The Board Compensation Debate

Experts consider the legal, regulatory and reputational risks of paying trustees

By Charlotte Huff

Paul Levy, former chief executive of Boston’s Beth Israel Deaconess Medical Center, used to be largely opposed to paying governance leaders of nonprofit hospital systems. Despite the skills and responsibility involved, in 2008 he wrote on his popular health care blog, “... we would think it somehow untoward if hospital board members were compensated.”

Reached by phone earlier this year, Levy now adopts a different stance. The stakes and challenges for today’s multifaceted systems are too steep to reject payment out of hand, he says. “As I’ve thought about it over time, it just seems to me that the complexity, particularly of the big centers or the big systems, demands a level of board involvement that’s more equivalent to the duty and care and loyalty that you would expect at a public company.”

Just 13 percent of U.S. hospitals report paying board members, according to a 2011 American Hospital Association Health Care Governance Survey report. Nonprofit systems traditionally have been reluctant to pay trustees, beyond reimbursing meals and travel expenses, given the institutions’ focus on community mission. Payment can raise other issues, ranging from the impact on liability protections for volunteer board members to influences on community perception and fundraising.

But as nonprofit hospitals become bigger and more complex, with some morphing into billion-dollar-plus health systems, Levy is far from the only one to question whether it’s time to pay trustees for shouldering such responsibility, according to governance and compensation experts. “There is no question that the subject of pay is coming up, and is being taken far more seriously than it was in the past,” says James Gauss, chair of the board services practice at the executive search firm Witt/Kieffer.

It’s a subject that reaps as many opinions as hospital trustees. Dan Roble, a retired partner from law firm Ropes & Gray and, since 2011, a trustee at Children’s Hospital of Philadelphia, said he would refuse payment even if it were offered. “I think people want to be trustees because they believe in the cause of the organization,” he says. “I really firmly believe that.”

Increasingly, though, boards are searching beyond their local area to identify the information technology, population health and other expertise they need to tackle challenges related to the Affordable Care Act and the ongoing evolution from fee-for-service reimbursement to value-based care. The board time and responsibility involved continues to ramp up, say Gauss and others interviewed. Meanwhile, the most intriguing board prospects might already be sitting on several other boards, health-related or not.

“Those people who have the deepest and greatest expertise are highly sought,” Gauss says. “Unfortunately in some cases, to compete for those members, particularly the younger members, not those who are at the end of their career or retired, there is just an expectation that given the time commitments required, there would be not a lot, but some requisite compensation.”

New for Nonprofits

Current compensation discussions involve nonprofit hospitals or systems, particularly those with hospitals in multiple states and various revenue streams, says Chicago-based governance consultant Jamie Orlikoff. For-profit
hospitals traditionally have been more likely to pay board members, he says. Publicly funded hospitals also may pay, but something more along the lines of a token fee, such as $50 per meeting, says Orlikoff, who also serves as a senior consultant to the AHA’s Center for Healthcare Governance.

The specifics for public hospitals vary state by state, as specified by law. In Washington state, for example, the law allows hospital district commissioners to be paid for board meeting time, as well as related time devoted to board business, such as governance training or a hospital-related community meeting. The total amount can’t exceed $114 per day or $10,944 annually. The law also includes a provision that allows the commissioner to waive all or part of the pay.

In a 2012 report, a panel convened by the Center to look at transforming governing practices suggested that hospital leaders might consider whether compensation is “necessary and permissible,” as one in a series of bold moves to navigate the transition to value-based reimbursement. The AHA governance survey currently in the field will provide a fresh look at whether recent pay-related discussion has translated into “an uptick in actual payments,” says John R. Combes, M.D., chief operating officer and president of the Center.

Governance and compensation consultants declined to name hospitals or health systems that already compensate trustees, citing client confidentiality, but talked more broadly about amounts and pay structures. Gauss pegged the typical range at roughly $40,000 to $75,000 per trustee. William Quirk, national director of health care industry consulting at the Philadelphia-based Hay Group, provided a somewhat lower range for large nonprofit systems, from $25,000 to $50,000 per board member annually.

The pay can be structured as an annual retainer, per meeting or based on the trustee’s workload, or any combination thereof, Quirk says. He says one nonprofit $500 million health care client opted to pay a $25,000 annual retainer, plus $2,000 for each committee on which a board member served, plus an additional $5,000 for chairing a committee. A $250 million client decided on a flat compensation of $45,000 annually, with the stipulation that board members must serve on at least one committee.

As with anything in the health care world, the decision about whether to pay is deeply influenced by a mix of history, and traditional and cultural mores that surround nonprofit organizations, Gauss says.

“It’s my observation that there are parts of the country, New England particularly comes to mind, where there seems to be a very, very deep-seated aversion in some communities to paid board members,” he says. “There are other places, some that immediately come to mind in the Midwest and the West Coast, that seem to be more open on this subject.”

**Proceed with Caution**

Hospital leaders shouldn’t make any foray into paying board members without first initiating a broader discussion and analysis of potential legal and Internal Revenue Service implications, says Michael Peregrine, a partner with law firm McDermott, Will & Emery LLP. Ideally, the process to determine if payment should be pursued and the amount should be kept independent from the board members themselves, he says [see Brace for Scrutiny: Legal and Regulatory Concerns, page 11].

Hospital leaders also should consult an attorney to determine if their state permits payment, Peregrine says. Roughly one-third of state laws explicitly allow payment of nonprofit trustees, one-third are opposed, and among the rest the law is less clear, he says. If payment is eventually approved, Peregrine recommends notifying the state attorney general’s office in advance of the implementation, as a courtesy to that office.

Several others interviewed pointed to Massachusetts Attorney General Martha Coakley’s criticism of director payment at several health plans based in her state, as an illustration of the sort of public scrutiny that can be brought to bear. While the practice is not illegal, the attorney general’s office wrote in an April 2011 report that it “further blurs the line between charitable and for-profit entities,” and thus must only be pursued by public charities “if they have a sound and convincing rationale.”

Nationally, legislators such as Sen. Chuck Grassley have raised questions about various compensation practices at nonprofit organizations, in light of their tax-exempt status, Orlikoff points out. “Am I confident that this isn’t going to be a flash point in a couple of years?” he asks.
“The answer is, `No, I’m not.’ ”

Other potential concerns to weigh:

- **Influences on board autonomy:** If trustees are being paid, Orlikoff asks, does that subtly sway their allegiances closer to the health system’s C-suite? The potential risk, he says, is that the “board member becomes more focused on getting the compensation, and retaining the retainer, than they do on overseeing management.”

- **Does money equal better governance?** While some payment might help to recruit vital expertise, that doesn’t mean money inherently results in higher quality oversight (take, for example, Enron’s board). Both Orlikoff and Peregrine recommend revisiting governance criteria to make sure that meeting attendance, continuing education and other board requirements are spelled out.

- **Any fundraising impact?** Compensation might create perception issues, if board members are asking people in the community to donate their own money while they themselves are getting paid, says David Nash, M.D., dean of the Jefferson School of Population Health in Philadelphia. “I think it would hinder their ability to raise money,” he says. Quirk, though, dismisses that concern. “It’s not relevant,” he says, adding that people expect trustees to raise funds for their own institutions.

- **Community perception fallout.** Consider the optics. When hospital leaders decide to pay board members, they need to be ready to back up that decision and the figures involved, Orlikoff says. Combes agrees. While the need for the best trustees has never been greater, the potential erosion of community connections and trust also should be contemplated, he says.

“The community may look at this as: Whose interests are you operating in?” Combes says. “Are you operating in the interests of the people who are paying you? Or, are you operating in the interests of the community?”

**Paying for Expertise**

Big health systems aren’t the only ones who might need to explore compensation, perhaps to fill a few vital gaps on the board, says Tim Cotter, managing director of Sullivan, Cotter and Associates Inc. Smaller hospitals might not be able to field the skills they need from their surrounding community.

“I would argue that if you are devoted to your community health system, and you have nobody who knows quality and population health,” Cotter says, “and you can get two people who can help you with that, and you can’t get them any other way, then maybe $30,000 to each is a small price to pay to get competencies that you simply don’t have.”

But there are risks, such as “internal equity issues that would have to be debated,” Cotter said. Paying some trustees and not others, whatever the expertise or other rationale, creates the potential for “a two-class board system,” Orlikoff says. “Secondly, and perhaps more insidiously, it blurs the distinction between a board member and a consultant,” he says.

Above all, hospitals shouldn’t pay board members if they can attract the people and skills they most desire regardless, Cotter says. At the same time, the time squeeze of today’s working world shouldn’t be ignored, he says. “As the business world becomes more and more competitive, the executives who heretofore had time to serve on nonprofit boards are increasingly challenged to find time to run their own companies.”

Cotter, a proponent for paying when needed, is one of the few interviewed who hasn’t seen an uptick in the last few years. The subject has been bandied about off and on since the 1980s, he says. During that time, hospital executive bonuses and other short-term incentive compensation have become nearly routine, paid by 84 percent of hospitals in the firm’s most recent survey compared with fewer than 5 percent in the 1980s, he says.

Meanwhile, trustee pay has failed to gain traction, with the AHA governance survey report stating that the 13 percent figure hasn’t changed significantly since 2005. “It really hasn’t grown anywhere near as much as I would have thought, given the changes that we’ve seen in the [health care] industry,” Cotter says.

Others are more bullish. The Hay Group’s Quirk predicts that as many as 20 percent of nonprofit systems will be paying trustees five years from now, with the largest hospital systems leading the way.

Whether that occurs will rest in large part
upon how many board members feel, as Roble does, that the value of the work, the intellectual demands and the ability to give back is sufficient compensation. “The amount that I have learned from CHOP managers and CHOP trustees is really significant,” Roble says. “To me, that’s just been a great gift. And you couldn’t pay me for that.”

“I think that there are a lot of really talented people in this country who are very interested in hospitals and hospital systems,” he says. “It may take you longer to find them. But I think that they’re there.”

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**Brace for Scrutiny: Legal and Regulatory Concerns**

To even consider compensation, the existing hospital board must develop an arms-length process as a way to avoid Internal Revenue Service scrutiny of tax-exempt organizations, according to attorneys and governance experts.

One suggested approach is to create an independent body comprising former board members, respected members of the community and other savvy individuals without any current connection to the hospital system. The goal is to avoid triggering intermediate sanctions by the IRS under Section 4958 of the tax code by illustrating that the compensation was determined without any conflict of interest.

Still, the final sign-off can present a dilemma for hospital systems, given the federal agency’s emphasis on an authorizing body free of any conflicts, says William Quirk, national director of health care industry consulting at the Hay Group.

“If the board is the final authority, then who approves the compensation of the board?” Sometimes, such as when a hospital system is overseen by a faith-based organization, another party can assume that role, he says.

The involvement of an independent authorizing body is one of three IRS requirements to establish a “rebuttable presumption.” If the requirements are met, the compensation of board members and others with significant influence over a nonprofit’s operations is presumed to be reasonable. The other two requirements stipulate that data from comparable organizations are used to make the pay recommendation, and that the process is documented throughout.

During the review process, legal considerations also should be reviewed, as board members can lose some of the liability protections they have enjoyed by working in a volunteer capacity, says Chicago-based governance consultant Jamie Orlikoff.

Under the federal Volunteer Protection Act of 1997, those volunteering for nonprofit or governmental entities are not considered liable for harm involved with acts or omissions, as long as they are not paid more than $500 annually. But the federal act doesn’t immunize board members even if they are uncompensated against allegations of gross negligence, and an attorney could argue that a particular quality or patient safety claim falls under that rubric, Orlikoff says.

In addition, state laws provide some degree of liability protection for uncompensated trustees at nonprofit organizations, which should be considered, says Tim Cotter, managing director of Sullivan, Cotter and Associates Inc., a Chicago-based consulting firm. Those protections can be similarly confined, though, to board members acting in good faith, he says.

Another consideration: Many of the state statutes only protect against tort liability, not against allegations of breach of fiduciary duty, says Michael Peregrine, a Chicago-based attorney who represents nonprofit health systems on corporate and governance law. Thus, in the context of director compensation, losing that liability protection may not prove to be as significant a penalty as board members might initially believe, he says. — C.H.