

(SAMPLE) ORGANIZATION AND GOVERNANCE STRUCTURE

This section of the report presents the organizational objective, governance principles and organizational structure. The organizational objective clarifies the purpose and intent of any entity overseeing the RHIO. Governance is necessary to provide oversight of how the RHIO is developed and used.

A. METHODOLOGY

The Project Team collected and analyzed information, both legal and factual, from a range of resources including [XYZ], [ABC], participants in the pilot project, members of the project team, several “model organizations” and the [Nonprofit Incubator], as well as our own legal research. As our initial step, we used these resources to help us identify the needs and desires of those already involved in the project, both as funders and as participants. In particular, we studied the findings from the interviews of the pilot project participants in order to better understand their interests and goals. A detailed summary of interviewee responses to the governance, membership and governing body interview questions can be found in Exhibit E. Based on our findings, we developed a set of organizational and governance principles (the “Principles”). (See IV.B.2. Governance Principles.) We asked [XYZ] and [ABC] to approve the Principles before moving forward in our analysis.

Using the Principles we had established as the base point for further inquiry and analysis, we reviewed the information that [XYZ] provided in response to our request for documents. We also analyzed the business planning proposals and participated in weekly team meetings to ensure the compatibility of the business planning and organizational components of the project. In addition, we worked to identify existing organizational structures as potential models for the RHIO Entity.

Our research of existing governance models did not uncover any organizations with missions and activities comparable to the RHIO Entity. However, we identified several entities organized to promote and enhance the sharing of clinical health information by and among a range of participants in the health care delivery system for purposes of research and/or the provision of care. We examined the Indiana Health Information Exchange, a community health information network working to establish a clinical data repository in electronic format, to be used for population-based research and clinical decision research. In addition, we looked at MA-SHARE, a regional collaborative initiative operated as a subcommittee of the Massachusetts Health Data Consortium, a 501(c)(3), and organized as a facilitator and incubator for projects exploring healthcare data connectivity. We also examined the Santa Barbara County Care Data Exchange (another project of [XYZ]), which is a collection of medical groups, hospitals, clinics, laboratories and pharmacies, payors and other healthcare organizations working in concert to exchange clinical data at the point of care. We looked to how these organizations were formed and organized as a potential blueprint for the RHIO Entity. A chart identifying and describing the organizations we researched is attached as Exhibit F.

Finally, we performed extensive legal research to identify an appropriate legal structure for the RHIO Entity, both at an organizational level and from a tax perspective. We considered several

forms of nonprofit corporations, for-profit corporations and joint powers agencies. We then cross-referenced each Principle against each potential form of entity to help us determine the form best structured to realize the Principles. A matrix of our organizational analysis is provided in Exhibit G. We also compared and contrasted the tax consequences of forming and operating different types of tax-exempt entities, examining how specific classifications under the Internal Revenue Code and the [State] Revenue & Taxation Code would affect the operations and funders of the RHIO Entity. Our tax analysis is further described in Exhibit H. Our conclusions were further informed by our research of and communication with the [Nonprofit Incubator]. In addition to our interview with its representatives, the information we relied upon to better understand the [Nonprofit Incubator] is attached in Exhibit I.

B. ORGANIZATIONAL OBJECTIVE AND PRINCIPLES

1. Organizational Objective

With respect to ownership and governance of the RHIO System (collectively the “the RHIO System”), the objective of the Governance Project is to establish a plan for a new organization (the “the RHIO Entity”) separate from the XYZ (“[XYZ]”) that will be independent; self-governing; self-financing; and that will have as its mission

- to acquire from [XYZ] and use broad rights to, develop, expand, maintain, preserve and protect the RHIO System,
- to acquire the authority and continue the vision, efforts and initiatives of, [XYZ] with respect to the RHIO System,
- to commence a business to operate all aspects of the RHIO System and acquire assets, engage personnel and incur liabilities as appropriate and necessary to carryout its mission (collectively the “the RHIO Program”),
- to permit broad utilization of the RHIO System in [State] by governmental agencies, health plans and other payors, healthcare providers and Beneficiaries (*i.e.* health benefits program enrollees and applicants) (collectively “the RHIO Customers”),
- to promote a shared effort among the RHIO Customers to further the development and implementation of the RHIO System standardization and expansion, but also allow for appropriate customization,
- to enable and enhance communication among and between the RHIO Customers and funding agencies and
- to enable the RHIO Customers to screen and enroll eligible [State] families and individuals in a comprehensive range of health benefits plans funded by public and private sources.

2. Governance Principles

1. Choice of Entity

- The RHIO Entity will replace [XYZ] as the operator of the RHIO Program and provide a logical transition to a free-standing enterprise that will maintain [XYZ]’s momentum and focus
- The RHIO Entity will be neutral to the interests of the various the RHIO Customers, *i.e.* the primary duty owed by each of the directors on the RHIO Entity’s Board of Directors shall be to the RHIO Entity, not to the RHIO Customer with whom a Director may be affiliated
- The form of entity will
 - permit the acquisition of the RHIO System without fair market payment to [XYZ]
 - be perpetual
 - be tax-exempt to the maximum extent possible
 - be qualified to receive grants
 - have a non-equity holding Membership (*See* definition of “Membership,” below.)
 - permit Membership to elect Directors
- The RHIO Entity will replace [XYZ] as a credible negotiator among the RHIO Customers and with the State
- The RHIO Entity will not be an extension or “creature” of governments
- The RHIO Entity may engage in some level of advocacy to influence legislation, regulation and policy
- The RHIO Entity will manage the relationships with State and local governments

2. Membership

“Membership” means the collective entities and individuals that are authorized to establish and maintain the governance structure of the RHIO Entity. Some Members will also be the RHIO Customers. However, [XYZ] and/or ABC (“[ABC]”) will also be Members. [XYZ] and [ABC]

will identify who shall be authorized as Members and the RHIO Entity's governing documents will grant that authority. The Membership shall be constituted as follows:

- Important stakeholders will be represented through Membership
- Classes of Membership may be established to establish different rights and duties for different Members, *e.g.*, certain counties could belong to one class of Members, with standard rights and duties, and [XYZ] and [ABC] could belong to a second class of Members, with certain reserved powers (*See* "Role and Reserve Powers of [XYZ]/[ABC]" under Roles of Stakeholders. *See* also definition of "Governing Body," below.)
- Members making a greater investment will have a major voice, *e.g.*, a Member that provides substantially greater funds or services may have additional rights, such as additional appointment powers to the Governing Body
- The Membership will elect the Governing Body (except *ex officio* members of the Governing Body)
- Membership will grow and change to reflect growth and change in the RHIO Customers and in the uses of the RHIO System

3. Governing Body

"Governing Body" means the group of individuals with ultimate authority for the management of the affairs of the RHIO Entity.

- The Governing Body will
 - appoint and direct the RHIO Entity officers
 - establish and oversee implementation of policies regarding
 - the RHIO product development
 - the RHIO standardization
 - fees and charges and
 - vendor arrangements
 - oversee financial performance
 - appoint the independent auditors

- accommodate Membership composition, growth and change
- Directors will be reflective in part of the RHIO Customers
- A significant number of Directors will be independent; the Governing Body and the Membership shall establish a common definition of “independence” (*i.e.* relationship to vendors, the RHIO Customers, funding sources)
- Directors will represent diverse backgrounds, skills and sophistication necessary to govern the RHIO enterprise
- The RHIO Entity’s executive management will be represented on the Governing Body
- [XYZ] and [ABC] will select some members of the Governing Body
- Directors will be fiduciaries of the RHIO Entity and not primarily representatives of the RHIO Customers or other affiliations
- The Governing Body will adopt written statements of its governance principles and code of conduct and regularly re-evaluate them
- The Governing Body will establish written performance criteria and periodically review Governing Body performance against those criteria
- The Governing Body will receive input from advisory boards of the RHIO stakeholders (e.g., the RHIO Customers, funding agencies and members of the public) established as necessary by the Governing Body
- Directors will
 - have staggered terms
 - have term limits
 - serve without compensation
- The Governing Body chair will be independent of management
- The Governing Body will meet without management at least once per year

- Audit, nomination, management evaluation, compliance and ethics functions will be carried out by non-management Directors and committees supported by management
- The Director nominating function will address
 - industry knowledge and know-how
 - competing time commitments
 - continuing director tenure
 - openness to new ideas
 - willingness to critically re-examine the status quo
 - effective board size
 - qualification for re-nomination based on individual behavior expectations – e.g., attendance, preparedness, participation, candor
 - the input of the Membership

4. Officers

- The CEO will
 - provide management of day-to-day operations of the RHIO Entity
 - recommend policy and strategic direction of the RHIO Entity for consideration by the Governing Body
 - be the spokesperson for the RHIO Entity
 - be a compensated executive
- The Governing Body chair will
 - conduct all meetings of the Governing Body and the Membership
 - oversee preparation of Governing Body and committee agendas
 - define the quality, quantity and timeliness of the flow of information between management and the Governing Body

- approve consultants who report directly to the Governing Body
- interview candidates for nomination as a director
- oversee development and revision of governance guidelines
- evaluate the CEO's performance
- recommend the composition of Governing Body committees and appoint committee chairs
- Executive compensation programs will be designed to ensure alignment of such programs with the long-term interests of the RHIO Customers
- Executive compensation will be fully disclosed
- There will be a CEO succession plan
- All directors will have access to senior management

5. Roles of Stakeholders

- The Governing Body should consider establishing advisory bodies to ensure necessary participation and input from the RHIO stakeholders (*e.g.*, the RHIO Customers, funding agencies and members of the public)
- Role and Reserve Powers of [XYZ]/[ABC]
 - As a source of credibility for the RHIO, [XYZ] and [ABC] and their continuing support will be strongly visible
 - [XYZ] and [ABC] will have specified reserve powers to ensure that the mission of the RHIO Entity with respect to the RHIO System is carried out and that the RHIO Entity is regularly accountable to [XYZ] and [ABC]
- Funding Agencies
 - The RHIO Entity will maintain close, strong relationships with funding agencies
 - Certain funding agencies may condition grants on reserved oversight and approval rights

- the RHIO Customers
 - will contribute the RHIO solutions to the RHIO Entity
 - will share the RHIO Entity and Software costs on an equitable basis
 - will leverage experience
 - will participate in efforts to standardize and simplify the RHIO System
- Members of the Public
 - The RHIO Entity will provide an opportunity to receive input from members of the public otherwise unaffiliated with the RHIO Customers and health benefits funding sources

C. ORGANIZATIONAL RECOMMENDATION

In order to achieve the Principles, the RHIO Entity must replace [XYZ] and [ABC] as the operator and overseer of the RHIO System. The RHIO Entity must acquire from [XYZ] the right to maintain and develop the RHIO System and must be organized to allow for acquisition of rights to develop and use the RHIO System without fair market payment to [XYZ]. The RHIO Entity must therefore be an entity to which [XYZ] can transfer rights to develop and use the RHIO System by way of a grant. The grant would obligate the RHIO Entity to carry forward all aspects of the RHIO Program as successor to [XYZ], with appropriate accountability back to [XYZ] and operating criteria to ensure stable development and implementation of the RHIO Program.

The RHIO Entity must be able to promote as broad an adoption of the RHIO System as possible and coordinate a shared effort among the RHIO Customers to further its development. Additionally, through continuity of interest of [XYZ] and [ABC], the RHIO Entity must be able to succeed [XYZ] as a credible negotiator on behalf of the RHIO Customers. As the successor to [XYZ], the RHIO Entity must have legitimacy to continue [XYZ]’s efforts as liaison to the State of [State], the _____ and other important stakeholders.

Timing is key to the success of the transition of management, operations and assets of the RHIO System from [XYZ] to the RHIO Entity and the broad-based implementation of the RHIO System. The strategic business planning process has highlighted a need for an implementation and sales period, beginning upon completion of the County pilots and ending only when the viability of the RHIO Program has been demonstrated (the “Development Period”). The goals of the Development Period are to initiate the RHIO as a business entity as described later in this report. (*See* IV.C.2 Transition to a New the RHIO Entity.) The Development Period will be punctuated with defined milestones and critical success targets, including achievement of

sufficient sales and operating revenues to ensure the broad utilization and long-term viability of the RHIO System in a dynamic environment.

1. The RHIO Entity: Existing Organization or New Organization

After determining that a separate the RHIO Entity was needed, the Project Team analyzed whether there was an existing organization that could assume the role of the RHIO Entity or whether a new entity should be formed specifically for this purpose. The Project Team also examined the appropriateness of [XYZ] entering into an agreement with the State of [State] for the RHIO, similar to its arrangement for Health-e-App. Our research of existing governance and organizational models did not uncover any organizations with missions, purposes or activities analogous to the RHIO Entity or well-equipped to take on the challenge of the RHIO. The Project Team recommends that a new entity be created for the RHIO.

The advantages and disadvantages of using an existing or new entity are identified below. These attributes were identified by the Project Team, through interviewee responses and in consultation with the foundations, as follows:

Table 1: Advantages and Disadvantages of Using Existing Versus New Entity

Structure	Advantages	Disadvantages
Use An Existing Entity	<ul style="list-style-type: none"> • Stable, well-respected entity can potentially ease transition from [XYZ] to itself • More cost-effective • Less time-intensive than creating a new organization • Potential to increase cross-fertilization with other entities 	<ul style="list-style-type: none"> • May be unable to identify an existing entity that is neutral and not biased towards its existing mission • the RHIO may not receive full attention if subsumed by an existing organization • May not have appropriate broad-based representation among organization or its board • No existing organization does what the RHIO contemplates doing
Create A New Entity	<ul style="list-style-type: none"> • Neutrality of a new organization developed solely to fulfill the RHIO’s mission • Can ensure appropriate representation among membership and board • Can be phased in over-time in an appropriate manner • If new entity is outside government, can be insulated from direct political intervention 	<ul style="list-style-type: none"> • Higher infrastructure costs related to creation of a new entity • New organization has little to no credibility and visibility • May spend an inordinate amount of time raising funds to support its existence • Amount of resources used developing a new governing body

Each advantage and disadvantage is not weighed equally, some are more critical than others. In determining whether an existing or new entity should be used, the Project Team placed more

emphasis on the model that allowed for

- greater neutrality,
- timeliness in becoming operational and
- economies of scale

In addition, either the existing or new entity should have (1) the right financial incentives to fulfill the RHIO's mission and vision, (2) expertise (internally or outsourced) to build and sustain the RHIO's software and information technology systems, (3) a high level of credibility to sustain the RHIO effort and (4) the ability to replace [XYZ] in negotiating role between users, local government, the State and contractors.

In exploring possible existing entities, the following were reviewed. None of these types of entities appeared to be appropriate for co-locating the RHIO Entity within an existing organization.

- Trade Associations. Organizations such as _____ and others all have a vested interest in improving the eligibility screening and enrollment process for publicly-funded health and social service programs. Many trade associations advocate for such system improvements not only because they improve access to services, but because they also result in increasing the amount of stable State and/or federal revenues that are used to provide services to indigent and uninsured persons on the local level. This can result in decreasing the level of local general fund that is used for this purpose. While each of the trade associations noted above is state-wide and many have representation from all [State] counties, they are by their very nature focused on single subject issues. The RHIO is a cross cutting tool that will serve health and social services. Placing the RHIO in any one of these entities (excluding the [State] State Association of _____) might result in the RHIO Entity focusing too heavily on the issues of a particular trade association to the detriment of the other issues.
- Regional Consortia. Geographic consortia exist throughout the State to collaborate on a range of issues affecting similarly-situated organizations or counties. For example, geographic technology consortiums have been formed in concert with the County Welfare Directors Association of [State] and the [State] Department of Social Services. Regional consortia are in theory easier to manage than state-wide associations because of the smaller number of represented interest groups. In addition, given that the RHIO will not be implemented in all 58 counties at the same time, a regional approach may be appropriate for meeting the needs of geographic areas that are similar. However, as with trade associations, regional consortia also suffer from being single subject focused and they lack the broad-based multi-disciplinary approach needed for the RHIO.
- Government. With respect to having the State or another local government entity manage and operate the RHIO, several concerns were identified. While the RHIO fulfills a social mission, it must be operated in an entrepreneurial, business manner. Housing the RHIO Entity in the government sector (either State or local) may seriously impede critical business planning for the product. Due to competing demands, budget limitations,

system-wide resistance to risk-taking, and limited flexibility and ability to respond rapidly to changing environments, the government sector was not viewed as the ideal environment for incubating and maturing the RHIO. It was also felt that while the RHIO's staff will work closely with the State on implementation issues, it should be somewhat insulated from a highly charged political environment.

Given the RHIO's mission, the advantages and disadvantages noted above, and current array of existing entities that could assume this role, it appears that the requirements are sufficiently unique and demanding to warrant a new entity focused entirely on the RHIO. A new entity allows for greater neutrality and a representative governance (both in membership and governing body), but developing a new entity is not without its difficulties.

2. Transition to a New the RHIO Entity

In order to mitigate some of the disadvantages associated with creating a new entity, the Project Team recommends that a phased approach be taken to the development of the RHIO Entity. Effectively initiating this new, start up enterprise is just as important as reaching the milestones and targets that are specific to the RHIO Entity. We have learned from our experience with County Medi-Cal managed care programs, preferred provider and other managed care organizations that start-up businesses such as the RHIO Entity require a full-service launch in order to be successful. All elements of the work force, facilities, infra-structure and support system must be in place at a single point in time. Acquisition of these elements in that context is always costly, difficult and inefficient.

The Project Team also makes this recommendation based on the following factors. (1) trepidation expressed by interviewees during this project (particularly the RHIO Leadership Group members) of a "rapid pull out" foundation visibility, advocacy and support for the RHIO, (2) concern that a new the RHIO Entity will immediately become overburdened and bogged down with governance issues in its early formation impeding quick and timely business planning development and (3) concern that that the momentum for the RHIO will dissipate. A transitional approach enables [XYZ] and [ABC] to plan for the full development of a separate the RHIO Entity in a deliberate manner.

Instead of initiating a full-service launch of the RHIO Entity at the beginning of the Development Period, we recommend that [XYZ] and [ABC] engage a fiscal sponsor or nonprofit incubator by contract to provide the work force, facilities, infra-structure and support incrementally as required during the Development Period. The transitional approach calls for the development of an the RHIO program office. The RHIO program office would be used to transition day-to-day the RHIO activities from [XYZ] to itself, to develop a fully functioning the RHIO Entity and to ultimately transfer day-to-day the RHIO responsibilities from its jurisdiction to the separate the RHIO Entity. Once the RHIO Entity is organized and its tax-exempt status recognized, it would be in a position to assume the assets and liabilities of the program office.

The program office could be located within either foundation or the foundations could contract with a separate organization to serve this function. If the decision is made to contract out for this service, it is important to contract with an organization that has experience operating program

offices, has credibility and is cost-efficient. Fiscal sponsors are organized and equipped on behalf of their projects to receive funding, enter into and administer contracts, employ and compensate staff, procure insurance and provide necessary administrative infrastructure. While appropriate diligence should be conducted to ensure selection of a proper fiscal sponsor, our investigation has disclosed that a likely candidate for fiscal sponsor would be the [Nonprofit Incubator], based in the Presidio of San Francisco.

The [Nonprofit Incubator] has indicated to us that the development of the RHIO Entity is an appropriate activity to qualify as a project of the Incubator. Should [XYZ] and [ABC] choose to establish a program office (the “the RHIO Project”), the [Nonprofit Incubator] would engage a project coordinator as the point of contact and manager of the RHIO Project. The [Nonprofit Incubator] Board of Directors has the full governing, legal and fiduciary responsibility for all sponsored projects. However, through its recommendations to the Tides Board, an “advisory board” would direct the affairs of the RHIO Project. (*See* IV.B.4. Governance Recommendation.) The [Nonprofit Incubator] Board of Directors will follow the direction of the advisory board provided there is adequate funding to support execution of any contracts, leases or other agreements and the liabilities incurred by the [Nonprofit Incubator] on behalf of the RHIO Project either do not extend beyond the term of the RHIO Project agreement with the [Nonprofit Incubator] or the [Nonprofit Incubator] is assured that these obligations will be assumed and the [Nonprofit Incubator] released from liability when the Project is spun off. Based on our preliminary discussions, the [Nonprofit Incubator] believes that the RHIO Project could be initiated in two to three months. At the successful completion of the Development Period, the RHIO Project could be spun-off from the [Nonprofit Incubator] to the RHIO Entity. Excerpts from the [Nonprofit Incubator]’s website and a copy of a pro forma Memorandum of Understanding are attached as Exhibit I.

The scope of this project did not include preparation of a transition plan. However, based on its work and discussions with [XYZ] and [ABC], the Project Team has identified the following issues that should be addressed by those charged with planning for the transition from current operations to operation of a program office:

- develop a detailed operating budget for the RHIO,
- review existing Deloitte Consulting contracts and determine most effective and cost-efficient mechanism for contracting services and leveraging the RHIO purchasing power,
- hire staff for the RHIO Project,
- review licensing rights that may or may not be provided to Deloitte Consulting related to the RHIO,
- develop policies and procedures for the RHIO Project,
- outline the relationship between the foundations and a the RHIO program office (either internal or external to the foundations),
- further explore [Nonprofit Incubator] as a potential program office (e.g., review of fee structure, completion of due diligence, development of sole source justification, etc.),
- review analysis of potential county access to state and/or federal matching funds to cover the RHIO participation costs and

- undertake broader and deeper market research to verify appropriateness of product portfolio.

3. Recommended Form for the RHIO Entity

We recommend that the RHIO Entity be organized as a [State] nonprofit public benefit corporation. We further recommend that the RHIO Entity seek recognition from the Internal Revenue Service as a tax exempt organization described in Section 501(c)(3) of the Internal Revenue Code, that is operated exclusively for charitable purposes and qualifies for public charity (non-private foundation) status under Section 509(a)(2) of the Internal Revenue Code. If the RHIO Entity is not successfully recognized as an organization described in Section 501(c)(3), we recommend that it seek recognition as an organization described in Section 501(c)(4) as a social welfare organization that is nonprofit and operated exclusively to promote social welfare.

In recommending an organization, we measured the Principles against various entity structures to identify the structure best suited to enable the achievement of the Principles. The entities we considered include a nonprofit public benefit corporation, nonprofit mutual benefit corporation, joint powers agency, special joint powers agency and for-profit entity. Our analytical template is attached in Exhibit G. Descriptions of the characteristics of the other organizational structures we considered are included at Exhibit J. A brief description of the characteristics of [State] nonprofit public benefit corporations and the implications of tax-exemption follows.

A nonprofit public benefit corporation may be formed for any public or charitable purpose, provided its assets are irrevocably dedicated to that purpose. To satisfy the organizational test for a nonprofit public benefit corporation, an organization must be organized and operated for a public or charitable purpose that is exempt from taxation under the Internal Revenue Code (the “Code”) and may not distribute corporate assets to its members, as expressly provided in its Articles of Incorporation. No more than an insubstantial part of its activities may be in furtherance of a non-exempt purpose. Nor may the organization engage in certain prohibited political activities.

Any type of entity or individual may participate in a nonprofit public benefit corporation and new participants may be added, pursuant to the Bylaws of the corporation. Although it does not have shareholders, a nonprofit public benefit corporation may be controlled by its Members, who elect the Board of Directors. If the organization does not have Members, the Board must elect its own successors. Normally, the Board will appoint a CEO, President and/or other professional manager to run the organization’s daily operations but retain the ultimate responsibility for oversight of the organization. Each of the directors on the Board owes a duty of loyalty and care to the corporation, and must act in accordance with the best interest of organization.

Although the [State] Secretary of State will automatically approve the formation of a nonprofit public benefit corporation, provided its Articles of Incorporation meet the statutory requirements, mere formation of the corporation does not achieve tax exempt status. Rather, the corporation must apply for and obtain recognition of exemption from both the IRS and the state Franchise Tax Board (“FTB”). The process for obtaining recognition is lengthy, it may take three months or more for the IRS to grant recognition and several more weeks for the FTB to do the same.

The RHIO Entity will be organized such that recognition of exemption may be sought under two alternative provisions of the Code. The choice of provision is key, as the type of recognition granted will fundamentally affect the manner in which the RHIO Entity may conduct business as well as the tax consequences of the transfer of the RHIO System from [XYZ] to the RHIO Entity and grants from philanthropic entities to the RHIO Entity. Were the RHIO Entity to qualify as a 501(c)(3) organization, qualification as a public charity will also be key because it carries significantly fewer restrictions on activities than qualification as a private foundation. Below, we describe the federal tax exemption options for the RHIO Entity. An analysis of the tax implications of each option is provided under Exhibit G.

1. Section 501(c)(3) Organization

Organizations that are organized and operated primarily for charitable and/or public purposes may seek exemption under Section 501(c)(3) of the Code and Section 23701d of the [State] Revenue and Taxation Code. These code sections offer exemption from taxation on the income the organization receives and enable contributors to take a charitable income tax deduction for donations they make to the organization. In general, there are no federal tax limitations on another Section 501(c)(3) or a Section 501(c)(4) organization (such as [ABC] or [XYZ]) making grants to a Section 501(c)(3) public charity. (*See* discussion of public charity status below.) Corporations organized and operated for charitable and/or public purposes are precluded from engaging in any political campaign activities. Such organizations are permitted to advocate and attempt to influence legislation, provided they do not devote a substantial part of their activities to lobbying. Organizations qualified as Section 501(c)(3) public charities may even make a special election to become subject to a more objective standard for lobbying activities than the “substantiality” test, thereby making it easier for the organization to monitor its lobbying activities. An organization that loses its Section 501(c)(3) exemption on the basis of political campaign or substantial lobbying activities cannot thereafter qualify as a Section 501(c)(4) social welfare organization.

2. Section 509(a)(2) Public Charity Status

Within the Section 501(c)(3) classification, there are two distinct categories of organizations—“public charities” and “private foundations.” A Section 501(c)(3) organization is presumed to be a private foundation unless it can demonstrate that it meets one of the tests for qualification as a public charity. Private foundations are subject to a number of excise taxes and restrictions on their activities that do not apply to public charities. In addition, gifts to private foundations generally are deductible by donors at lower thresholds than gifts to public charities. Private foundations are also subject to more burdensome and time-consuming recordkeeping and reporting requirements. Accordingly, classification as a public charity is in almost all cases more favorable than classification as a private foundation.

One way for a Section 501(c)(3) organization to qualify as a public charity is to meet the “one-third/one-third test” under Section 509(a)(2). In order to meet the one-third/one-third test, an organization must receive more than one-third of its support from a combination of gifts and fees from its exempt activities, and not more than one-third of its support from investment income. All contributions from “substantial contributors” (persons or entities giving more than a certain amount relative to the organization’s total support) are excluded in calculating support

from gifts. In addition, in computing the amount of support received from fees for exempt activities, fees received from any one person (including a governmental unit) are includable only to the extent that they do not exceed the greater of \$5,000 or 1% of the organization's total support for the year. Thus, it can be difficult for an organization to meet the one-third/one-third test if it receives major gifts from substantial contributors or fees for exempt activities from only a limited number of payors who are subject to the 5,000/1% limitation.

3. Section 501(c)(4) Organization

Organizations that are organized and operated primarily for social welfare purposes may seek exemption under Section 501(c)(4) of the Code and Section 23701f of the [State] Revenue and Taxation Code. Unlike with Section 501(c)(3) organizations, donors to these organizations are not entitled to take a charitable income tax deduction for contributions and donations to Section 501(c)(4) organizations may even be subject to a gift tax. (*See* IRS Rev. Rul. 82-216, 1982-2). In addition, it is generally more difficult and disadvantageous for Section 501(c)(3) private foundations (such as [ABC]) to make grants to Section 501(c)(4) organizations. It can also be difficult for Section 501(c)(3) public charities to make grants to Section 501(c)(4) organizations, further limiting a Section 501(c)(4) organization's ability to attract support for operations, if necessary. Unlike Section 501(c)(3) organizations, however, Section 501(c)(4) organizations may take a position in support of or in opposition to a candidate for public office, provided this type of political activity is not its primary purpose. In addition, Section 501(c)(4) organizations can engage in unlimited lobbying activities, provided such activities are relevant to and further the organization's exempt purposes.

4. Governance Recommendation

The Principles related to governance contemplate three levels of activity—Membership, Governing Body (Board of Directors) and Officers. (*See* IV.B.2., Governance Principles.)

- Membership is to be broadly based to include significant the RHIO stakeholders in some way through a stratification of membership classes that will elect the Governing Body. Stakeholders making the greater investments in the RHIO will have a major voice.
- Governing Body or Board of Directors will have all of the customary powers of a board of directors, with the additional ability to change the membership to include additional classes of members with rights to elect Directors to allow full participation of the RHIO Customers. While the Governing Body will be reflective of the RHIO Customers, a significant number of Directors will be independent and management will be represented as well. The Governing Body will be informed by advisory bodies of stakeholders. The chair of the Governing Body will be independent of management. Committees of the Governing Body will focus on categories of Board responsibility, such as finance, audit and compensation and governance. The Governing Body will elect officers of the RHIO Entity.

- Officers will be compensated managers who report directly to the Governing Body and implement approved business plans and policies and manage the RHIO Entity in accordance with budgets approved by the Governing Body.

The Strategic Business Plan contemplates three distinct phases of development of the RHIO—Beta, Development and Mature Operations. The organizational structure accommodates these three phases with Beta continuing within [XYZ], Development being initiated under a program office and Mature Operations conducted by the RHIO Entity. This Governance Recommendation addresses the Development Period and the Mature Operations Period, in reverse order.

1. Mature Operations Period

We recommend a governance structure for the RHIO Entity, as follows:

Governing Body. We propose a Governing Body or Board of Directors of seven Directors, consisting of six Directors elected by the membership and the CEO serving *ex officio*. We believe a small board is appropriate for the RHIO Entity because of its focused activities which require a well-informed, involved Board that can be nimble and decisive. One-half of the Directors would be elected by the principal funders, [XYZ] and [ABC], and one-half would be elected by classes of stakeholders. The initial Board will draw lots to establish a 2- or 3-year staggering of terms. The initial Board of Directors would be appointed by [XYZ] and [ABC] from recommendations from a nominating committee consisting of representatives of [XYZ] and [ABC] and the pilot counties. As vacancies on the Board of Directors would occur, the Membership electing Directors to fill such vacancies would be assisted by the governance committee of the Board. The governance committee will nominate candidates for election as Directors by the membership classes, taking into account qualifications of candidates to serve on the Board of the RHIO Entity and their industry experience, competing time commitments, continuing director tenure, openness to new ideas, willingness to critically re-examine the status quo, qualification for re-nomination based on individual behavior expectations – *e.g.*, attendance, preparedness, participation, candor, and input from the Membership.

Membership. We propose four categories (classes) of membership, as follows:

- Founders – the Founders class will include [XYZ] and [ABC]. The Founders as a class will have the authority to elect 3 Directors. Directors elected by the Founders must be independent of the RHIO Customers and at least one Director shall represent the interests of Beneficiaries. The Founders will also have the following reserved powers:
 - Disposition of all or substantially all property of the RHIO Entity
 - Amendment of the Articles of Incorporation and Bylaws of the RHIO Entity
 - Merger of the RHIO Entity with or into another entity

- Dissolution of the RHIO Entity
- Incurrence of debt by the RHIO Entity over a specified dollar amount (*e.g.* \$250,000)
- Approval of strategic or long-term plans adopted by the Governing Body
- Founding Members¹ - the Founding Members class will include _____ so long as they are the RHIO Customers. The Founding Members as a class will have authority to elect one Director and as a class must approve the merger or dissolution of the RHIO Entity. The Founding Members class would be consolidated with the Urban Members class beginning with the election of Directors to take place in 2008.
- Urban Members² – the Urban Members class will consist of all Members (other than Founding Members until 2008) that are the RHIO Customers with a population in excess of one-half million. Urban Members as a class will have authority to elect one Director and as a class must approve the merger or dissolution of the RHIO Entity. When the Founding Members and Urban Members classes are consolidated in 2008, the consolidated Urban Members class will have authority to elect two Directors.
- Rural Members³ – the Rural Members class will consist of all Members (other than Founding Members and Urban Members) that are the RHIO Customers. Rural Members as a class will have authority to elect one Director and as a class must approve the merger or dissolution of the RHIO Entity.
- New Classes – with the expansion of the RHIO Customers to include _____, non-governmental entities, etc., the Board may expand the Membership to include logical groupings of new classes of membership, each with the authority to elect one Director. For every new class, the number of Directors elected by the Founder class would increase by one in order to preserve the balance between the custodianship of the Founders with the interests of the RHIO Customers.

Officers. Compensated officers would include a CEO and a CFO/Secretary. The CEO would serve as a Director *ex officio*.

Advisory Bodies. The Board of Directors should consider establishing as necessary one or more advisory bodies to provide a means of broad participation of and input from stakeholders, including Beneficiaries.

¹ The determination of who would be the RHIO contact and who would be empowered to vote on behalf of a Member.

² See footnote 1, *supra*.

³ See footnote 1, *supra*.

2. Development Period

The Development Period will present challenges for the implementation of the RHIO Program identified in the Strategic Business Plan. During the Development Period, many of the challenges of the Beta period will continue, such as marketing to potential key customers and high level interactions with the State of [State]. New challenges will also be faced as a work force or vendor network is established and standardized practices and policies are developed and implemented.

We recommend that all elements of the Mature Operations Period Governance Structure be given effect during the Development Period, and if a fiscal sponsor is engaged, with the RHIO Board of Directors serving as the Advisory Board for the fiscal sponsor and the CEO of the RHIO serving as the project manager. The Development Period can also serve as a laboratory setting for development of the operations structure and testing the governance structure of the Mature Operations Period.