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## Corporate Governance

### Health Reform Hands Hospital Boards Big Responsibilities

By MICHAEL W. PEREGRINE AND J. PETER RICH

**W**ith the impending enactment of health care reform, it becomes necessary to consider the likely governance-related implications for hospitals and health systems. The ultimate legislation will arguably have the most significant impact on the health care financing system since the enactment of Medicare in 1965. By its actions, Congress will essentially be handing hospital/health system boards an enormous “homework assignment,” the likes of which they have not previously confronted. These boards will thus be presented with an unprecedented fiduciary challenge, to which they will be expected to respond both swiftly and effectively. The time for preparing boards for this important responsibility is “now,” and the hospital/health system

general counsel can play a valuable role in such preparation.

The board's obligation to quickly consider and comprehend the new legislation is manifested in at least three specific components of its core duty of oversight of corporate affairs:

- The duty to understand, review, and monitor the implementation of the organization's strategic plans.
- The duty to review management plans for business resiliency/enterprise risk.
- The duty to advise management on significant issues facing the corporation.

The financial and operational implications of the anticipated legislation are so extraordinary that they will clearly affect the organization's strategic planning, affect the organization's business risk profile, and otherwise constitute a significant operational challenge.

The board thus will need to be “front and center” as the effects of the reform legislation are realized within the hospital and throughout the health system. Board members will be expected to demonstrate an enhanced duty of care as they work with management to evaluate the strategic implications of health care reform and determine responsive strategies. Such a close management/board collaboration can have highly positive effects, not only in terms of a coherent strategic di-

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rection but also in terms of the organization's credit rating.<sup>1</sup>

The impact of reform on corporate governance will be felt not only through the exercise of the board's general oversight duties, but also on the board's organizational structure. For example, will board size need to be increased to adequately address health care reform issues? What will be the most appropriate committee structure to respond to reform-related challenges? What new qualifications will be important in future board leaders? A reform-prompted reconsideration of board structure and composition must be conducted.

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### **“Hospital and health system boards face a big homework assignment.”**

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The following committees will play particularly important roles in this process:

- **Finance:** Evaluating the impact of changes in federal reimbursement/Medicare payment rates and arrangements with private insurers. Together with the Quality of Care Committee, focusing on new operating models which will better position the hospital to be responsible and accountable for the quality, cost and overall care of the patient community, including consideration of possible new forms of physician integration, such as accountable care organizations and medical homes. Working with the system's investment bankers to address the credit rating implications of reform-related governance response.
- **Executive/Strategic Planning:** Monitoring issues and opportunities for collaborations and affiliations with other providers arising from reform-motivated strategic re-alignment.
- **Governance/Nominating:** Ensuring the proper mix of committees and the right qualifications for new directors. Evaluating the potential for conflicts of interest issues to arise from new, reform-driven operating models and physician integration arrangements.
- **Executive Compensation:** With greater scrutiny of all the factors that contribute to rising health care costs, board compensation committees will face greater pressure to justify their executive compensation decisions. Of particular importance will be incentive compensation arrangements: Is quality of care as important as financial strength? Is the long-term benefit to the community as important as short-term operational success? Do incentives run counter to controlling the rise in health care costs?
- **Audit:** Establishing policies with respect to, and monitoring compliance with, the new supplemental requirements for I.R.C. Sec. 501(c)(3) tax-exempt status for hospitals. Working with the independent auditor to consider new accounting

changes and rules prompted by reform legislation and initiatives.

- **Quality of Care:** Focusing on new challenges with respect to clinical processes and outcomes, patient care and utilization. Coordinating with the compliance officer and the compliance committee the organization's risk profile for allegations of delivery of substantial care.
- **Compliance:** With the guidance of the general counsel, responding to the many significant new anti-fraud provisions in the new legislation and the corresponding new government enforcement emphasis on eliminating Medicare/Medicaid fraud and abuse. Focusing in particular on the looming regulatory issues associated with new reform driven hospital/physician relationship proposals.
- **Board Education:** Ensuring that the board receives the proper amount of education on the new law in the shortest practical time (*i.e.*, a comprehensive board education program, not just a 15-minute presentation by the CEO over lunch at the next board meeting). Remember, though, that the board is “not on its own” with respect to these new fiduciary obligations. It is entirely appropriate for the board to rely on the executive leadership team, including the general counsel, to develop an appropriate educational plan and governance restructuring proposal for board consideration.

**Focus on Delivery Systems.** The board should anticipate a particularly acute need for significant attention to the development of a strategy related to clinically and financially integrated delivery systems. These pressures likely will come from both internal and external sources, as Congress moves to control costs and improve quality in the health care system through new statutory incentives for the creation of state-of-the-art delivery system models such as accountable care organizations (ACOs) and medical homes, significant components of Congress's current health reform bill.

ACOs seek to control costs and improve quality by making incentive payments to multi-provider integrated delivery systems that meet cost and quality targets. Medical homes promote the goal of improving patient care outcomes through payments to a patient's personal physician to manage the patient's care across clinical and non-clinical care delivery settings. As Medicare and other payers move to decrease fee-for-service payment rates and replace the cuts with models such as ACOs and medical homes, boards should expect the need respond to inquiries about participation in these models from their hospitals, and particularly from affiliated physicians who will face increasing financial pressure and thus will want to obtain the reimbursement incentives offered by these integration models. Boards also should anticipate communications from third-party payers seeking to use these models to control costs.

**New Committee Formation.** In order to evaluate the merits of participation in new integrated care delivery arrangements, boards should give careful consideration to creating a new board committee charged with addressing physician integration. Integrated delivery system models present challenges related to many areas of governance including tax-exempt status, quality of care, and compliance. Although existing committees may be able to address these concerns in a piecemeal manner, it will be important for the board to have a

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<sup>1</sup> See, *e.g.*, the favorable comments of Moody's Investors Service on how such collaboration on financial challenges was a contributing factor to many hospital credit rating “upgrades” in 2009.

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committee with members who have the requisite skill sets to address integration issues, particularly as they relate specifically to the development and implementation of rapidly evolving concepts such as ACOs and medical homes.

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These and other challenges will require close cooperation between board and management if the board is to be successful in contributing to the strategic direction of the hospital/health system in a post-reform environment. It thus makes sense to begin placing governance-related reform planning on the board agenda for first quarter 2010.