

AHERF Bankruptcy Promises to Shed Light on Significant Non-Profit Healthcare Issues

By Mark Stadler

The AHERF bankruptcy warrants close scrutiny. Though the initial filing occurred months ago, many issues remain to be raised and resolved. Through these adversary proceedings, the parties will argue, and the court decide, items of significance to the healthcare industry regarding such areas as nonprofit corporate governance, tax exemption and federal preemption of state regulatory power. Absent this real world laboratory or testing ground, many of these issues would be debated and analyzed only on an abstract or theoretical basis.

The issues to watch include the following:

For Sale: Membership Rights

Can a bankrupt parent entity be compelled to sell its membership rights in non-bankrupt subsidiaries in order to create a larger pool of resources for application to claims of the parent's creditors? Under Pennsylvania nonprofit corporation law, corporate members are generally precluded from transferring a membership or any right arising as a result of that membership. Will the rights of AHERF's creditors override this provision of Pennsylvania law and result in a court mandated non-consensual sale of AHERF's membership rights in its Western hospitals?

Preemption of Attorney General

In its role as *parens patriae*, the Pennsylvania Attorney General is required to review each fundamental corporate change transaction involving a nonprofit charitable healthcare entity to ensure that the public interest in the charitable assets of the entity is fully protected. The bankruptcy court's obligation to maximize the funds available to AHERF's creditors is in apparent opposition to the Attorney General's duty to protect the public's interest in the System's charitable assets. Will the interest of the federal bankruptcy court be viewed as preempting or superceding the interest of the Attorney General? Not necessarily. There is case law holding that, where important state law or general equitable principles protect the public interest, those principles will not be automatically overridden by federal bankruptcy policy. (See *Penn Terra LTD v. Department of Environmental Resources*, 733 F.2d 267 (3rd Cir. 1984)). This case is like-

ly to be a focal point in the AHERF bankruptcy, and we are likely to discover the limits of that decision.

How Much is Too Much?

Given the media attention paid to the compensation provided to certain members of AHERF's management team, we can expect intervention from the IRS as well as the bankruptcy court. These challenges will likely shed some light on the ultimate question concerning executive compensation in the nonprofit/tax-exempt setting, i.e., how much is too much? Will the IRS avail itself of the latest weapon in its arsenal (intermediate sanctions) in an attempt to enforce a 20% excise tax against AHERF executives? To what extent will the bankruptcy court attempt to force these executives to disgorge themselves of alleged excess compensation? Did AHERF use comparability studies and other industry information to establish the reasonableness of these compensation packages, and will the procedures used by AHERF in this regard effectively shield the executives from excise tax and payback obligations?

Accountability

To what extent, if at all, will the AHERF board members and executives be charged with and then held accountable for breaches of their fiduciary duties? Assuming the appropriate bylaw provisions were adopted for AHERF, its directors cannot be held personally liable for money damages for failing to perform the duties of their offices unless that failure constitutes self-dealing, willful misconduct or recklessness. The proper application of these standards may prove to be a focal point in the AHERF bankruptcy. Also, in discharging their duties, board members of a nonprofit may, but are not required to, consider the effect of their actions on certain groups i.e., employees, suppliers, customers, creditors and the communities the corporation serves. As the AHERF bankruptcy further unfolds, we are likely to learn whether the AHERF board can be held accountable to these constituencies. Media reports indicate that at least one lawsuit has been initiated in this regard by a group of physicians in the Philadelphia area. We may also gain insight regarding corporate indemnification of officers and



Mark Stadler

directors and the limits of coverage provided by D&O insurance products.

Transfer of Funds

Given the allegations of improper funds transfers within the AHERF system, some guid-

ance may be provided on the limitations applicable to the transfer of funds among various related entities in a large healthcare system. Among the interesting issues likely to be addressed here are the propriety of "borrowing" restricted or limited use funds at a time when the borrower is insolvent; the creditor status within the bankruptcy to be given to a related entity having made loans to the bankrupt entity; and the extent to which a series of fund transfers among various related entities will support a claim that the system should be considered as a single entity.

Association

The AHERF bankruptcy may also shed light on the extent to which an entity which has become affiliated with a health system can regain its autonomy as a result of alleged misrepresentations made prior to the affiliation and/or alleged breaches of the affiliation documents.

Consultant Liability

In the event the AHERF creditors choose to pursue claims against AHERF's outside advisors and consultants, we are likely to gain valuable insight into the ultimate responsibility or accountability of these parties for the apparent misconduct of their client—which misconduct they are alleged to have facilitated. While issues such as these have been extensively litigated in the for-profit/business context, it will be instructive to see whether the applicable standards are altered to any great extent in the not-for-profit/tax-exempt setting.

For more information, please contact mstadler@cohenlaw.com

When are Volunteers “Employees” Who Must Be Paid for Their Time?

by John E. Lyncheski

Healthcare institutions typically make frequent use of volunteers—well-intentioned members of the community and off-duty employees who donate their time to aid in the care and comfort of patients and residents. Healthcare facilities encourage volunteerism because it is a valuable supplement to the institution’s services. However, healthcare employers must exercise caution to ensure that they do not run afoul of the Wage and Hour laws by not paying individuals for services which must be treated as compensable under the Fair Labor Standards Act (“FLSA”).

Under the FLSA, in the private sector, individuals may volunteer their time and efforts without compensation to charitable, religious and similar non-profit organizations that have public service, charitable or humanitarian objectives. Special provisions of the FLSA are applicable to persons who volunteer services in the public sector, i.e. to a state, political subdivision or government agency. The FLSA, however, does not actually define “volunteer” as it applies in the private sector. Moreover, according to the Department of Labor (DOL) Wage and Hour Division, individuals may not volunteer services to for-profit entities engaged in commercial activities without proper compensation.

To qualify for an exemption under the FLSA, it is not sufficient that the entity at which the volunteer service is performed has civic, charitable or humanitarian purposes; the individual who performs the service must also do so without promise, expectation or receipt of compensation and must be subjectively motivated by altruistic intentions. The services must also be offered without coercion.

Differentiating between whether an individual is a volunteer or employee hinges on the economic dependence of the individual on the business and the importance of the work performed to the business’s operations. Individuals are not employees who must be compensated where they have no economic



John E. Lyncheski

dependence on the employer and where they are not an integral part of the facility’s operations. The determination of whether an individual or group of individuals qualify as volunteers or employees, unfortunately, is made on a case-by-case basis applying an “economic reality test”.

The lack of compensation (actual, promised or expected) is not, however, the sole determinative of volunteer, nonemployee status. If the “volunteers” are otherwise treated in the same capacity as other employees, except for being paid, they may be considered an employee for whom compensation is required.

In a legal proceeding under the FLSA, the following factors are generally considered to determine whether an individual volunteering services must be treated, and be paid, as an employee:

- 1) Is the individual compensated in any way?
- 2) Was the individual required to undergo any “hiring procedures”?
- 3) Does the individual perform the same duties as regular employees?
- 4) Does the individual receive any benefits normally provided to regular employees?
- 5) Is the individual working of his/her free will or is there evidence of coercion?
- 6) Does the individual have any economic dependence on the facility?
- 7) Are the individual’s services an integral part of the facility’s operations?
- 8) Do the individual’s services provide a consequential economic benefit to the facility?
- 9) Are the individual’s services “supervised” by a facility manager or supervisor?

10) Is the individual performing services for his/her own pleasure?

Particular caution must be exercised when the volunteer services are being provided during supposedly off-duty time by an individual who is also a non-exempt employee of the facility. In such cases, if the services are of “consequential economic benefit” to the facility, the employee must be paid at the employee’s regular rate, or, if applicable, at overtime rates. Even if the employee is volunteering time for personal reasons, such as an emotional attachment to a patient, or is motivated by altruism, the DOL will find the time compensable if a consequential economic benefit inures to the facility. By way of example, an employee who simply provides companionship or who reads to a patient or resident may be treated as an uncompensated volunteer, but an employee/volunteer who assists a patient with bathing, eating, exercising or other personal care would be “working” according to the DOL. Similarly, a nurse who takes blood pressure readings or a lab technician who draws blood at a health fair is considered as working and not volunteering if that event is sponsored by the employer.

For practical reasons, the DOL Wage and Hour Division is not always vigorous in policing FLSA compliance with regard to volunteer services in purely charitable organizations. However, in its recent audit of the nursing home industry, including many not-for-profit homes, the DOL identified failure to compensate individuals for “volunteer” services as a significant problem. The DOL said these services crossed the line and violated the FLSA.

All private sector healthcare employers, particularly those which are for-profit, would be well advised to review their volunteer programs for FLSA compliance and to look very closely at employees performing volunteer services in their off-duty hours.

For more information, please contact jllyncheski@cohenlaw.com