



CEO FOCUS

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M&A Governance Takes a Thoughtful Approach

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New Jersey has undergone substantial consolidation over the last decade and the market remains extremely competitive with three dominant large health systems. As one of the few independently operated organizations remaining in the state and very competitive central New Jersey market, we must always consider our competitive position with an eye on the future.

I initially joined the organization in 2015 as president and following a change of leadership in 2017 I assumed the combined role of president and CEO. Planning for our future began in earnest in the spring of 2017. Among the various issues facing Saint Peter's at the time was the need to determine whether we should continue to remain as an independently operated organization or seek a strategic partnership with a larger health system. Consequently, our board decided that, as a Catholic hospital, we would begin a mission-based decision-making discernment process to determine the best option to secure Saint Peter's future and maintain our Catholic identity. From that spring to the following fall, we laid the groundwork that led to a formal approach that began with a board retreat in September 2017 with the support of external advisors. We needed to evaluate our competitive market position in the context of our mission and the significant consolidation taking place at that time.

Saint Peter's historically had marginal financial performance. Cash reserves were much less than our long-term debt, and we had a substantial liability related to a frozen defined benefit pension plan. Our bond rating was below investment grade. We began the discernment process with a thorough market analysis to see where we stood against

our peers, looking at how the market was shifting, using publicly available information, to determine who might be the best potential strategic partner.

Ultimately the question we needed to answer was, given the marketplace consolidation and our desire to sustain our Catholic mission for the long-term, could we remain independent? Then we had to ask ourselves, if we believe that we could remain independent, should we? Based on our five-year financial forecast at the time, it was determined that we could continue to operate independently, but we were concerned about the potential impact from the significant changes occurring in our market during that time.

So, we decided to take the next step to pursue a partner through the request for proposal process. The following is the short story and some important lessons we learned along the way.

The RFP Launch

With our external advisors and a legal team that included antitrust counsel and a Canon Lawyer helping us at each step of the way, we launched the Request for Proposal process in October 2018 with national outreach to over 40 organizations including teaching, non-teaching, Catholic, secular, big national Catholic systems, and for profits. We narrowed the list down to a few participants and ultimately decided to move forward with RWJBarnabas Health (RWJBH), one of the largest health systems in New Jersey. At the time, we bought into an aligned vision about how we could best serve the community in New Brunswick and central New Jersey, especially the most vulnerable population. We entered into a non-binding letter of intent in December 2019 and subsequently began working on a definitive agreement.

New Jersey was on the front lines of those states hardest hit by the initial onslaught of the COVID-19 pandemic and Saint Peter's was among the busiest hospitals in the state responding to extraordinary community needs. Although consumed with our response to the pandemic, we finally reached a definitive agreement in September 2020. This was followed by submitting the required filings of both the state and federal regulatory processes. Nearly two years later, although the State of New Jersey approved the transaction, the Federal Trade Commission (FTC) voted unanimously to block the merger and immediately filed suit in June 2022. After much thought and consideration, our organizations mutually made the difficult decision not to litigate and we walked away.

For all involved, the proposed merger was always about how to best serve the community and was never meant to be anti-competitive, as asserted by the FTC. Much

“I cannot imagine what it would be like to work in this scenario without an engaged board committed to a sustained effort over an extended period of time with the ultimate goal of preserving the mission for the long-term.”
—Les Hirsch

time, energy, and money were expended in a time-consuming effort in which we came up short. The challenge now would be how to go forward to secure Saint Peter's future.

Saint Peter's Ideal Partner Attributes

1. Ability to maintain our Catholic identity.
2. Be sure of our role in management and governance.
3. Access to capital.
4. Ability to gain operating efficiencies.
5. Ability to serve the community together.
6. Access to technology and human capital to enhance our clinical abilities.

The Governance Process

We knew we needed a coherent, inclusive strategic planning and decision-making process that focused on clear objectives to assure Saint Peter's Catholic mission for many years to come. To do this important work, we decided to utilize regularly scheduled board meetings rather than separate periodic retreats. Historically, our board usually met every other month, so when we moved into the discernment process, the board agreed that we should meet monthly. We began the meetings with a 90-minute executive session that focused on the strategic partnership work. In retrospect, that was helpful in being able to keep the work moving at a good cadence with the board now functioning as a "committee of the whole." Saint Peter's board does not have a standing committee responsible for strategic planning.

I wanted to make sure the board understood the discussions about the initial letter of intent and term sheet, the separate Catholic identity agreement, and the definitive agreement, as these included a lot of detail. As we zeroed in on the definitive agreement, we held weekly one-hour briefing sessions over six to eight weeks to review each section to help everyone understand any differences between the terms outlined in the letter of intent in comparison with the definitive agreement. Board members were not required to attend these informal meetings; however, for those who were able to attend, these meetings helped them gain a better understanding of the proposed transaction. Having this knowledge contributed to the quality of the ensuing discussions at formal board meetings and aided the board in its decision making.

About Saint Peter's Healthcare System

Saint Peter's long-standing Catholic mission of humble service to the community dates back over 116 years with the establishment of Saint Peter's General Hospital in 1907. Saint Peter's Healthcare System, formed in 2007, is one of the few remaining single-hospital health systems in New Jersey and one of the few remaining Catholic hospitals in the state. The single-hospital system includes a network of ambulatory facilities and physician practices. Services include:

- Saint Peter's is a major teaching hospital that also serves the role of community hospital with full-service adult and pediatric EDs, and a state-designated children's hospital and regional perinatal center with a Level IV NICU.
- 130 residents in freestanding, ACGME-accredited internal medicine, obstetrics/gynecology and pediatric residency programs and fellows and is a major clinical affiliate of Rutgers Biomedical and Health Sciences.
- Renowned for maternity and pediatric care.
- 3,600 healthcare professionals and support personnel, and more than 1,000 doctors and dentists on the medical staff.
- Treats more than 23,000 inpatients and 245,000 outpatients annually.
- Saint Peter's Physician Associates, a network of primary and special care physicians.
- Saint Peter's Foundation.

Mission:

Keeping faith with the teachings of the Roman Catholic Church and guided by the Bishop of Metuchen, Saint Peter's University Hospital is committed to humble service to humanity, especially the poor, through competence and good stewardship of resources.

We minister to the whole person, body, and spirit, preserving the dignity and sacredness of each life. We are pledged to the creation of an environment of mutual support among our employees, physicians, and volunteers and to the education and training of healthcare personnel.

We are witnesses in our community to the highest ethical and moral principles in pursuit of excellence and patient safety.

Lessons Learned

One might consider the time we spent on this extended period of discernment a waste, but by going through this process, our board has been involved in conversations about the future of Saint Peter's for several years that it would not otherwise have had, especially considering that the market has continued to evolve. I can't say enough about how engaged the board has been and the thoughtful conversations it has had about our Catholic mission, culture, and the importance of serving the community. This experience has increased the board's effectiveness in carrying out its governance responsibilities.

I have always emphasized the need for a transparent relationship with the board. There is nothing more important for a CEO than earning the trust of his/her board and trust can only be built over time through positive interactions and results. As the CEO, you must be dependable—do what you say you will do and always deliver on your commitments, while being open to constructive criticism and input. Differences of opinion can be healthy, as is the way in which these differences are navigated and resolved. Keeping the board informed through detailed and frequent communication is also a critical key to success especially when dealing with complex issues. Our board has placed a lot of trust in me and it's an honor to be their "managing partner."

Looking to the Future

When we decided not to litigate with the FTC, we immediately pivoted with the board to prepare for next steps. Since June 2022 we have been in "Discernment Process 2.0." We did not conduct a formal RFP this time; we asked our advisor, Kaufman Hall, to make some targeted inquiries to see if there were any organizations interested in exploring strategic partnership opportunities with us. We did further analysis, completing another financial forecast for the next five years. The good news is that our financial strength dramatically improved over the last several years as evidenced by four recent upgrades in our bond rating. In fact, thus far in 2023, we are one of the few hospitals nationally that have been upgraded. Fortunately, we significantly outperformed the initial five-year forecast from 2017 and came through COVID exceptionally well. Today, although being in a stronger financial position and still operating with a positive margin, we have felt the pressure of workforce shortages and higher wages, as well as the impact of (managed care) payers arbitrarily denying, down-coding, and doing whatever they can to pay us less or not pay at all for services rendered. This has become a huge problem for the hospital industry in New Jersey and nationally as hospitals are not being fully paid for services provided and there is little to no accountability.

We still believe we need a strategic partner, as our capital needs are greater than we can generate as a stand-alone organization. As of the fall of 2023, we are now six-and-a-half years into this process and still working on finalizing our plan for the future. Although our financial position is much stronger than previously, a huge achievement considering the circumstances, we still believe that we can benefit from being part of a larger organization and the increased scale that it could bring.

If I could go back and do anything differently, it would have been to move the process faster; though we moved at the pace that was comfortable for everyone at that time, while also managing some unforeseen circumstances. We have learned valuable lessons. Our board culture is healthy and productive and I appreciate the level of engagement of our board members in moving through this process. You can't do this with a board that isn't engaged.

