Rural Focus

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COVID-19 and the Future of Community and Rural Hospitals

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More than 500 rural hospitals were at "immediate risk of closure" even before COVID-19 arrived.[1] Today, nearly 900 rural hospitals—40 percent of rural hospitals nationwide—are at either immediate risk or high risk of closure.[2] Hospitals everywhere are wrestling with unprecedented financial pressures, shifting regulatory burdens, and uncertainties related to new leadership in Washington, D.C. And still, the pandemic remains.

Initially stung by the cancellation of elective surgical procedures and reduced revenue, hospitals saw their expenses spike due to the supplies, equipment, and staffing required to treat COVID-19 patients. And, unfortunately, they are not out of the woods yet. According to a recent Kaufman Hall report, operating room minutes were down 18 percent in January 2021 from a year ago, and emergency department visits are down 25 percent. Gross outpatient revenue is also down 10 percent.[3]

Many rural hospitals weren't well-prepared with cash on hand to weather the COVID-19 storm and the reduced revenue that accompanied it.[4] While emergency CARES Act funding helped soften the blow for some, it was a short-term fix that did not address pre-existing systemic issues. For hospital boards, the pandemic has made a challenging situation even more difficult, and for many hospitals the decisions

1 Ayla Ellison, "State-by-State Breakdown of 897 Hospitals At Risk of Closing," *Becker's Hospital Review*, January 22, 2021.
2 Harold D. Miller, *Saving Rural Hospitals and Sustaining Rural Healthcare*, Center for Healthcare Quality and Payment Reform, September 2020.
3 Kaufman Hall, *National Hospital Flash Report*, February 2021.
4 According to the NC Rural Health Research Program's May 2020 Findings Brief, "based on the most recent cost report data, rural Prospective Payment System (PPS) 26–50 bed hospitals had a median of only 21.3 days cash on hand and rural Medicare Dependent Hospitals (MDH) hospitals had a median of only 28.4 days cash on hand prior to the onset of COVID-19 in the United States."

→ Key Board Takeaways

The COVID-19 pandemic has underscored the importance of community-based hospitals while simultaneously exposing and heightening the financial realities facing the same hospitals. Board members should:

- Take active roles in the organizations they serve. Ask questions and request additional information from the hospital's leadership team as needed in the decision-making process.
- Ensure they have the information (especially financial information) they need from management to make independent decisions on matters that will impact the hospital's future.
- When evaluating options to ensure continuing operations, consider the expertise of knowledgeable outside advisors and be open to new operating models and partnerships.
- Remember that by taking action now, boards can improve their ability to pursue the most favorable course of action for their hospitals and communities.

made by directors over the next few months could critically impact the availability of quality healthcare services in communities across the United States.

The Responsibilities of the Board

Individuals who serve on non-profit hospital or health system boards are accountable for the actions of the organizations they lead. Board members have a legal obligation to be well-informed and actively involved in ongoing efforts to meet the objectives of the hospital or health system. Entrusted with overseeing the fulfillment of the organization's mission, directors have fiduciary responsibilities that include well-defined duties of care, loyalty, and obedience, depending on the corporate structure of the organization:

- The **duty of care** requires active participation in decision making on behalf of the hospital and the exercise of judgment independent of management. The board member must be familiar with all relevant and available facts regarding the hospital's operation and financial standing. Directors are expected to ask questions and request additional information from the hospital's leadership team as needed in the decision-making process. In most jurisdictions, the law imposes an expectation upon directors to supervise management, which requires directors to critically eye the proposals and actions management may proffer.

- The **duty of loyalty** means that directors must place the hospital's interests above their own.
- The **duty of obedience** describes the director's responsibility to be faithful to the organization's stated mission. In the hospital or health system setting, this typically entails ensuring and preserving the availability of healthcare services to members of the community the hospital serves. One trap that we see at times is that directors delegate this duty to management.

Increasingly, board members should be open to new operating models and partnerships. Pouring hundreds of thousands of dollars in upgrades into a freestanding acute-care hospital in a smaller community may not be worth the expense if consumers are opting for a larger facility just a few miles away. Could that money be better invested in clinics, outpatient centers, and telehealth capabilities? Although "big dollar" buys are flashy and can be popular, it is incumbent on boards to look at what their communities really need as they evaluate the cost-benefit of the acquisition with what will benefit their communities long-term and, ultimately, what can they afford to invest? A hospital closure has long-term detrimental effects on the economic health of the entire community; but even more devastating is a lack of healthcare services, generally, in a community. The combination of unemployed hospital workers and reduced access to healthcare services bodes ill for any small community.

The Director's Focus Today

The coronavirus pandemic has added new financial and organizational pressures to independent hospitals. As a result, the importance of boards focusing on the hospital's future with a strong understanding of the financial situation is more important than ever. To ensure the continuing operation of their hospitals, boards should have sufficient information from management to make independent decisions on matters that will impact the hospital's future. This information includes a 13-week cash flow projection, updated monthly and compared to actual performance. Among other things, this cash flow projection will not only show directors how secure the short-term financial health is but will also show whether management is capable of projecting short-term performance. In addition to requesting information from the hospital's leadership, directors should consider utilizing the expertise of knowledgeable outside advisors.

These advisors could include management consultants and data analysts who could help incorporate industry-proven best practices into the hospital's strategic planning and financial management processes. Attorneys with healthcare-specific experience are a valuable resource to hospital board members. Healthcare attorneys play a key role with respect to transactional matters, commercial finance and restructuring, healthcare regulatory compliance, licensing, reimbursement, and operations. Investment bankers with healthcare experience can help ensure that financial reports are accurate and provide much-needed insight in mergers and acquisitions or debt and equity financing. Valuation analysts experienced with establishing the fair market value of healthcare facilities and businesses may also be helpful if the hospital decides its best step forward involves a sale, joint venture, or refinancing. In instances involving a change of ownership or a strategic affiliation with a larger health system, boards should also consider engaging a public relations firm to manage communications with the media and community members. Although advisors cost precious financial resources, they provide boards with invaluable information as well as legal protections. Many courts will find that a board's business judgment has been enhanced when it relies upon experts in making strategic decisions.

COVID-19 and What Comes Next

Once the hospital board and executive leadership have taken a deep dive into the financial data and consulted with their team of assembled advisors, it may be time to evaluate options and make what could be difficult decisions about the hospital's future. The level of financial distress confronting the hospital can significantly influence the choices available to the hospital and the time it has to address the situation. Hospitals will be best served by taking steps early, before operations or finances become critical, to analyze their financial situation. By taking action now, boards can improve their ability to pursue the most favorable course of action for their hospitals and communities.

We anticipate a nearly inevitable uptick in the number of community and rural hospitals in distress as a result of the economic uncertainty created by the COVID-19 pandemic. Margins are tighter, and the financial relief provided by the government will have to be repaid. This means that the duty of care that applies to board members will require them to investigate the financial status of the hospitals and then help them fulfill their mission moving forward. Directors have a legal obligation to consider every option available in order to make the best decisions possible for the hospitals they serve. In many cases, the best available option could be to merge with another tax-exempt health system, sell the hospital to an investor-owned healthcare company, or completely overhaul the hospital's offerings. Although each of these is a difficult (and often distasteful) decision, the ultimate goal should be to maximize healthcare offerings for the community at a price point the community can comfortably afford.

Conclusion

The COVID-19 pandemic has underscored the importance of community-based hospitals while simultaneously exposing and heightening the financial realities facing the same hospitals. The legal duties of care, loyalty, and obedience require hospital board members to take active roles in the organizations they serve. This includes being fully informed and exploring all options to help ensure the continued availability of high-quality healthcare services in their communities, and these options may include a sale, merger, or joint venture with a healthcare company or another community health system. It may be difficult for hospitals that closely identify with the communities they serve to consider such a change. Doing nothing, however, might only result in a sudden reduction in services, employee layoffs, a decline in quality, and ultimately closure.

The Governance Institute thanks John Tishler, Partner, Waller Lansden Dortch & Davis, LLP, for contributing this article. He can be reached at john.tishler@wallerlaw.com.