

## HealthPartners Report Raises Stakes for Nonprofits

Minnesota Attorney General Mike Hatch (the “AG”) recently announced the results of a business compliance review (dated January 22, 2003) of the HealthPartners integrated delivery system. This review occurred in two stages. The first stage is the issuance of a report that is critical of HealthPartners’ executive compensation, outside consultant contracts, and travel and entertainment expenses, and of the Board’s oversight of these matters. The second stage is litigation instituted by the AG on February 3, 2002 to appoint two additional outside members to the HealthPartners Board. In conducting this review and announcing his findings, the AG follows an approach similar to his controversial 2001 business compliance review of Allina.

It is uncertain whether this type of nonprofit compliance review will remain strictly a Minnesota phenomenon or, given the current “corporate responsibility environment,” will be adopted for use by other state attorneys general. Nevertheless, the sheer intensity of the AG’s review, the surprising Board reconfiguration proposal and the public notoriety the matter has generated, combine to suggest that other nonprofit health care organizations (whether or not located in Minnesota) carefully consider the implications of this published report.

### Nonprofit Director Oversight Lessons

As in Allina, the AG’s allegations are based on a legal theory resembling the cause of action for “waste of assets” under charitable trust law. The AG appears to argue (a) that poorly documented or allegedly unreasonable expenditures are a waste of the assets of the nonprofit charitable corporation and (b) that the Board’s failure to exercise appropriate oversight over these expenses is a breach of their fiduciary duty. This has led to the argument that the alleged breach merits a reconfiguration of the Board.

Criticizing a “culture of luxury” at HealthPartners, the AG’s report alleges Board oversight deficiencies in the following areas:

1. **Executive compensation arrangements**, including:
  - Insufficient Board oversight of executive compensation,
  - Failure to report all compensation arrangements completely and timely on the annual Form 990, and
  - Inappropriate reliance on increased profits in determining executive incentive pay.
2. Failure to oversee establishment of policies governing **third-party consulting contracts**, and to assure that such policies are consistent with industry standards and a nonprofit mission.
3. Failure to adopt and assure compliance with policies on **travel and entertainment expenses** to deter “wasteful spending of limited health care resources.”

Particularly surprising is the AG’s focus on what he claims is the Board’s failure to satisfy the “rebuttable presumption of reasonableness” safe harbor under the IRS intermediate sanctions rules. The AG suggests (without apparent legal basis) that failure to qualify for this safe harbor constitutes a breach of the Board’s duty of care. Equally noteworthy is the focus on alleged failure of the organization to follow its own existing policies and procedures regarding corporate expenditures.

The HealthPartners review is the first example of a nonprofit compliance review of Board activity during the post-Enron “corporate responsibility environment.” In that regard, it is interesting to note the AG’s concern with the level of corporate expenditures in a period of rising health care costs, and continued emphasis on auditor independence matters. It may be useful for nonprofits to consider the AG’s oversight criticisms, and to evaluate the benefits of adopting proactively the AG’s recommendations with respect to executive

compensation and benefits, consulting contracts, and travel and entertainment expenses. For example, in the area of executive compensation and benefits, nonprofit healthcare organizations may wish to carefully consider the following recommendations:

- Satisfy the “rebuttable presumption of reasonableness” (under the IRS intermediate sanctions rule) for all executive compensation and benefits;
- Establish an independent Board committee to oversee executive compensation and benefits;
- Report executive compensation and benefits to the full Board;
- Adopt a corporate policy on executive compensation to guide the oversight and approval processes of the Board or Committee;
- Assure accurate and complete disclosure of executive compensation and benefits arrangements on the IRS Form 990; and

- Demonstrate how each executive compensation arrangement furthers the organization’s charitable mission.

Similar “recommendations” exist for consulting contracts and for travel and entertainment expenses. If you would like to see a more complete list of recommendations in these areas, please let us know.

Nonprofit health care organizations must acknowledge that, in this post-Enron era of corporate responsibility, nonprofits and their Boards operate in a fishbowl. Even technical compliance with rules and reporting requirements is not enough in some situations to avoid sanctions in the court of public opinion. The Allina and HealthPartners reports can give useful reminders of the kind of steps that prudent nonprofits and their Boards should be considering.

If we can be of assistance in reviewing policies, procedures and payments in these areas, or in suggesting practical ways to reduce potential exposure in these areas (under the protection of the attorney-client privilege), please contact the GCD attorney who serves as your regular contact. Alternatively, please contact any member of our Health Law Department.

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