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The Governing Board's Role in Assessing Possible Hospital Closure or Downsizing

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Hospitals find themselves at a challenging crossroads in the United States. Long viewed as central to the fabric of the community, they are relied upon as trusted providers of essential healthcare and as key employers. Never has that been truer than now, in the face of the COVID-19 pandemic.

At the same time, hospitals are vulnerable to unprecedented financial duress. For the leadership of some health systems, it will be advisable for the governing board to do an intensive assessment and develop a plan that acknowledges the future possibility of substantially altered operations that may include hospital downsizing or, in the worst-case scenario, closing. For others, it will be appropriate to embark upon the unwelcome and immediate journey of evaluating whether to close or downsize hospital operations and, if necessary, overseeing this action. This article identifies key considerations for health system and hospital governing boards in evaluating and implementing these actions.

The Backdrop

Closure Trends

Across the United States, in both urban and rural communities, hospitals have been closing at an accelerating rate. According to MedPAC, 47 hospitals closed in 2019, representing over double the 23 closures in 2018.[1] And Bloomberg reports that during 2019, at least 30 hospitals entered bankruptcy.[2]

1 Rich Daly, "47 Hospitals Have Closed in 2019, MedPAC Reports," HFMA, December 10, 2019.

2 Lauren Coleman-Lochner and Jeremy Hill, "Hospital Bankruptcies Leave Sick and Injured Nowhere to Go," *Bloomberg*, January 9, 2020.

Key Board Takeaways

- Hospital closures across the country have been accelerating in recent years. Rural hospitals are especially vulnerable, but non-rural hospitals serving medically underserved populations are also experiencing significant fiscal challenges.
- The COVID-19 pandemic has amplified this financial distress. Some hospitals may have immediate concerns. Others may be strained, but more focused on long-term uncertainties for hospitals, as compounded by COVID-19.
- Against this backdrop, boards should consider assessing the current financial strain on the enterprise, and developing targeted action items on the basis of its findings. This article suggests two possible board approaches, depending on the organization's current status:
    - For many hospitals, it will be beneficial to develop a detailed management plan that could be deployed in the event of future financial distress, which lays out various possible action items that include, but are not limited to, facility downsizing or closure. This should be thought of as prudent planning for a future mission-critical event.
    - For a smaller group of hospitals, it may be necessary to evaluate on a more immediate basis possible facility downsizing or closure. Any such action requires active board oversight, and should be undertaken with the appropriate level of organization, attention, and resources given the complexity of this action.
- In either case, the board should be unflinching in its evaluation and oversight, recognizing that important fiduciary duties are being exercised.

A February 2020 analysis by the Chartis Center for Rural Health found that 120 rural hospitals have closed since 2010, with 19 of these closures in 2019. In an alarming conclusion, the report identified an additional 453 rural hospitals as vulnerable to closure.[3]

Urban hospital closures also have been increasing, particularly among smaller hospitals and in areas serving medically underserved patient populations. A comparison of the MedPAC and Chartis data suggests that the majority of these closures in 2019 occurred among non-rural hospitals.

The highly-publicized closure and bankruptcy filing by Hahnemann University Medical Center in Philadelphia this past year underscored the vulnerability of safety net hospitals, even those that have been long-time community anchors and that serve as teaching hospitals.[4] The closure drew national attention to the impact on medical residents, and to the reality that some struggling hospitals with non-profit roots may now be controlled by for-profit investors.

The cause of this trend is multi-faceted, and altogether too familiar to hospital leadership. Overall Medicare and Medicaid reimbursement lags behind costs, with the potential for additional restrictions on Medicaid supplemental payments. Occupancy rates and procedure volumes have suffered in the face of the push to healthcare delivery in lower-acuity and ambulatory settings. The transition to value-based care delivery and reimbursement models is challenging. And hospitals not affiliated with large systems may find themselves losing workforce and patient volume to other area providers.

The COVID-19 Effect

Against the backdrop of accelerating hospital distress, COVID-19 hit in early 2020.[5] For hospitals and health systems, healthcare delivery in a pandemic is absolutely mission critical. At the same time, however, it is imposing an even greater operational and financial burden at an already-challenging time. Elective procedures may be suspended, which deprives the institution of important revenue. Patient acuity, and corresponding operating expenses, may have increased. These expenses may include workforce accommodations, and numerous adjustments in order to address infection control. And in the face of all of this, government and commercial reimbursement is unclear.

In the short term, some hospitals are experiencing immediate financial challenges that may cross the line into liquidity issues. While federal and state governments are taking measures to provide supplemental support to hospitals in acknowledgement of these stresses on the delivery system, there are concerns that the extent of support may be insufficient, and may not be channeled to the hospitals needing it most.

In the longer term, it remains to be seen whether the massive slowdown in the economy limits the percentage of patients with insurance, or imposes such financial strain on state and local governments that their ability to reimburse or provide financial support for hospitals is impaired. With a presidential election later this year, it is even difficult to predict the core federal philosophy around healthcare delivery that will be in place in a year, and how that will translate into hospital reimbursement.

On a very fundamental level, the length of the COVID-19 pandemic, and its full impact on the overall economy and the welfare of hospitals, is an unknown. What is known is that the operational and financial strain on hospitals is unprecedented.

Fiduciary Duties in Difficult Times

For a hospital and health system governing board, it is important to fully evaluate the range of potential short-term and long-term impacts to the organization in an era of overall operational and financial stress. From a fiduciary oversight perspective, this requires an unflinching and ongoing assessment of current realities and various future scenarios. If closure or downsizing is an immediate possibility, then the board is strongly advised to implement a comprehensive and documented action plan to ensure that its oversight is sufficient.

Core Duties

The three pillars of a hospital board's fiduciary duties are:

- The **duty of care**, which requires that directors make thoughtful and informed decisions through active engagement and oversight. Vigilance is important, and boards must assure themselves that they have sufficient information to make informed decisions, have ample opportunity to review information, and have the advice of experts as warranted. The board should adjust the extent

3 The Chartis Group, *The Rural Health Safety Net Under Pressure: Rural Hospital Vulnerability*, The Chartis Center for Rural Health, February 2020.
4 Soumya Rangarajan, "The Closure of a Historic Hospital Is an Ominous Warning Sign," *Scientific American*, September 17, 2019.

5 Kirk Siegler, "Small-Town Hospitals Are Closing Just As Coronavirus Arrives in Rural America," NPR, April 9, 2020.

and scope of its oversight to the circumstances.
- The **duty of loyalty**, which requires each director to act in the best interest of the organization and to put no personal interest ahead of this obligation.
- The **duty of obedience**, which requires the board of a non-profit organization to ensure the organization acts in accordance with its mission and purpose, and complies with the law.

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It is important to distinguish between a situation in which a hospital or health system board should understand various alternatives for addressing significant financial distress, as opposed to that in which a hospital closure or downsizing plan needs to be evaluated immediately and, in all likelihood, executed. Each requires care and an understanding of how closures or downsizings take place, but the latter demands significantly greater board involvement.

Scenario 1: Board Assessment of Significant Financial Strain and Possible Future Responses

For many boards, it will be appropriate to establish a focused approach to assessing the current extent of financial and operational stress on a hospital or health system, and to evaluate potential future scenarios. This likely goes beyond the ongoing good work of the finance and strategic planning committees, and instead takes the opportunity for a deep dive into the current internal and external realities of financial health, reimbursement, care delivery, and market realities. Possible steps may include:

- Convene an interdisciplinary group, perhaps an *ad hoc* or advisory committee, to work with management to assess current financial realities and foreseeable possibilities in terms of organizational financial stress. Based on this financial assessment, the group should create a series of recommended actions and possible future steps for the enterprise.
- The board may want to establish, as an expected outcome of this group, a formal evaluation of both the financial conclusions and the possible future actions. Note that some or all of these future actions likely would be identified as possibilities rather than definitive action items. The goal would be to have a roadmap to guide future decision making, should it prove necessary, and to create a process for periodic board assessment of this evaluation.
- Aside from internal resources, the board may want to directly retain external subject matter experts to assist in these efforts.
- Possible future actions to be identified and understood certainly could include traditional initiatives such as expansion of service lines, launching of new facilities, effective fundraising, and pursuit of expanded government funding. At the same time, however, it should also consider, as appropriate, more aggressive measures such as the possible discontinuation of service lines, refinancing, affiliation with other organizations, and, as needed, downsizing or discontinuation of operations. For each of these measures, there should be an understanding of what future metrics will trigger possible activation, areas of responsibility within the organization, the role of the board in decision making and oversight, the continuing process for assessing and implementing each type of measure, and the internal and external barriers to successful execution.
- This can be thought of as development of a plan that would be available to guide the organization as needed. As is the case with any such plan, it is better to know how the enterprise will organize itself, and details regarding implementation of possible responses, before the crisis hits.

Scenario 2: Board Action in the Face of Immediate Financial Duress

If a hospital or health system board finds that the organization's financial realities call into question its viability, then a more immediate, intensive, and action-oriented approach is needed. While third-party corporate affiliation or refinancing might be possible, it may be the case that the organization needs to evaluate closing or downsizing one or more facilities or service lines.[6] In this situation, the board should consider the following:

- The board bears ultimate responsibility for closure or downsizing, through the execution of its fiduciary duties. This requires that the board be

6 For an example of hospital closure guidelines, see *Hospital Closure Guidelines: Best Practices from the Field*, New Jersey Hospital Association Health Planning Department, 2008.

fully engaged and organized, despite the inherent challenges of doing so under stressful circumstances.

- Aside from the duty of care, a non-profit board also should appreciate that the duty of obedience requires adherence to the hospital's mission, and therefore there should be a thoughtful and well-documented assessment of alternatives to closure or downsizing and why they were not feasible. This assessment also may prove beneficial in any regulatory or attorney general inquiries.
- These events are complex, and there should be a detailed closure or downsizing plan with clear responsibilities to ensure that the many governance, financial, workforce, clinical, patient safety, risk, legal, contractual, communications, and other issues are addressed.
- The board should understand which wind-down areas present the greatest risk. Frequently, for example, significant patient safety issues arise in the closure of a hospital, as staff dwindles.
- In some states, hospital closure or downsizing requires regulatory approval. For a non-profit organization, the state attorney general may oversee the disposition of assets for the benefit of the community.
- It is especially important that the organization, and perhaps the board separately, have access to competent outside experts. This includes financial and legal advice. If bankruptcy is possible, then insolvency counsel also should be included from the outset.
- Hospital closure or downsizing tends to be very contentious. A well-crafted and executed plan for communications and community engagement is advisable, and outside communications and government relations resources may be needed. Failure to address these issues can create impediments to timely action, up to and including litigation and government inquiry.

Conclusion

Hospitals and health systems have been experiencing significant stress and uncertainty in recent years, as reflected in the accelerating closure of facilities across the country. The COVID-19 pandemic amplifies this strain, especially for rural and safety net hospitals. Boards should take steps in the near term to evaluate financial and strategic metrics in an organized and interdisciplinary way, in order to develop a working plan for how future financial and operational realities will be addressed. This process should be unflinching in its assessment of the current state and the full range of possible future outcomes, and should lay out a process by which the board and management will continue to confront these issues on an ongoing basis. For boards of hospitals and health systems with immediate or foreseeable viability concerns, it is imperative to establish governance oversight in an engaged manner, taking into account the complexities associated with potential insolvency and possible closure or downsizing of facilities.

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