The Regents of the University of California

COMMITTEE ON HEALTH SERVICES
March 14, 2001

The Committee on Health Services met on the above date at the James E. West Alumni Center, Los Angeles campus.

Members present: Regents Atkinson, Davies, O. Johnson, S. Johnson, Kohn, Kozberg, Lansing, Lee, Marcus, and Preuss; Advisory member Seymour

In attendance: Regents Bagley, Connerly, Fong, Hopkinson, Miura, Montoya, Moores, and Parsky, Regents-designate T. Davis and Morrison, Faculty Representatives Cowan and Viswanathan, Secretary Trivette, General Counsel Holst, Provost King, Senior Vice Presidents Darling and Mullinix, Vice Presidents Broome, Drake, Gomes, and Gurtner, Chancellors Berdahl, Bishop, Cicerone, Dynes, Orbach, Vanderhoef, and Yang, Executive Vice Chancellor Simpson representing Chancellor Greenwood, Vice Chancellor Erickson representing Chancellor Tomlinson-Keasey, and Recording Secretary Bryan

The meeting convened at 12:20 p.m. with Committee Chair Kohn presiding.

1. **UPDATE ON STRATEGIC DIRECTION FOR MOLECULAR MEDICINE, LLC, SAN DIEGO CAMPUS**

Dr. Edward Holmes, Vice Chancellor for Health Sciences, recalled that, in support of its programs in genetics and molecular biology, UCSD had established a Human Gene Therapy program in 1995. It had two distinguishing capabilities: (1) its Clinical Applications Laboratory, which enables the on-site manufacturing of viral vectors and genetic materials under the most stringent and clinically acceptable manufacturing standards, and; (2) the UCSD Stem Cell Transplantation Program.

UCSD leadership recognized in 1996 that this rapidly growing technology required enhancement and support of an industry partner in order to provide the required expertise in product development, marketing, and capital requirements essential to success. Therefore, in July 1997, Molecular Medicine LLC (LLC) was established as a University-industry joint venture. Structured as a limited liability company, the LLC was 51 percent owned by Boehringer Mannheim Corporation (BMC) and 49 percent owned by the University. The LLC was capitalized at approximately $8.2 million, composed of approximately $4.2 million in cash from BMC, with the balance as the University's in-kind contribution of existing laboratory operations. In 1998, BMC was acquired by Roche Pharmaceuticals, a division of Hoffman LaRoche Switzerland (Roche).

The primary mission of the LLC is to produce for the marketplace modified viruses, which can be used as carriers to transfer specific genes to target cells in gene therapy and drug development research. The LLC is located on the UCSD campus, leasing space in the Cellular and Molecular East building adjacent to the School of Medicine and space in Building 4 on the campus.

Financial Performance

The LLC was projected to incur losses on operations for the first three years and to show a break-even cash flow in year four. Since its inception, operating losses have totaled $1,734,000 versus originally projected losses of $807,000. Operating losses are funded by Roche's cash contribution, which makes up its 51 percent ownership. For the fiscal year ended December 31, 2000, year three of the venture, the LLC projected a slight gain of $658,000. However, due to lower sales than projected and higher costs associated with increased staffing in quality assurance and quality control, the project incurred a loss of $339,000. A slight profit is being projected for 2001, with sales projected to grow from $2.8 million in the current year to $4.5 million in 2001.

Partner's Intent to Sell

In late 2000, Roche notified UCSD of its intent to sell its interest in the LLC because of its need to focus on its primary research portfolio and reduce its investments in the field of gene therapy. In January, Roche began the search for a purchaser. Roche has notified the campus that its expects to hold discussions with prospective buyers in March and to finalize the transaction in April or May. Given Roche's decision to divest, the campus, with support from the Office of the General Counsel and Clinical Services Development in the Office of the President, is evaluating its continued ownership in molecular medicine. Depending on the value of the LLC and the market opportunity, UCSD may decide that the time is right to recoup its investment and to sell its interest simultaneously with the Roche transaction. Currently, PricewaterhouseCoopers LLP is conducting an appraisal on behalf of the University to determine the range for an appropriate purchase price. If a sale appears to be in the best interest of the University, UCSD may return to The Regents requesting approval of the final transaction. If the timing and the market conditions are appropriate, approval may be sought under interim authority before the next Regents meeting.

Regent Preuss recalled that there was a strategic reason in 1997 for entering the agreement. He asked whether there was a change in the reason for being in the business independent of the partner's selling its part of the LLC. Dr. Holmes responded that the campus' interest in this type of technology has not diminished. What remains to be determined is whether this particular entity of molecular medicine is necessarily the best way for San Diego faculty to achieve their goals.

Regent Hopkinson asked whether the expense side of the financial background included the University's in-kind laboratory operations cost. Chief Financial Officer Sakai reported that the in-kind contribution was valued originally at $4.2 million. Amortization of that amount is $767,000 a year.

Regent Lee noted that, if depreciation is discounted, the LLC performed better than was expected. He hoped that, if the campus decides to sell its holdings in the LLC, it will seek a price based on this performance.

Committee Chair Kohn asked whether the decision to divest or stay the course would be influenced by who the purchasing entity may prove to be. Dr. Holmes believed that it would, from several points of view. An important consideration is that UCSD faculty continue to have access to resources to be able to develop vectors for gene therapy. At least a portion of the administrative evaluation will relate to making certain that access is assured, whether it is with an entity that might purchase the University's portion or not. Other options are being investigated also. Regent Kohn wondered whether the campus will have the opportunity to evaluate potential purchasers. Mr. Sakai reported that the LLC agreement permits the University to reject a potential purchaser. The campus is participating in the due diligence and evaluation of potential buyers.

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

Vice President Broome reviewed the first six months of financial activity at the University's medical centers. She reported that trends have not changed since late fiscal 1999. She noted that the reports exclude the San Francisco campus, for which there is no comparable data.

Ms. Broome noted that over the last four years there has been a steady trend of increases in patient days, which are driven primarily by admissions. All the University's medical centers have had increases in this category except Irvine, which experienced an increase in the acuity of its patients. Along with having sicker patients who stayed longer, there was a slight shift away from Medicare and Medi-Cal and toward contract payors, who pay a better rate. Generally, the medical centers are following the national trend of moving certain procedures from in-patient to out-patient settings. At the Irvine medical center there has been a dramatic increase in outpatient visits, while these visits have decreased at the Davis medical center, which closed four ambulatory care clinics that were unprofitable.

Concerning excess of revenues over expenses, for the combined four medical centers there was a significant dip in 1999 that was influenced by heavy losses at the Los Angeles medical center. Ms. Broome recalled that during 1999 the impact of the reductions in the Balanced Budget Act of 1997 were first felt. She noted that in 2000 the trend is upward. Davis has had an increase in patient volume and has benefitted from the sale of the energy from its co-generator. Irvine has had an increase also, based on the previously mentioned acuity level, and it had a helpful across-the-board rate increase. The Los Angeles medical center has started to recover from its previous losses. Increases in its net revenues have resulted from cost cutting, but the impact of retroactive labor adjustments is beginning negatively to affect that comeback. The San Diego medical center has benefitted from an increase in net revenues and from funds provided by SB 1732. To provide perspective, she pointed out that the San Francisco medical center is reporting about a $10 million loss, which was the amount that had been budgeted.

Ms. Broome reported that, in the category budget-versus-actual, the Davis, Irvine, and San Diego medical centers experienced increases over budget. At Davis this is due largely to surplus energy sales; at Irvine it is related to the higher patient acuity and contract increases. San Diego has experienced increased patient volume, and Los Angeles is below budget.

Regent Montoya asked why patient acuity might have increased at Irvine. Ms. Broome explained that acuity is a difficult measurement both to explain and to predict. Even slight fluctuations can have significant financial impacts.

Regent Hopkinson recalled that in May the Regents will receive a complete report on the hospitals. Committee Chair Kohn indicated that it will be on the future of funding for medical education and will incorporate the financial condition of the medical centers.

Regent Marcus asked what is used as a capital asset depreciation in the financial reports. Ms. Broome explained that the medical centers depreciate their assets using a large range of lives. The University is in the process of adopting the depreciation of assets.

Ms. Broome discussed the measures of financial position. She noted that Davis and San Diego had slight increases in their cash in investments. Irvine and Los Angeles had decreases. The Los Angeles medical center has had to borrow $7 million from the campus and to secure a $35 million line of credit. It will have difficulty improving its cash position while it is struggling to make money. The Irvine medical center is very dependent on SB 1255 and SB 855 funding. The medical centers should have about 60 days of cash on hand. Only Davis and San Diego are in that position. Irvine has 10 days, Los Angeles has zero, and San Francisco has 10. Each has a contingency plan for providing cash if necessary. She noted that days of revenue in accounts receivable have increased at all the medical centers.

Regent Lee observed that, if days of revenue in accounts receivable could be decreased, the medical centers would have sufficient cash on hand. He believed that the hospitals should be gaining market share, based on the fact that people are living longer. Ms. Broome noted that, although people may be living longer, they are healthier. The biggest impact on market share for the University's hospitals is managed care. Committee Chair Kohn commented that the finances of the health care industry are extremely complicated. It would be simplistic to assume that just because the state's population is increasing and getting older, the business of health care will prosper. Managed care has imposed enormous financial burdens on health care facilities. Many hospitals have closed, and the University's respected academic healthcare complex is continually in a precarious financial position due largely to factors beyond its control.

Regent Kozberg asked whether anything is being done in the regulatory area to shorten the period of time between service and payment. Ms. Broome responded that the medical centers are doing all they can procedurally. The problem is being seen across the industry. Vice President Gurtner commented that there have been some lawsuits in recent years by the larger hospital systems, Blue Cross being their prime target. The ability to pinpoint which payor is lengthening time to payment is difficult. The authority-granting process for providing the care has become so complex that it may be 60 days before the bills are even processed. He believed that all five medical centers are aggressively pursuing collection of their receivables.

Regent O. Johnson asked whether charges are the same at all the University's medical centers. Mr. Gurtner explained that the rates are set at the individual institutions relative to the marketplace. What each patient ends up paying is based only loosely on the rate; rather, it is based on the contract between that facility and the carrier that is paying for the care the patient has received.

The meeting adjourned at 1:00 p.m.

Attest:

Secretary