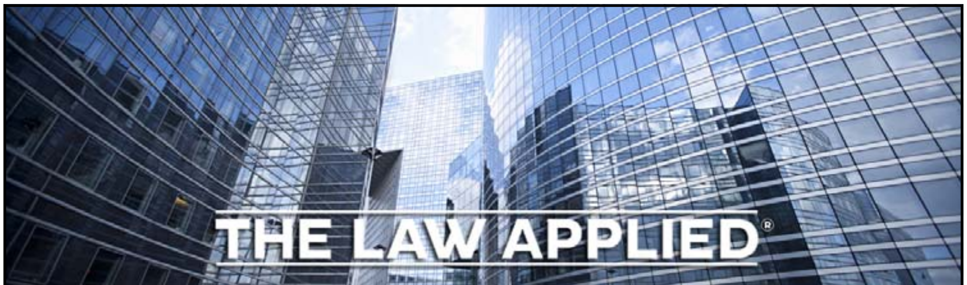

Good Governance Practices for Not-For-Profit Corporations and Avoiding Conflict of Interest

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What Board Members Should Know About Operations

- Laws, Regulations, Rules Affecting Industry
- Board Responsibilities
- Fiduciary Duties
- Finance 101

2

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Key Issue for Boards: Oversight

- Boards should not try to manage day-to-day operations.
- Boards should focus on achieving an organization’s mission, not micromanaging operations.
- Boards focus on long term objectives, policies, hiring administration and receiving reports.
- Administrators focus on tactical steps to achieve strategic plan, implementing and enforcing policies, handling day to day issues, dealing with employment issues, and reporting to Board.

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Key Issue for Boards: Authority

- The Board has authority, not individual members.
- The Board may delegate authority to committees or individuals.
- Individual Board Members lack authority to act on their own unless authorized by the Board.
- Board Members acting outside of their scope of authority may expose themselves to liability.

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Key Issue for Boards: Composition

- Board candidates should be selected with a set of criteria in mind that are specific to the needs of the particular not-for-profit organization.
- The board (through a nominating committee, if there is one) should engage in a review of the composition of the board as a whole periodically, including the balance of independence, business specialization, technical skills, diversity, fundraising ability and/or willingness to make personally meaningful gifts, geographic representation and other desired qualities that directors bring to the board (such as integrity and sound judgment).

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Governing Laws

- New York Not-for-Profit Corporation Law (N-PCL); Revitalization Act: Effective July 1, 2014
  - Nonprofit Revitalization Act Goals:
    - Enhance nonprofit governance and oversight to prevent fraud and improve public trust; and
    - Reduce unnecessary and outdated burdens on nonprofits.
- Internal Revenue Code
  - Rules for tax exemption Section 501(c)

6

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Attorney General Oversight

The Attorney General may sue not-for-profit directors and officers for a breach of fiduciary duty.
In addition, the Attorney General has authority under the N-PCL to regulate fundamental changes and to play a role in overseeing major developments and transactions at a not-for-profit corporation which require court approval, such as:

- Amendments to certificates of incorporation that change an organization's purpose;
- Sale, lease, exchange or other disposition of all or substantially all the assets of the organization;
- Dissolution; and
- Mergers and consolidations.

IRS "Recommended" Policies

- Conflict of Interest
- Whistleblower
- Document Retention & Destruction
- Executive Compensation
- Investment & Joint Ventures

Conflict of Interest Policy

Mandatory Conflict of Interest Policy Must Include:	A definition of conflicts
	Procedures for disclosure of conflicts to Board or Committee
	Conflicted person must be recused from deliberations & voting on the subject
	Conflicted person may not attempt to improperly influence the vote
	Decisions involving a conflict must be documented in meeting minutes

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Conflict of Interest Examples

Examples include:	Contract with entity owned by Board Member or related person
	New service that may affect Board Member or related person
	Action that might impact a competitor of a Board Member outside interest
	Rules or policies that may result in material financial impact on Board Member or related person
	Where interest would reasonably influence Board Member's judgment

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Enhanced Attorney General Enforcement Authority

1. The AG is authorized to seek damages, restitution, removal and/or an accounting in connection with improper related party transactions.
2. The AG may seek double damages for "willful and intentional conduct" in connection with an improper related party transaction.
3. Directors, officers and Key Employees are subject to supervision of AG in same manner as the organization.

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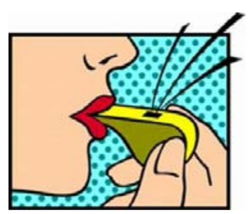
Whistleblower Policy

- Theft
- Misleading financial reporting
- Improper or undocumented transactions/issues with billing or documentation
- Improper destruction of records
- Improper use of assets
- Violations of conflict of interest policy
- Other improper occurrences regarding cash, financial procedures or reporting



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Fiduciary Duties

Trustee = Fiduciary

- Trustee – holds or cares for property for the benefit of others; one in whom trust is placed.
- Fiduciary – holds or cares for property of another; faithful, loyal, true.

Fiduciary Duties

- Duty of Care
- Duty of Obedience
- Duty of Loyalty

Duty of Care

Reasonable Person Standard:

- Officers and directors must carry out duties in good faith using the "degree of diligence, care and skill" of "ordinarily prudent" persons in similar positions under similar circumstances

Standard of Care Does Not Require Perfection:

- Good faith
- Exercising level of diligence, care & skill a prudent person would use under similar circumstances
- Reasonable belief acting within the best interest of the organization
- Reasonable Inquiry

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Duty of Care

- Attend meetings, read all materials; take reasonable steps to be informed
- Be prepared, ask questions; make reasonable inquiry
- Review minutes for accuracy prior to approval (confirm vote tallies are accurate)
- Active involvement in selection/review of officers
- Ensure compliance with policies regarding conflicts, executive compensation, joint ventures and whistleblowers
- Ask an expert to attend meetings for input; may rely on officers, committees or outside professionals if reliance is reasonable

16

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Duty of Care

For reliance to be defensible it must be placed upon experts who are competent in their fields; competence generally implies expertise. When relying on an "expert" opinion, diligence requires that the board investigate the expert's qualifications and ascertain his competence. The director must review the material and follow up with any questions presented by that material.

"If all a director knows about a report is the conclusion, he is not acting in good faith or with the required diligence." Moreover, if a director has some expertise in a particular field, he is held to a higher standard while evaluating information presented to the board, even though other board members would only be subject to a layman's standard in order to satisfy the duty of care.

Duty of Care

- Document efforts and information used in board minutes
- Exercise independent judgment; do not "rubber stamp" decisions
- Vote "no" when necessary
- Do not act in haste; defer and wait for additional information if needed
- Establish appropriate committees to address key areas
- Establish mechanism to receive and review reports

Duty of Care

When Voting, Ask Yourself:

- Is the transaction in line with our mission?
- Are we getting the best (not necessarily the cheapest) deal?
- How long are we committing for?
- Are we within our budget?

OIG Guidance:

- “It is the process the Board follows in establishing that it had access to sufficient information and that it has asked appropriate questions that is most critical to meeting its duty of care.”

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Duty of Loyalty

Directors & Officers Have a Duty to Always Act in the **BEST INTEREST** of the Corporation:

- Avoid or seriously consider transactions where a director or officer benefits
- Disclose conflicts of interest to the Board (in accordance with Conflict of Interest Policy)
- Approve transactions that are fair and reasonable
- Establish procedures for employees to report financial impropriety (Whistleblower Policy)
- Do not use position for individual gain or to compete with hospital
- Do not usurp an organization opportunity

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Duty of Obedience

Ensure the Organization:

- Complies with applicable federal & state laws and regulations
- Complies with its internal documents and policies, including bylaws and Board delegation
- Uses its resources to further the charitable mission and advance goals as expressed in organization bylaws
- Board Members may be liable for acts outside their scope of authority

The Business Judgment Rule

Even when a corporation's ultimate outcome has been negative, Courts are reluctant to second-guess Boards of Directors that establish the Board followed a careful and thoughtful process during deliberations.

The Business Judgment Rule

Minutes and Records: Boards and their committees should ensure that minutes of their meetings, and actions taken by written consent, are contemporaneously documented.

- Summarize the deliberative process undertaken by the board and committees as they address organizational issues in the proper discharge of their fiduciary duties; in this way, the minutes/records serve not only as important reminders as to what has been decided and why, but also serve as evidence as to how the board and committees fulfilled their fiduciary duties.

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Expectations for Board Oversight of Compliance Program Functions

A Board must act in good faith in the exercise of its oversight responsibility for its organization, including making inquires to ensure:

- A corporate information & reporting system exists, AND
- The reporting system is adequate to assure the Board that appropriate information relating to compliance with applicable laws will come to its attention timely and as a matter of course

In re Caremark Int'l Inc. Derivative Litigation, 698 A.2d 959 (Del. Ch. 1996):

- "[A] director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the Board concludes is adequate, exists, and that **failure to do so under some circumstances, may, in theory at least, render a director liable for losses caused by non-compliance with applicable legal standards**."

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Business Judgment Rule Cases

Stern v. Sibley Memorial Hospital

- Trustees deposited hospital assets at local banks at low or no interest; no reasonable investments
- Board Members had ties to the bank
- Finance committee never met in 10 years
- Breach of fiduciary duty

In re Caremark Int'l Inc. Derivative Litigation

- Caremark has to pay millions in fines for violating fraud and abuse laws
- Board sought advice from counsel
- Counsel said area was gray – regulators disagreed
- No breach of fiduciary duty

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Board of Director Guidance References

Corporate Responsibility and Corporate Compliance: A Resource for Health Care Boards of Directors	• *Published by:* The Office of Inspector General of the U.S. Department of Health & Human Services, and American Health Lawyers Association
Corporate Responsibility and Health Care Quality: A Resource for Health Care Boards of Directors	• *Published by:* The Office of Inspector General of the U.S. Department of Health and Human Services, and American Health Lawyers Association
Right from the Start: Responsibilities of Directors and Officers of Not-for-Profit Corporations	• *Published by:* The New York State Attorney General's Office
Internal Controls and Financial Accountability for Not-for-Profit Boards	• *Published by:* The New York State Attorney General's Office

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2015 Guidance Issued

Practical Guidance for Health Care Governing Boards on Compliance Oversight

- *Published by:* The U.S. Department of Health and Human Services Office of Inspector General (OIG), in conjunction with the American Health Lawyers Association (AHLA), the Association of Healthcare Internal Auditors (AHIA) & the Health Care Compliance Association (HCCA)

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Duty of Confidentiality

Directors & Officers Have a Duty of Confidentiality:

- Not to use or disclose confidential, non-public information obtained in capacity as Board Member without authorization
- May be liable for improper disclosures

28

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Board Responsibilities

- Commitment to organization mission, vision, and values
- Strategic Planning
- Hiring effective administration
- Financial stability
- Community relations

Board Responsibilities

- Respect process
- Understand and support duly made decisions
- Be publicly supportive of organization
- Follow established chain of command
- Ask questions, follow-up on issues

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Board Responsibilities

- Statutory and regulatory compliance; risk analysis
- Board education and efficient processes
- Approving budgets
- Oversight of policies and procedures
- Obtaining reports from administration
- Planning for succession

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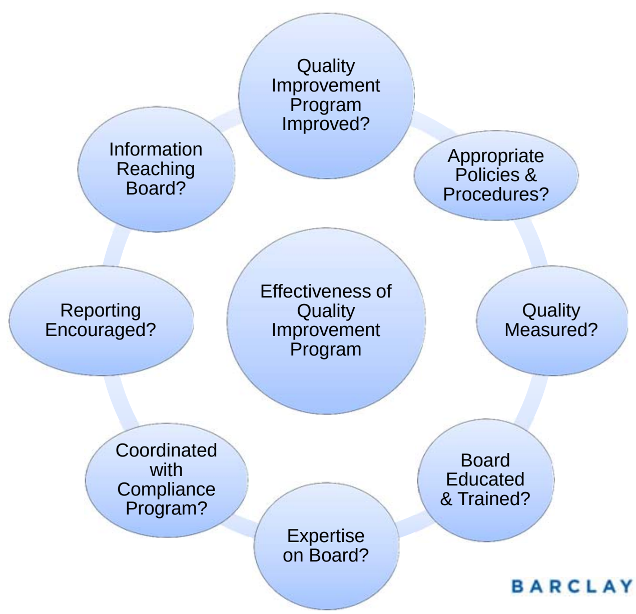
Board Responsibility for Quality



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Board Issues with Cyber Security: Claims Related to Breach of Fiduciary Duty

- **Wyndham** - (dismissed in October 2014) - In dismissing the lawsuit, court referenced discussions at 14 board meetings; in at least 16 audit committee meetings; and that Wyndham hired a security consultant and began to implement the consultant's recommendations.
- In the **Target** case (dismissed in July 2016) - No action allowed based upon the data security measures in place pre-breach, the changes enacted post-breach and management's reports to the board's audit committee and corporate responsibility committee covering the company's data security measures.
- In the **Home Depot** case (dismissed in November 2016) - In dismissing the case, the court observed "numerous instances where the Audit Committee received regular reports from management on the state of Home Depot's data security, and the Board in turn received briefings from both management and the Audit Committee."

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BoardSource's "Twelve Principles of Governance that Power Exceptional Boards"

- 1. Constructive Partnership – Exceptional boards govern in constructive partnership with the chief executive, recognizing that the effectiveness of the board and chief executive are interdependent.
- 2. Mission Driven - Exceptional boards shape and uphold the mission, articulate a compelling vision, and ensure the congruence between decisions and core values.
- 3. Strategic Thinking - Exceptional boards allocate time to what matters most and continuously engage in strategic thinking to hone the organization's direction.
- 4. Cultural Inquiry - Exceptional boards institutionalize a culture of inquiry, mutual respect, and constructive debate that leads to sound and shared decision making.
- Independent mindedness - Exceptional boards are independent-minded. When making decisions, board members put the interests of the organization above all else.

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BoardSource's "Twelve Principles of Governance that Power Exceptional Boards"

- **6**. **Ethos of Transparency -** Exceptional boards promote an ethos of transparency by ensuring that donors, stakeholders, and interested members of the public have access to appropriate and accurate information regarding finances, operations, and results.
- **7**. **Compliance with Integrity** - Exceptional boards promote strong ethical values and disciplined compliance by establishing appropriate mechanisms for active oversight.
- **8.**. **Sustaining Resources** - Exceptional boards link bold visions and ambitious plans to financial support, expertise, and networks of influence.
- **9. Results-Oriented** - Exceptional boards are results-oriented.. They measure the organization's advancement towards mission and evaluate the performance of major programs and services.
- **10. Intentional Board Practices -** Exceptional boards intentionally structure themselves to fulfill essential governance duties and to support organizational priorities.
- **11. Continuous Learning** - Exceptional boards embrace the qualities of a continuous learning organization, evaluating their own performance and assessing the value they add to the organization.
- **12**. **Revitalization** - Exceptional boards energize themselves through planned turnover, thoughtful recruitment, and inclusiveness.

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Questions?

Thanks for your time.

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