

Where Was the (Health System) Board?

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A series of corporate controversies over the past year involving director attentiveness provide important lessons to health system boards on the scope of their oversight responsibilities, and on their ability to spot warning signs of corporate concern.

You may remember some of them: an automotive company's malfunctioning safety device; a financial services firm's sales program pushing unnecessary credit accounts; advance warnings to a consumer credit reporting company that its data system was being hacked; indications that a health technology company was using standard technology in its blood testing operations, rather than its touted proprietary technology; and the repulsive actions of an entertainment company executive being a widely known industry "secret."

Common threads among these controversies were 1) that they brought the company "to its knees" from both financial and reputational perspectives; and 2) the governing board was essentially unaware of the burgeoning concern until the crisis hit in full force.

These are the "Where was the Board?" headlines; media coverage that often leads to forceful responses from corporate constituents and regulators with responsibility for monitoring director conduct. Suggestions that directors were inattentive to "red flags" of misconduct or financial crisis can certainly prompt inquiry, and the Internet-based media increases the potential that allegations of inattentiveness will become public. And there is no question that similar controversies can (and probably do) arise in the healthcare sector on a regular basis.

These controversies go to the essence of the director's oversight obligation; the expectation that the board will have in place an information reporting system that will provide information that requires its attention (e.g., "things that

cause management to wake up in the middle of the night"). Such a system is intended to position the board to make reasonable inquiry when "suspicions are aroused or should be aroused."

With these kinds of controversies, the "we didn't know" defense is increasingly less sustainable—even if it may be factually accurate. The response is increasingly "You should have known; you should have a system and culture in place that would have alerted you to the warning signs." And that can be a hard argument to rebut, more often than some boards may want to admit.

For these and similar reasons, the health system board should proactively evaluate the effectiveness of its information reporting systems.

An effective corporate compliance program is one way to provide the board with such information, but only if the board is vigilant in working with senior management to assure its continued effectiveness. This includes a streamlined means by which reporting on credible compliance and hotline developments is "mainstreamed" in a timely manner to the audit (or similar) board committee.

Evaluating the relationship of corporate structure to board reporting may also be a helpful exercise. A decentralized corporate structure—in which accountability, reporting systems, and decision making was pushed downstream to the major business unit level, rather than to the headquarters level—has been cited as a major contributing factor in a huge corporate misconduct controversy in the financial services sector.

Culture can also be a significant factor. The board has an express obligation to promote an organizational culture that encourages ethical conduct and a commitment to compliance with

the law. Health system boards should take advantage of the current governance emphasis on workforce culture to encourage employees to share with their superiors incidents of possible workforce misconduct, in whatever form. Those superiors should, in turn, be directed and incentivized to report those incidents upstream.

An additional measure is for the board to clarify the lines of authority and information from management. This involves a common understanding of those types of developments that, upon becoming aware of them, senior management must bring immediately to the board's attention.

And then there is the very valuable step in having the general counsel review with the board "the basics" (i.e., not only an appreciation

for its oversight duties, but also a familiarity of the type of developments that case law suggest might fit within the definition of "red flag" and require further board inquiry).

The non-profit health system board should take close note of recent headlines involving corporate controversies, and their "Where was the Board?" theme. In the non-profit sector, the state attorney general views the board as the "first line of defense" against fraud or mismanagement, particularly given the absence of the market factor. And nothing good happens if the board fails in that capacity.

For that reason, it's a good use of the board's time to make sure it has an effective process by which information regarding possible "red flags" will get to its attention in a timely manner.

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