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Local Hero: Edward Kangas Rides Out A Crisis In Stride

With focus and fortitude Kangas helped pull Tenet Healthcare back from the brink

By Karen Murray

“If you like white-water rafting, you’ll love being on the board of Tenet.” So says Ed Kangas, the non-executive chairman of Tenet Healthcare. Kangas has been mastering rapids since joining the Tenet board in April 2003. Fellow directors say his leadership has been key to getting the scandal-racked company back on course — a turnaround role that makes the former global chairman

and CEO of Deloitte an Outstanding Director.

Tenet, the country’s second-largest hospital system, was riding high when it suddenly hit the rocks in the fall of 2002. Company officials had figured out a way to boost earnings, and a securities analyst discovered the scheme. By hiking the rates it charged for procedures, Tenet ensured reimbursements from Medi-

care in the form of outlier payments. These are payments made to hospitals to cover the cost of particularly expensive patient cases. “It was not illegal, but it was wrong,” says Kangas. Tenet found a loophole in Medicare, and “they drove a truck through it,” he says.

Two days later, the FBI raided a

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Tenet hospital in Redding, Calif., alleging that physicians had performed unnecessary cardiac procedures. And in December 2002, federal agents seized records at Tenet-owned Alvarado Hospital in San Diego County to ascertain whether certain relationships with physicians violated anti-kickback laws.

Tenet stock plunged 74% from October of 2002 to July of 2003. Struggling to show investors it was addressing the problems, Tenet brought back former executive Trevor Fetter as president. “We realized we’d have to make some major changes to the board,” Fetter says. When the search firm suggested Kangas, “I said, ‘If this guy will agree to be on our board, I’ll do anything to get him.’”

Kangas, a Kansas native whose father was one of the team that started Cessna, joined Touche Ross straight out of school and stayed for his whole career. He was one of the chief architects of the 1989 combination that created Deloitte & Touche. Under his leadership, the firm grew from \$3.5 billion in revenues in 1989 to \$11 billion in 2000. He headed Deloitte Consulting for five years, as well, which gave him considerable insight into why businesses succeed or fail.

“Ed told me he looked at the situation, he believed it could be saved, he believed it was worth saving, and he believed he could play a leadership role in saving it,” Fetter remembers. Three months after joining the board, Kangas was named non-executive chairman and began systematically to rebuild. Fellow director and former senator Bob Kerrey notes, “Ed stayed calm. He doesn’t panic.”

The board’s first task was to remove CEO Jeffrey Barbakow. “From there the CFO, COO, general counsel — they all had to go,” Kangas says. “If this company could not show the government that it was a new company with the

best governance, with a quality board and a quality CEO, the government would put it out of business.”

Kerrey agrees that convincing the government was a primary task. “We’re at the mercy of their good will toward us. And they didn’t have much good will toward us,” he notes wryly. In fact,

solved yet, and the board didn’t know whether I’d be judged culpable.” Fetter, who was serving as acting CEO, had left Tenet only three years earlier.

Kangas knew that “the new CEO would need the board’s full support. I didn’t believe Trevor would have that without going through the search pro-

DIRECTOR’S SNAPSHOT

Born: May 22, 1944, Wichita, Kan.

Education: BA and MBA, University of Kansas in Lawrence

Career Highlights: Global Chairman and CEO of Deloitte

Hometown: New Canaan, Conn.

Family: Wife Cathy; 3 children; 3 grandchildren

Most Memorable Summer Job: 3 summers at Kiddie Land, a mini Disneyland for young children

Best Movie Seen This Year: *Happy Feet*

Best Book Read This Year: *The Audacity of Hope* by Barack Obama

Favorite Composer/Poet: Rod Stewart

Favorite Charities: National Multiple Sclerosis Society



Something Most People Would Be Surprised to Know About Me: “I can put up and take down a Ferris wheel.”

Won’t Leave Home Without: “My notebook computer.”

Most Recent Vacation: “Taking my son and his twins to Disneyland.”

Current Public Company Boards: Tenet Healthcare, EDS, Hovnanian Enterprises, Eclipsys

the Senate Finance Committee suggested Tenet was “ethically and morally bankrupt.” The board recruited eight new directors, and the company replaced 80% of management. In addition, the entire slate of directors is now up for reelection annually.

The next task was to appoint a CEO. “There was widespread disagreement about whether to choose me as CEO,” says Fetter “The litigation wasn’t re-

cess,” he explains. In the end, Fetter got the job, but only after the board had retained Spencer Stuart to present alternative, outside candidates.

Compensation had to be tackled, as well. “The company was one of the high-flying companies in America until October 2002. Compensation levels were around the 90th percentile. There was no way a company fighting for its life could pay people that

way,” says Kangas with shrug. Today, top management receives restricted stock at the 50th percentile level. Options are now performance-based. And performance measures are tied to the company’s stock price. Kangas also recommended expensing options long before it became a requirement. The changes produced results: ISS boosted Tenet’s governance rankings from the 50th percentile to the 99th percentile among S&P 500 companies.

Next came litigation. “Ed led the effort to select the right outside counsel to advise the board, to lead our negotiations with the government and to represent us in court,” explains Kerrey. Kangas offered strategic advice to Fetter, as well. “I told him, ‘When you meet with the government, take a slide of director photos from 2002. For the next slide, put a big red X through the pictures of everyone who’s gone. Then do a slide of officers, with Xs through the ones who’ve left,’” he says with a grin.

The company sold off problem hospitals, dramatically reducing its roster of facilities from 113 in 2002 to 55 today. It resolved for \$395 million the Redding suits charging unnecessary cardiac procedures and paid out \$215 million in early 2006 to settle a variety of shareholder suits. The Medicare mess was settled for \$900 million — a payment of \$725 million, plus \$175 million that Tenet waived its right to collect from Medicare. And the company paid \$21 million to settle the U.S. attorney’s criminal case against its Alvarado Hospital, agreeing to sell the hospital as well.

As Tenet and its board worked through these complicated matters, the company suffered another blow. Hurricane Katrina severely damaged four of its hospitals in New Orleans. “Tenet sometimes feels like Job,” Kerrey says with a sigh.

But Kangas never gave up. “The guy is unflappable,” says Fetter.

Today, revenues are at nearly \$9 billion. But the stock price remains mired in the \$7 range. “The headwinds at this time in our business have been tremendous,” Fetter concedes. “It takes a tremendous amount of courage and conviction for a board to stick with a strategy when they see all the metrics pointing to success but the stock price is not.” That strategy is based on a commitment to quality, which the company dubs “C2Q.” Tenet wants to build volume by becoming the hospital of choice among physicians, patients and nurses. “The focus on quality is a huge shift. It

“The guy is unflappable.”

Trevor Fetter, CEO, Tenet Healthcare

costs money, but it’s starting to gain traction,” Kangas says.

Evidence that the quality initiative seems to be paying off is shown in the number of United Healthcare “Center of Excellence” (COE) designations Tenet has earned. Today it boasts six times the national average for U.S. hospitals. While only 5% of hospitals with which United has a relationship earn COE designations, 29% of Tenet’s hospitals have won COE status. And those designations appear to impact hospital admissions. United Healthcare’s admissions to Tenet hospitals named as COEs in cardiology grew by 11% in 2006, compared with growth of only 1% in Tenet hospitals without the COE designation.

Kangas points to physician satisfaction surveys as another measure of Tenet’s revival. For the 18 months ending November 2006, physician satisfaction grew by 9.1% to a score of 75.3. “Eventually, you’ll see higher admissions, which will lead to higher earnings and higher profits,” he says confidently. “We’re building a company that has sustained value. The stock

price will increase when admissions improve and profits get better.”

Kangas also serves on the board of Electronic Data Systems, the \$20 billion provider of information technology services. That company had its difficulties as well, with Chairman and CEO Mike Jordan coming out of retirement to help turn it around. “EDS has gone through a major transformation,” says Jordan. “I found Ed incredibly useful because of his consulting background at Deloitte.”

EDS faced longstanding litigation, and Kangas once again rode to the rescue. In 2005, he headed a special securities settlement committee. Fellow trustee Ellen Hancock served with him on the committee. “The company was being bogged down by the litigation,” she explains. “Our role was to review the litigation and review the company’s response to that.” Kangas stressed that the committee needed independent advice from its own advisor. “Ed made sure we had our own lawyer so that we could do our own due diligence,” Hancock continues. In 2006, EDS settled the securities class action litigation for \$137.5 million — a successful outcome given that the plaintiffs had requested just under \$1 billion in damages.

Kangas sits on three public company audit committees and attends many of Tenet’s audit committee meetings in his ex officio role. Some board watchers question whether audit committee services should be limited. “They are a lot of work,” Kangas agrees. “But with my background, I’ve found it’s not a problem.” He estimates he spends about 250 hours per year on each board, between meetings, preparation, travel time and phone conferences. “Tenet took 1,000 hours for one year,” he says, smiling. “Now it’s down to 400 hours.” ■

Ed Kangas will speak about “The Midnight Phone Call: Controlling a Crisis” at **ODX New York** on June 15, 2007. Please call Ajay Bham-bri at (212) 542.1229 to attend.