does not prohibit conflicts of interest; i.e., the presence of a conflict of interest does not *per se* constitute a breach of fiduciary duty. Rather, the officer or director's compliance with his fiduciary obligations will be evaluated in large part by the manner in which he or she responds to the conflict.

Modern business and nonprofit corporation laws generally allow conflicts of interest transactions when certain statutory safeguards are satisfied (discussed further below). This approach reflects a public policy that conflicts of interest are best addressed by scrutiny and management, rather than by efforts to eliminate or prohibit them. This "permissive" approach is in direct contrast to older, trust-grounded corporation laws that held officers and directors to the standards of trustees of a charitable trust (or similar higher level of conduct); i.e., a prohibition of conflicts of interest transactions.

### Duty of Loyalty

As noted above, corporate law recognizes that conflicts of interest will arise in the activity of a corporate board, particularly one with a diverse constituency reflective of various civic, community, business, professional, and other background and experience. When conflicts arise, the duty of loyalty requires that the implicated officer or director respond with "care and candor," which would include full and prompt internal disclosure of the potential conflict consistent with organizational policy.

Some elements of common law suggest that board members also may have a duty to avoid conflicts of interest to the extent possible. This is particularly the case with respect to arrangements that no board could reasonably waive or manage in the best interests of the corporation, given the underlying facts and circumstances.

### **Duty of Care**

Beyond core duty of loyalty issues, it is important to recognize that critical aspects of the conflicts identification, review, and mitigation process implicate the board's duty of care. This process includes (1) the delegation of conflicts oversight responsibilities to a specially chartered committee; (2) how the board/committee makes, confirms, and monitors its decisions; (3) committee meeting frequency and reporting to the board; and (4) enforcement of conflicts policy violations.

Should the board vote to approve a conflict of interest transaction (presumably in compliance with the below-referenced state laws), the duty of care will extend to the development, implementation, and oversight of any board-mandated conflicts of interest management plans.

### **The Basic Analysis**

The traditional conflicts analysis focuses on whether the officer or director has an interest in an arrangement of such personal significance that could reasonably be expected to affect his/her judgment when called upon to vote upon, or otherwise exercise oversight with respect to, the arrangement.

### **State Statutes**

Some state statutes incorporate a recitation of the duties of care and loyalty in a manner that provide guidance on the favored approach to conflicts of interest. Other states do so through common law.

Many state corporation codes provide that conflict of interest transactions are not automatically void or voidable if any of certain factors have been satisfied; e.g., the board (or the corporation's members) makes a fully informed decision to approve the arrangement, or the arrangement is fair to the corporation at the time of its authorization. The relevant analysis typically incorporates some determination (based on appropriate diligence) that no reasonable alternative to the arrangement exists. There is significant nuance involved in the interpretation and application of these statutory provisions.

### **Why We Care**

Directors should be highly motivated to properly address conflicts of interest transactions for three principal reasons. *First* is the potential that a third party (e.g., regulator, corporate member, constituents in a derivative action) could challenge the underlying transaction or arrangement as voidable (i.e., the product of bias or self-dealing). *Second* is the risk of substantial damage to the reputation of the organization. *Third* is the potential for officer or director exposure to breach of fiduciary duty allegations and to individual reputational damage.

The current health industry controversies provide an exclamation point to these reasons. There is also a reasonable potential that the current controversies may lead to stricter regulatory scrutiny of conflicts transactions, and to state legislation that could limit or even prohibit types of conflicts transactions (i.e., a return to the trust law approach).

It should also be noted that conflicts of interest can have a spillover effect on regulatory perceptions of the effectiveness of the board, its adherence to fiduciary duties, and its commitment to an organizational culture of compliance. In addition, evidence of material conflict or self-dealing also can implicate the private inurement, excess private benefit and intermediate sanctions provisions of the Internal Revenue Code, among other laws grounded in the effects of self-dealing.

## **Who Cares About It**

Allegations of violations of conflicts of interest and the related fiduciary obligations can attract scrutiny from a wide variety of regulatory bodies. For nonprofit organizations, these primarily include the state attorney general and the Internal Revenue Service. For public companies, these include constituents through derivative actions and regulatory agencies such as the Securities and Exchange Commission.

## **What's New and Different**

Beyond the relevance of the recent controversies, broader trends within health care are operating to add new complexity to the conflicts equation. These trends include the evolution of the health care delivery model; rapid consolidation of the inpatient provider sector; new entrants to the competitive landscape; director "overboarding"; dramatic advances in technology and data development; more diverse boards, and more expansive investment portfolios.

Individually and collectively, they serve to significantly expand the type and scope of business relationships and other arrangements that could give rise to potential or actual conflicts of interest. The ultimate question is whether the health system board's current approach to conflicts identification, review, and mitigation is sufficient to address those trends.

## **Conclusion**

The interests of the organization (including both its reputation and the sustainability of its business relationships), as well as the interests of the board and its individual directors (including both matters of fiduciary compliance and reputation) are well served by a conflicts of interest update. Timing for such an update is "ripe" given the recent, highly publicized health industry conflicts of interest controversies. The health system's general counsel should be a major participant in any related board discussion or educational programming.

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