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Weighing Change: Converting Public Hospitals to Private, Not-for-Profit Organizations

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The American healthcare system is rapidly evolving, presenting unique challenges and opportunities for public hospitals. In responding to these changes, public hospitals must explore innovative solutions to meet the changing needs of their communities. This article addresses the factors to consider when evaluating a conversion from a public hospital to a private, not-for-profit 501(c)(3) entity and offers tools to facilitate the conversion process.

Evaluating the Trade-offs of a Transition

Out of the over 4,000 hospitals in the United States, approximately 530 are owned or operated by public or government entities. For decades, public hospitals have played a significant role in the healthcare industry; however, due to COVID-19 and the shift to outpatient care in the healthcare sector, coupled with public hospital-specific challenges such as open meeting and open record laws, many public hospital boards are re-evaluating the strategies that can best benefit their communities and secure their missions. Often, public hospitals conclude that a transition to private 501(c)(3) status is in the hospital's and community's best interests.

The fiduciary duties that a board owes to its organization and mission also drive the evaluation of the conversion from public to private status. Board members must uphold fiduciary duties of care, loyalty, and obedience in their decision-making process. To fulfill these duties, board members should weigh the drawbacks of conversion against their benefits. Although converting to private status may forgo sovereign immunity and certain

supplemental payments from government payer programs, for many hospitals, these losses are greatly outweighed by the substantial opportunities for private investments, joint ventures, geographic expansion, and confidential strategic planning. Trade-offs are inevitable and are at the heart of the fiduciary review process. For certain hospital systems, the benefits associated with conversion provide hospitals with substantially more resources and capabilities than those possible under public status. Given the complexity and anticipated transformation within the healthcare industry, adaptability is necessary. When thinking about the duties of care, loyalty, and obedience, it is essential to acknowledge that what has been successful historically might not be successful today or in the future.

Moreover, the prudent fiduciary practice of informed, proactive decision making highlights the benefits of converting to a 501(c)(3) entity. Transiting to private status does not mean that the organization has failed. Rather, it likely indicates a deeply engaged board and leadership team keenly focused on the hospital operations, strategic planning, and the sustainability of the hospital's mission. The best time for an organization to evaluate and improve its operations is when it has room to act voluntarily and proactively, not when it is under duress. When an organization acts long before it is forced to, there is more space for studying market trends, organizing ideas, and obtaining stakeholder and community approval. Thus, a proactive fiduciary review process that sparks evaluation of conversion from public to private status is by itself a sign the hospital board is taking its fiduciary duties seriously.

Factors to Consider

The process for converting a hospital system from a public to a private 501(c)(3) entity has no template and looks different for every hospital and community. However, when initiating discussions about a possible transition, public hospital leaders should consider several themes that are consistent throughout all successful conversions.

First, in their roles as fiduciaries, board members should analyze the organization's mission, comparing the trends in the healthcare industry to the hospital's long-term goals and forming a clear picture of the organization's options. For instance:

- Does the hospital seek to remain regional through expansion, partnerships, or a strategic transaction?
- Does it anticipate facing future competitors in its primary or secondary service area?

After all, a particular legal structure is not the goal; instead, the structure is a means to secure and even strengthen its mission. What is the best option considering its goals

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and capabilities? Insights from case studies, organizations that have recently converted to private 501(c)(3) status, trends in public policy, and data about the community are critical to this process. For example, are some of the benefits of public status—such as sovereign immunity and supplemental payments—already at risk by political or budgetary factors? At the state and federal level, very often there are legislative initiatives designed to chip away at the historic benefits that public hospitals enjoy. Losing even some of the benefits of being a public hospital without gaining the flexibility of becoming private is probably the worst-case scenario and would likely spell disaster for many public hospital systems.

Through thoughtful communication about the plan, all relevant community stakeholders should be engaged with regard to the evaluation process. Internally, this requires clear communication with doctors, nurses, and staff who care deeply about their work. Externally, it entails establishing and maintaining credibility and transparency among community members and leaders. Close collaboration among the legal, communications, and finance teams can also ensure effective communication regarding the purpose and context of the transition. Inevitably there will be challenges and even setbacks, and building and maintaining goodwill is paramount to a successful evaluation and transition process.

Additionally, maintaining transparency throughout the decision-making process is essential to an effective conversion to private 501(c)(3) status. To minimize surprises and the unplanned disclosures of internal information with external sources, shareholders and individuals who drive public opinion should stay informed about where the public hospital is in the transition process. Transparency safeguards accurate information and creates public trust in the events to come, establishing a firm foundation for the transition to private status before it even begins.

Finally, board members should carefully assess the legal requirements that must be satisfied before a transition can occur. This process looks different in every state and is a key component of the cost/benefit analysis. Some require state legislative approval or attorney general review, while others do not because they have already adopted a conversion process for public hospitals. For some hospitals, conversion may need to be approved by a voter referendum. Given the varying steps required to transition from public to private status, a clear understanding of the process for each specific hospital at the outset of the decision-making review helps to ensure an efficient conversion.

In all, transitioning from public to private, not-for-profit 501(c)(3) status can offer numerous advantages for hospitals, including more flexibility, access to private investments, and greater autonomy. In particular, a proactive transition to private status can improve

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hospitals' resiliency and enable hospitals to adapt to unexpected challenges. Almost always, a vote by the board to convert from a public hospital to a private 501(c)(3) hospital is a vote of confidence not just in the hospital, but also in the community's civic, political, and business leadership. It demonstrates optimism and confidence in the organization and its potential. By embracing conversion, hospitals can better serve the needs of their communities and position themselves for success in the healthcare industry. Though there is no template for a transition process, hospitals should assess their long-term goals, maintain transparency about where they are in the process, and weigh the legal hurdles they must overcome. Ultimately, by converting to private 501(c)(3) status, hospitals can secure and even expand their mission and make a positive impact in their community for decades to come.

Key Questions for the Board

- How would converting to a private, not-for-profit organization help further the organization's mission and future vision?
- What are the main drawbacks vs. benefits to making this transition?
- How can we best engage relevant community stakeholders (from internal staff to external community members and leaders) in the evaluation and decision-making process?
- What legal requirements must be satisfied before a transition can occur?

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