



The Governance Institute's E-Briefings



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Welcome to The Governance Institute's E-Briefings!

This newsletter is designed to inform you about new research and expert opinions in the area of hospital and health system governance, as well as to update you on services and events at The Governance Institute. Please note that you are receiving this newsletter because you are a Governance Institute member or expressed interest at one of our conferences.

News, Articles, and Updates

Revisiting the Role of the Executive Committee

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This article is the fifth in a series on efficient board committee practices (refer to previous issues of E-Briefings to read about the strategic alignment committee, executive compensation committee, audit committee, and compliance committee).

Hospital and health system boards should reconsider the continued utility of the executive committee, given recent developments in non-profit corporate governance and the rapid pace of organizational change prompted by healthcare reform. While a standing executive committee has long been a staple of boardroom practice, there are increasing questions about its relevance in the current environment. The executive committee is often not an appropriate substitute for full board action on important oversight and transactional matters. Similarly, extensive reliance on the executive committee can serve to exacerbate, not ameliorate, governance issues created by large boards. In addition, "loading up" the executive committee charter with extra, nontraditional duties can create particular board oversight concerns. Yet, there remains real value in preserving an executive committee function for truly urgent situations, and to address evolving organizational issues for which maintaining extreme confidentiality is a paramount concern. For these and other reasons, the board should reevaluate the role of the executive committee, as part of its 2011 agenda.

The Basic Role of the Executive Committee

The premise of the executive committee is grounded in the fundamental authority of the board to delegate certain tasks and responsibilities to

properly constituted committees. The role and scope of duties of the executive committee are typically set by statute and have been consistently applied over the years. Generally, these statutes provide that during the interval between meetings of the full board, the executive committee is empowered to exercise the powers of the full board with respect to any matter that, in the opinion of the board chair, should not be postponed until the next scheduled meeting of the board. Despite that grant of authority, the executive committee does not have the power or the authority of the board with respect to certain key actions, such as to a) adopt a plan of distribution of corporate assets; b) approve or recommend to the corporate member dissolution, merger/sale, or transfer of assets; c) fill board or committee vacancies; d) elect, appoint, or remove officers, directors and/or committee members or fix the compensation of a committee member; e) adopt, amend, or repeal the articles or bylaws; f) adopt a plan, merger, or consolidation or authorize the sale of all or substantially all of the assets of the corporation; and g) take action inconsistent with any resolution or action of the board when that resolution or action specifically provides that it can't be changed by committee action. In addition, the role and scope of the executive committee may be limited by the corporate bylaws or by governance policy.

It is important to remember that the board cannot delegate to any committee its core oversight

obligations. For that reason, a key part of executive committee practice is the regular reporting of its actions to the full board. This allows the board to exercise oversight with respect to the actions of the executive committee and, in particular, to ratify or reverse the action should it choose to do so. (In practicality, however, reversal may be easier said than done.) Minutes of executive committee meetings should be taken, with the same level of detail as with those of full board meetings, and distributed to the full board.

While reference to specific state law should always be made, the basic concept is pretty simple—the executive committee can usually act on behalf of the board between meetings, except that it is never authorized to act with respect to powers that are fundamental to board operation (e.g., composition of the board and committees), major transactions (e.g., mergers and acquisitions), and corporate status (e.g., amending the articles and bylaws).

The non-profit laws of many states limit membership in the executive committee to currently serving board members. Oftentimes, this translates to the senior board officers, with the chief executive serving in an *ex-officio* role, without voting rights. It makes sense for the general counsel to serve as “staff” to the executive committee, and to be present for all meetings. Interestingly enough, there is no strong trend advocating for the complete independence of executive committee members (as opposed to the composition of other key committees, such as compensation, compliance, and audit). This allows for greater flexibility in the composition of committee membership.

Review Points

Despite the consistency of the law as it relates to the scope and role of the executive committee, the “smart play” is for the board to reconsider its use as a governance tool. This is in large part due to the increased public policy focus on governance transparency, and the role of the entire board in both exercising oversight over corporate operations and in making informed decisions on major corporate issues. Broad, fundamental governance themes arising not only from the Sarbanes-Oxley reforms but also from the embers of the recession attribute great organizational value to full board participation in critical oversight and decision-making activity. In that regard, the continued role of the executive committee should

be evaluated against the following review points:

- **Committee power.** Given today’s fast moving healthcare environment, with change occurring at breakneck speed and major reform-prompted corporate transactions becoming the norm rather than the exception, there is great organizational value in the board’s ability to enhance its decision-making timetable (to be able to make decisions on an accelerated schedule). The executive committee has traditionally provided an organization with the ability to expedite the decision-making process when circumstances warranted. However, the question is increasingly becoming whether the types of major strategic opportunities that confront hospital/health system boards (e.g., ACO investment, physician integration transactions, debt strategy and capital investment, mergers and acquisitions) lend themselves well to executive committee action. The fluid nature of most healthcare markets calls for timely decision making with respect to these and other types of opportunities. Yet, some opportunities may be of such organizational significance as to push against the statutory limitations (express or implied) on executive committee action. The board should ask itself whether there are certain kinds of strategic decisions of such organizational significance that should be resolved by the entire board, even if the executive committee is not clearly prevented by state law from taking action. Where time is of the essence, would it be a better use of energy to call a special or emergency meeting of the full board to address the issue? The closer the issue gets to the limits of executive committee action, the greater the uncertainty that the committee’s actual decision will be enforceable. For example, in the transactional context, opposing counsel may refuse to accept executive committee action as evidence of corporate authority. That could be a real dice roll in “big deal” situations.
- **Large boards.** Over the last decade, the size of many hospital and health system boards has grown significantly, in part due to the need to accommodate significant community/partner constituencies, and in part due to the need to accommodate significant donors interested in board positions. This has often created cumbersome board deliberative processes,

a disinclination to meet on a monthly or near monthly basis, and a distinct barrier to obtaining a simple quorum in certain circumstances. The executive committee has traditionally provided the organization with the means for overcoming these types of governance challenges (i.e., a nimble and responsive body capable of meeting regularly on short notice, and maintaining effective communication links with senior management). Yet, extensive use of the executive committee in this context can start governance on the slippery slope of disenfranchising those members of the board who do not participate in any committee role. In other words, the executive committee has been a seductive antidote to the governance maladies of large or very large boards.

“Extensive reliance on the executive committee can create an unfortunate/inaccurate presumption that board control is isolated with a few individuals and that charitable assets may thus be placed at greater risk. This can especially be the case where the bylaws lack a specific authorization provision delegating key board functions and duties to the executive committee.”

In this way, extensive reliance on the executive committee can create its own unique governance issues. Board members who do not serve on the executive or other key committees may become totally isolated from the business of the board and from contact with executive management. Their ability to render informed decision making, and to affect diligent oversight of management and operations, is reduced. In extreme circumstances, their personal risk for breach of fiduciary duty may be increased because they are so removed from actual governance activity. The inability to provide meaningful input on governance matters may also have the effect of reducing board morale and making board service less attractive. It can also create an

unfortunate/inaccurate presumption that board control is isolated with a few individuals (i.e., the executive committee members) and that charitable assets may thus be placed at greater risk. This can especially be the case where the bylaws lack a specific authorization provision delegating key board functions and duties to the executive committee.

- **Loading up.** In recent years, many hospitals and health systems have sought to “streamline” corporate governance processes in multiple ways to reduce the perceived burden on management and volunteer directors. A popular streamlining option is to reduce the number of standing committees by combining certain discrete committee functions within a smaller subset of committees. An example of this is the practice of including audit, finance, and compliance oversight within one large audit committee. The executive committee is not immune to streamlining, as it is not unusual to see governance/nominating duties, conflict-of-interest review, and even executive compensation oversight combined within the scope of the executive committee charter. This type of streamlining creates at least three governance risks. First, it could serve to add functions that are typically the responsibility of a committee consisting entirely of independent members (e.g., executive compensation) to a committee that typically does not consist entirely of independent members (the executive committee), thus jeopardizing satisfaction of some state laws and “safe harbor” protections. Second, it could require the executive committee to take action for which, in certain extreme instances, it may not be authorized to take under state law (e.g., appointing officers, directors, and committee members or approving committee member compensation). Third, it could help to increase any preexisting inclination for the executive committee to (intentionally or unintentionally) usurp the authority of the full board. The greater the concentration of authority in the executive committee, the less likely certain important issues will reach full board review.
- **“Temperature taking.”** On a more positive note, an underutilized role of the executive committee is to serve as a sounding board of sorts for senior executive leadership. The executive committee allows a way for management to take the temperature of the

board with respect to certain important and potentially controversial issues. The ability to informally discuss certain important pending issues with board leadership/the executive committee can often provide executive management with timely feedback on whether to pursue certain important initiatives. Along the same lines, the executive committee can also serve to provide a point of interim board oversight and reference on critical transactions and important developments, where there may be legitimate confidentiality concerns about disclosure to the full board as the developments emerge (e.g., the receipt of an unsolicited offer to purchase the facility, or the commencement of an internal board or external governmental investigation). Using the board in a “temperature taking”

role can balance the sometimes competing interests of fiduciary oversight, management feedback, confidentiality, and timing.

Conclusion

The executive committee is an established part of the governance structure of most non-profit hospitals and health systems. There are many useful roles that the committee may play in support of enhanced corporate governance. At the same time, recent external developments and internal shifts in governance process and board size can combine to raise questions about the utility of continued reliance on the executive committee. As a result, a close review of the continued utility of executive committee practice is worthy of addition to the board’s 2011 agenda.

The Governance Institute thanks Michael W. Peregrine, Esq., partner, from McDermott Will & Emery, LLP for contributing this article. He can be reached at mperegrine@mwe.com.