The Regents of the University of California

COMMITTEE ON HEALTH SERVICES
July 16, 1998

The Committee on Health Services met on the above date at UCSF - Laurel Heights, San Francisco.

Members present: Regents Atkinson, Chandler, Davies, Khachigian, Leach, Ochoa, Preuss, and Sayles

In attendance: Regents Bagley, Connerly, Espinoza, Gould, Hotchkis, Johnson, Kozberg, Lee, Miura, Montoya, Nakashima, Parsky, and Willmon, Regents-designate Taylor and Vining, Faculty Representatives Dorr and Weiss, Secretary Trivette, General Counsel Holst, Assistant Treasurer Young representing Treasurer Small, Provost King, Senior Vice President Kennedy, Vice Presidents Broome, Darling, Gomes, Gurtner, Hershman, and Hopper, Chancellors Carnesale, Cicerone, Dynes, Greenwood, Orbach, Vanderhoef, and Yang, Vice Chancellor Bainton representing Chancellor Bishop, and Recording Secretary Bryan

The meeting convened at 9:50 a.m. with Committee Chair Khachigian presiding.

1. **PURCHASE OF COMPCARE, A MEDI-CAL PRIMARY CARE CASE MANAGEMENT PLAN, MEDICAL CENTER, SAN DIEGO CAMPUS**

The President recommended that, in consultation with the General Counsel and the Vice President for Clinical Services Development, he be authorized to execute a stock purchase agreement and any other documents necessary to allow UCSD to purchase CompCare Health Plan, Inc., transfer the Medi-Cal enrollees into UCSD Health Plan, and to subsequently dissolve the CompCare Corporation.

It was noted that the San Diego campus seeks approval to purchase 100 percent of the shareholder equity (shares of common stock) of CompCare Health Plan, Inc., a California for-profit corporation for an amount not in excess of $575,000, which is consistent with the fair market value range as determined by an appraisal of CompCare completed by Deloitte & Touche LLP in July 1998 at the request of UCSD. The purpose of the Corporation is to provide health care benefits to Medi-Cal enrollees under an agreement with the State of California. Following the purchase of CompCare, the California Department of Health Services will authorize the transfer of CompCare's approximately 7,200 Medi-Cal enrollees into UCSD Health Plan. This transfer will assist UCSD in maintaining sufficient Medi-Cal volume for its Medical Center and Medical Group during the Medi-Cal program's transition to managed care.

The purchase price which has been proposed includes: (1) a cash payment of $149,000 to the CompCare shareholders, (2) a $26,000 cash payment to be allocated to nonshareholder contracting providers of CompCare, and (3) assignment to the CompCare shareholders certain "shared savings" balances due and owing to CompCare from the State of California for health care services rendered by CompCare after March 31, 1997. The dollar value of the shared savings is presently undetermined (due to the State's procedures for calculating shared savings balances and in notifying Medi-Cal plans of these balances), but is estimated to be between $400,000 and $500,000 when fully received by CompCare from the State of California. The shared savings portion of the purchase price will be decreased by any amounts owed by CompCare to third parties as a result of contractual commitments by CompCare to share such shared savings balance.

The UCSD-CompCare Relationship

CompCare Health Plan, Inc. began operations in February 1996 under an agreement with the California Department of Health Services to enroll Medi-Cal beneficiaries in San Diego County. UCSD Healthcare and CompCare entered into an Administrative Services Agreement for UCSD to perform certain managed care operations (e.g., claims processing, utilization management, member and provider services, and provider contracting) on behalf of CompCare. UCSD began these operations in February 1996 and will continue these operations through July 1998.
Consistent with the agreement, UCSD employed marketing staff and incurred advertising expenses. These expenditures, on behalf of CompCare, were to be either: (1) absorbed by UCSD, as partial compensation for CompCare's business, if UCSD later became a Knox-Keene licensed Medi-Cal plan and desired to transfer the CompCare enrollees to UCSD's plan; or (2) repaid from the profits of CompCare. CompCare's operating expenses have consistently exceeded its resources. As a result, the University has incurred approximately $1.9 million in expenses that CompCare has not paid, and is now due and owing to the University. UCSD has assumed these advances will not be repaid and has fully reserved for these amounts as uncollectible both in current and prior years. This debt due to the University has been taken into consideration in calculating the fair market value of CompCare.

UCSD has benefitted from this relationship particularly in light of its intent to operate its own Medi-Cal Health Plan.

- It has acquired experience in managing a Medi-Cal health plan including administration and claims processing, as well as gaining experience in marketing this product to physician providers and Medi-Cal beneficiaries.

- The UCSD Medical Group has responsibility for the medical care of approximately 20 percent of the enrollees in CompCare under capitation arrangements.

- Referrals to UCSD Medical Group and admissions to UCSD Medical Center have been greater from CompCare providers than from other providers who participate in other Medi-Cal managed care plans.

- Because the marketing materials have included both the CompCare and UCSD name, UCSD has maintained a presence in the Medi-Cal provider and patient communities.

Status of Healthy San Diego Program

In March 1998, The Regents approved UCSD to modify its Knox-Keene Health Care Service Plan license and to execute an agreement with the State of California to participate in the Healthy San Diego Program as one of several contracted health plans. Under this new program, the majority of Medi-Cal beneficiaries in San Diego County will be required to enroll in one of seven managed care plans. Since CompCare Health Plan, Inc. will not be one of the contracted Medi-Cal managed care plans offered under the new Healthy San Diego program, its Medi-Cal enrollees will be required either to choose a new managed care plan or, under a purchase agreement such as the one being proposed, the CompCare enrollees will be transferred into the purchasing health plan.

Status of the UCSD Health Plan

The UCSD Health Plan has successfully completed all of the steps necessary to be operational under the Healthy San Diego program. In becoming operational, UCSD Health Plan has contracted with a San Diego County-wide network of health care providers including UCSD Medical Center, UCSD Medical Group, and the CompCare contracted providers. Marketing to Medi-Cal enrollees is expected to begin in July 1998. With the purchase and conversion of CompCare, the UCSD Health Plan will significantly increase UCSD's start-up enrollment.

Summary of Transaction

UCSD and CompCare will execute an Agreement for Purchase and Sale of Stock. This Agreement specifies that The Regents purchase from the five-physician CompCare shareholders 100 percent of the issued and outstanding shares of CompCare subject to specific terms and conditions including:

- Shareholders' closing deliveries, including the share certificate issued by CompCare in The Regents' name, cancelled share certificates issued in the shareholders' names, written consent of shareholders' spouses to the sale, the written resignation of all officers and directors of CompCare, the corporate minute book, stock ledger, register, and corporate seal, the opinion of the shareholders' counsel; and

- The Regents' closing deliveries, including the $175,000 cash portion of the purchase price and the written assignment of the shared saving balances, and appointment of two community physician shareholders as determined by UCSD to the Board of the UCSD Health Plan.

Other provisions in the Agreement include:

- All CompCare shareholders who are contracting providers with CompCare will execute UCSD Health Plan provider agreements;

- CompCare shareholders shall use their best efforts to assist UCSD in joint marketing efforts and to obtain executed provider agreements with CompCare's current contracting physicians; and

- For a period of three years after the date of closing, the CompCare shareholders shall not participate as investor, proprietor, partner, shareholder, officer, director, or employee in any entity that is a competitor of the UCSD Health Plan.

This Agreement also documents additional representations, warranties, and covenants as conditions precedent to The Regents' obligations to close under the Agreement.

Dean Alksne summarized the value to UCSD Healthcare of the transaction from a business development perspective. He noted that Regental approval to develop a Medi-Cal health plan in San Diego was sought mainly to ensure a sustained patient population for the Medical Center's teaching programs. A target was established of 20,000 enrolled Medi-Cal beneficiaries over the first year of operation of the plan, which is scheduled to begin August 1. The target is necessary in order to provide patients for the teaching program and to support the financial viability of the health plan operation. A strategy is being developed for achieving the enrollee goal. Based on experience in other health plans in other cities, it has been determined that advertising and marketing expenses will cost about $100 per new enrollee. The University has circulated its marketing materials to Medi-Cal recipients in San Diego County. The advantage of purchasing the CompCare group is the opportunity to accelerate the enrollment into the Medical Center's health plan. It is not known how many of the 7,000 existing enrollees will remain, but it is hoped that over 5,000 will. Enrolling them early will give the University a head start at meeting the financial obligations of operating the health plan.

Regent Khachigian noted that the CompCare books show incurred expenses of $1.9 million. Dr. Alksne explained that in 1995, the Medical Center entered into an agreement with CompCare to help its doctors establish a primary care case management program. The Medical Center assisted the doctors in marketing and advertising the program. A significant part of this loss occurred in the first year. Start-up costs included the expenditure of University resources to cover the time worked by Medical Center employees. The actual CompCare operation from a medical service position is better than break even, but it is not sufficient to cover the start-up costs. As this group is folded into the Medical Center's health plan, not only the professional fees but the institutional fees will go to the University, providing adequate funding in the future.

Regent Gould observed that the transition of Medi-Cal beneficiaries to managed care has been difficult in some counties. In the current situation, there are seven providers looking to provide services. He asked what the level of confidence was in achieving the 20,000 necessary enrollees, given the complexities of the transition and the reduction in the number of Medi-Cal beneficiaries who are eligible statewide. Dr. Alksne acknowledged that it will be a difficult goal to achieve. The Medical Center is working with the Department of Health Services to try to obtain preferential treatment in default enrollment, but that has not been assured. The Medical Center is conducting a major marketing campaign and is trying to maintain good relationships with community providers. With a large Medi-Cal population, the University has a good opportunity to get a competitive rate structure. Chancellor Dynes noted that a monitoring process with careful goals and objectives has been put in place. If the enrollment goals are not being reached, the arrangement will be reviewed. Regent Gould commented that often the success of the transition is dependent upon the State Department of Health Service's decisions regarding rollover patients and other factors. He believed that it would be to the Medical Center's advantage to get written clarification from Health Services, closing out as many issues as possible.

Upon motion duly made and seconded, the Committee approved the President's recommendation and voted to present it to the Board.

2. **UPDATE ON CLINICAL SERVICES DEVELOPMENT MONITORING OF CLINICAL SERVICES REGENTAL ACTIONS**

It was recalled that, according to Bylaw 12.7(b), the Committee on Health Services is responsible for "all matters related to business transactions affecting the clinical services of University academic medical centers and schools of health sciences including, but not limited to, acquisition of physician practices, hospitals, and other facilities, clinical and ancillary services, and participation or membership in joint ventures, partnerships, corporations, or any other entities...."

Over the past four years, over fifteen business transaction items have been brought forward to The Regents for consideration. To provide The Regents and the members of the Committee on Health Services with the information necessary to carry out this responsibility, the Vice President--Clinical Services Development, in consultation with the Office of General Counsel and the Senior Vice President--Business and Finance, will periodically report to the Committee on Health Services as to the status of those business transactions which have been previously acted upon and approved by The Regents.

This is the first of a number of such status reports that will be provided to The Regents:

Review of Financial Performance of Limited Liability Company Jointly Owned by Boehringer Mannheim Corporation and UC San Diego School of Medicine

At the November 1996 meeting of The Regents, the Committee on Health Services and the Committee on Finance approved the establishment of a limited liability company with Boehringer Mannheim Corporation (BMC), an Indiana corporation, for the purpose of jointly owning and operating a Molecular Diagnostics and Therapeutics Service Center at the San Diego campus. The Office of the Vice President--Clinical Services Development has reviewed the objectives established with regard to the joint venture between BMC and UCSD in terms of its economic viability and programmatic impact and is of the opinion that the Limited Liability Company has met the expectations of its partners. The following is a brief overview of the goals and financial direction of the venture.

<u>Introduction</u>

Molecular Medicine LLC (LLC) was organized July 8, 1997. Based upon the valuation of assets, capital contributions, and operating support, BCM owns 51 percent of LLC, while the University of California is 49 percent owner of the corporation. Located at the San Diego campus, LLC is governed by a seven-member Board of Managers. The University's interests are represented by three members: two members of the School of Medicine, Dr. Theodore Friedman and Dr. Thomas Kipps, and David Sakai, CFO, UCSD Health Sciences. LLC's President is Dr. Charles Prussak, formerly an employee of the University.

The primary purpose of LLC was to provide capital and operating support for the Clinical Applications Laboratory of the UCSD Gene Therapy Program and Stem Cell Processing Laboratory at no expense to the University. LLC was not expected to generate income in the first few years of the operations.

Rationale

Prior to the formation of LLC, the School of Medicine at the San Diego campus operated a prototype production and service facility for viral vectors and stem cell processing for its own researchers and for third parties. UCSD had a major investment in faculty, equipment, and facilities in the creation of the Human Gene Therapy and Stem Cell Transplantation Program. However, to reach the full potential of these programs as well as support rapidly growing expensive technology, UCSD sought the support of an industry partner to provide additional ongoing capital requirements and the essential expertise in product development and marketing.

BMC was chosen for its international reputation in the field of molecular diagnostic tests. With annual revenue of $4 billion, it had both the financial and technical capacity to support the joint venture. Although BMC was acquired by Roche Pharmaceuticals, a division of Hoffman LaRoche, Switzerland in early 1998, the joint venture has been implemented as scheduled.

Objectives

The joint venture between BCM and UCSD School of Medicine proposed to accomplish the following:

- Offer advanced molecular diagnostic and genetic screening capabilities. Molecular diagnostic and genetic screening is soon to be implemented in a newly renovated facility.

- Provide contract manufacturing of genetic materials and vectors in an existing, licensed laboratory for University of California faculty, other universities, other non-profits, and for-profit companies. The vector contract manufacturing program is fully operational.

- Provide high quality stem cell processing services in a new, licensed laboratory. As part of the final negotiations with BMC, the Stem Cell Processing Laboratory was retained by UCSD. This has allowed UCSD to incorporate the Stem Cell Processing Laboratory into the recently approved joint venture with Sharp Health System for the Bone Marrow Transplantation Program.

- Provide expertise in product development and marketing, and support the ongoing capital requirements essential for the success of LLC. LLC was capitalized at approximately $8.2 million, composed of BMC's commitment for a cash contribution of $4.2 million, with the balance represented by the University's in-kind contribution of the existing laboratory and research operations. Moreover, LLC conducted a symposium at UCSD on gene therapy, with distinguished presenters from a variety of research institutions. A marketing effort has been initiated based on a detailed strategy aimed at key market segments.

Financial Performance

LLC was expected to incur losses for the first three years, showing a break-even cash flow in year four. The revised budget reflects the exclusion of the Stem Cell Processing Program from LLC operations.

As anticipated, the first quarter 1998 financials show a net loss of $260,000; however, compared to budget, the first quarter results are approximately $74,000 higher. The improved margin resulted from better pricing of the first quarter business. Expenses were up, partly due to increased administrative costs, largely a result of not receiving reimbursement from BMC/Germany for expenses of a symposium until after the first quarter.

For 1998, LLC is projecting a positive variance of approximately $500,000 from its budget.

Future Direction of LLC

The Roche-BMC management has continued to emphasize the importance of meeting targets and budgetary goals. The renovation project of the free-standing UCSD building was under budget.

A full-scale public relations strategy is being developed to market LLC to biotechnology companies, pharmaceutical companies, and academic researchers.

There is Board interest in designing an LLC Fellowship Program for UCSD students, which will become operational once financial results approach break even. LLC will also increase efforts to educate UCSD faculty on the benefits of the partnership.

Vice President Gurtner recalled that the Regents requested a review of the projects that have been brought to the Board over the past two years in order to assess their progress. This analysis is done by the Office of the President, with the cooperation of the campuses but independent of them. Director of Clinical Services Shannon summarized the report.

Chancellor Dynes commented that the arrangement is working as expected. It is speeding the transfer of technology from the research laboratory into industrial products.

Chairman Davies asked why the project is ahead of budget. Mr. Gurtner believed that Boehringer has been very focused on the goals and direction of the program.

Chairman Davies asked about the schedule for reporting on outside ventures. Mr. Gurtner responded that he intended to report on one or two at each meeting, covering all 15 within a year.

President Atkinson expressed his support for industry/University cooperative programs, which have continued to be very successful.

3. **ACTIVITY AND FINANCIAL STATUS REPORT ON HOSPITALS AND CLINICS**

Mr. Lawrence Furnstahl, Chief Financial Officer of UCSF Stanford Health Care, reported on the financial status of the merged entity for the six months since the merger. He focused on comparative results between the UCSF Medical Center and Mt. Zion Hospital (the north sites) and the Stanford University Hospital and Lucile Packard Children's Hospital (the south sites). He pointed out that UCSF Stanford Health Care is managed as an integrated clinical and operating enterprise. It is becoming increasingly difficult to calculate and less meaningful to report operational results by site. Finance, information technology, human resources, strategic planning and marketing, and most other central services are now budgeted and managed on an integrated, enterprise-wide basis. In addition, service lines are being developed which are programmatic groupings that span all sites. This, combined with uniform contracting, is leading to the movement of patient activity revenue and expense between sites to facilitate better patient care, program growth, service, and efficiency.

Mr. Furnstahl reported that an analysis has been conducted of direct margins by site for the first six months. The analysis has been reviewed by the finance committee of the UCSF Stanford board. He defined direct margin as patient care revenue minus direct site costs such as nursing and pharmacy. It does not include central expenses such as finance and information technology. This is a common way of accounting where there is a business with multiple divisions. It is often called contribution margin accounting. In the future, the meaningful segment reporting for the UCSF Stanford board will be based on programmatic rather than on geographic groups. An example would be children's health services spanning all sites as a segment within UCSF Stanford Health Care.

Mr. Furnstahl reported that the north and south sites are roughly equal in patient activity. The south site has more cases and slightly fewer patient days, reflecting a shorter average length of stay. Overall, the numbers are similar for both sites, but there is one significant difference in terms of patient activity. For the last nine years, Stanford has put special effort into reducing inpatient utilization and average length of stay. Length of stay is one day shorter at the south site, even though the case mix index is about 10 percent higher in the south. The direct margins from November through April are $61 million for the north site and $62 million for the south site. The $123 million total direct margin for UCSF Stanford Health Care supports $103 million of central expense, resulting in an operating gain of $20 million. The budget in the business plan for the first year of the merger was $21 million. In addition, there are about $8 million of non-operating items that bring the total net income up to $28 million. These results are consistent with analyses of FY97 financial results. Pre-merger, there were only two significant differences in overall operating gains by site. First, UCSF had no pension expense, reflecting the fact that it participated in the UC defined benefit plan, which was overfunded, while Stanford had a defined contribution plan to which it was making regular contributions. Second, the south site had more depreciation expense, which reflected the newer facilities on those sites.

Mr. Furnstahl reported that there were about 26,800 patient discharges at the north site and 31,800 at the south site. These both exceeded the projections for the first year of the merger and were above the actual figures for each for the previous year. There were 176,000 patient days at the north site and 174,000 patient days at the south site, which were also both over the budget and over the previous year's figures. Overall, patient activity increased by about 7 percent. Total operating revenue increased by about 8 percent. There were $217 million of institutional revenue at the north site and about $327 million at the south site. Direct expenses corresponded similarly. An analysis of the audited financial statements for UCSF Medical Center and Stanford Medical Center and Packard Children's Hospital confirmed that last year the north campus had a direct margin of $113 million, about $14 million higher than the corresponding margin at the south campus. This is exactly the amount of the lack of pension expense on the north campus. The overfunding remained with UC at the merger. Eighty percent of the UCSF Medical Center employees moved over to become employees of UCSF Stanford Health Care and joined its defined contribution benefit plan.

Finally, Mr. Furnstahl compared the direct margins to the FY97 results. Overall, the direct margin is up by $35 million, or 16 percent.

Regent Leach asked about the financial results to date of the entire UCSF Stanford Health Care enterprise compared to the original plan. Mr. Furnstahl reported that the plan showed a first year operating gain of $20.8 million. On a six-month basis it would have been expected to be about $10.4 million. The operating gain was $19.8 million, or $9.4 million above the plan. Not including some one-time items reflected in that figure, the operating gain is $1.4 million above the plan. Mr. Leach noted that the assets that each member of the entity contributed to the merger are performing equally well. He noted also that it will become increasingly difficult to distinguish between the two original partners, because in order to get some of the financial and patient care benefits of the merger, the organization's members are being redesigned along program lines to make them more consumer friendly.

Regent Preuss stated that he found the report very useful and that he would not expect to be presented with any further reports that separated the financial figures for UCSF and Stanford. Chairman Davies agreed, saying that he would rather see future presentations focus on how the combination has benefited the joint enterprise.

Regent Lee asked why the north campus had a better margin than the south campus and what could be done to improve the south's margin. Mr. Furnstahl responded that there are various ways of measuring the margin. Patient days have a higher margin at the south campus, but the north has a higher per admissions margin. In dollars, the south is ahead; as a percentage of revenue, the north is slightly ahead. The main reason appears to relate to the south campus' efforts to get ahead of the curve in reducing length of stay. Payors such as Medicare pay on a per case basis, under which the faster a patient can be moved through the system and out to a lower cost setting, the higher the margin will be. There is still a significant number of payors, however, that pay per day. Stanford and Packard have reduced their average length of stay quickly. In the short term, that could reduce their margins slightly, but it positions them better for the future. One of the great advantages of the merger is that detailed comparisons are available on operations, practice patterns, and costs. There is a major effort to adopt best practices on the length-of-stay question across the organization for next year. The goal is to at least stay even with the declining payment rates in the market. Regent Leach suggested that once sufficient experience has been gathered, there be a presentation on the cost accounting system. Mr. Gurtner noted that his office has been developing a broad-based monitoring tool to follow the progress of UCSF Stanford Health Care and would describe it in the future, also.

Faculty Representative Weiss commented that when UCSF Stanford Health Care was established, there were a number of committees set up that involved faculty and administration from each site to move forward the planning and evaluation efforts. She encouraged the Regents to hear from a few of those groups, particularly the one that has been examining the impact on the University's teaching and research missions.

The meeting adjourned at 10:35 a.m.

Attest:

Secretary