Office of the President

TO MEMBERS OF THE COMMITTEE ON HEALTH SERVICES:

ACTION ITEM

For Meeting of November 19, 2009

AGREEMENT WITH LOS ANGELES COUNTY ON MARTIN LUTHER KING REPLACEMENT FACILITY

EXECUTIVE SUMMARY

Campus: Office of the President

Project: Reopening of Martin Luther King, Jr., Hospital

Action: Approval

Total Cost: Approximately $500 million

Previous Actions: None

Project Summary: To provide physician coverage at — and appoint board members for — a new nonprofit hospital on the Martin Luther King, Jr., Hospital campus.

RECOMMENDATION

The President recommends that the Committee on Health Services recommend that the Regents approve execution and implementation of the proposed Coordination Agreement between the University of California and Los Angeles County.

BACKGROUND

In 2006, the Centers for Medicare/Medicaid Services terminated Martin Luther King, Jr., Hospital from the Medicare program; the hospital ceased inpatient services in August 2007. Shortly thereafter, the Governor and officials from Los Angeles County (LAC) approached the University of California to discuss reopening the hospital.

University representatives, acting in consultation with the Regents, have met with representatives from the Office of the Governor and LAC and jointly developed a proposal to re-open Martin Luther King, Jr., Hospital. The proposal is reflected in the “Key Elements Between County &
University Regarding Operation of MLK Community Hospital” (Attachment 1) attached to this item. Key elements are as follows:

1. LAC will, at its own expense, build and equip a seismically-compliant 120-bed community hospital with an emergency room, three operating rooms, and no trauma center. The facility will be ready for occupancy in phases, beginning in late 2012.

2. LAC will lease the foregoing physical plant to a new 501(c)(3) nonprofit corporation (NEWCO) that will operate the hospital.

3. The hospital will be a community asset that addresses the major health needs of the community—hypertension, heart disease, stroke, diabetes, and obesity—by emphasizing medical care and de-emphasizing surgical care (thus only three operating rooms). The hospital will become part of a larger clinic/outpatient-based community health care system.

4. NEWCO will be governed by a seven-member board of directors, with two directors appointed by the UC President, two directors appointed by LAC, and three directors appointed jointly by the UC President and LAC. Board members cannot be current officers or employees of UC or LAC, and must have at least ten years of experience in health care or a related field.

5. After five years, University and County may reconsider their authority to appoint members of NEWCO's board and will, if mutually agreed, jointly request NEWCO to modify such board-appointment authority.

6. Neither UC nor LAC will manage or operate the facility.

7. LAC agrees to the following funding commitments on behalf of the hospital.
   a. **Start-Up Fund.** LAC will establish and capitalize a one-time start-up fund for the hospital. Such funds will be used for necessary expenses related to opening the hospital (e.g., consultant services, staffing, equipment and supplies, as well as supplemental funding for operating expenses incurred during the period before all beds are operational). The fund will total $50,000,000 and be capitalized by budgeting and reserving $10,000,000 increments by each July 15, beginning on July 15, 2010. Such funds will be provided to NEWCO upon request.
   b. **LAC-Funded Line of Credit.** LAC will make available to NEWCO a revolving Line of Credit in the amount of $20,000,000 at LAC Treasury Pool rate, to be available when hospital operations commence. The hospital will only be permitted to access the Line of Credit under “exigent circumstances” as determined by an affirmative vote of five of the seven NEWCO board members.
   c. **LAC-Funded Reserve.** LAC will also establish and capitalize a one-time reserve fund for the hospital totaling $8,000,000. The hospital will only be permitted to access the reserve funds under “exigent circumstances” as determined by an affirmative vote of five of the seven NEWCO board members.
   d. **Intergovernmental Transfer.** LAC will annually make an intergovernmental transfer of $50,000,000 for the benefit of the hospital. For the first six years after the hospital has opened, payment of this obligation shall be secured by a $100 million letter of credit obtained by LAC from a major lending institution. After five years of hospital operations, the parties will confer and — if they agree — extend the letter of credit for an additional agreed-upon period.
e. **Indigent Care Payment.** LAC will annually make a payment of $13,300,000 to support indigent care services furnished at the hospital.

8. UC will participate in clinical planning and other activities which require physician expertise in connection with the opening of the hospital.

9. UC will contract with the hospital to furnish a broad spectrum of physician services necessary to operate the hospital. This obligation will be contingent upon University’s ability to secure (initially and on an ongoing basis) payments for its physician services that — in University’s discretion — are reasonable for the type, quality, and volume of services furnished. Staffing will likely involve roughly 14-20 UC-employed hospitalists and intensivists, supplemented with community-based physicians from White Memorial and Harbor-UCLA physician groups.

10. UC will make available qualified physician employees to act as the hospital’s chief medical officer.

11. UC will have the primary responsibility to direct and manage efforts to establish teaching activities for medical students, residents and fellows consistent with accreditation standards and time frames for the re-establishment of educational programs.

12. University will work with LAC and NEWCO representatives to establish a subcommittee of the NEWCO board to oversee all aspects of quality assurance in accordance with NEWCO's bylaws. Additionally, University will assure that its physicians play an active ongoing role in all medical staff functions, including — but not limited to — credentialing, quality assurance and quality improvement activities.

13. NEWCO, at its own expense, will employ — or contract with a third party other than UC or LAC — for the non-physician personnel working at the hospital.

14. UC will provide no start-up, ongoing, or other financial support for NEWCO, including without limitation serving as guarantor or co-obligor.

15. Neither party will represent to third parties that the hospital is owned, licensed, or operated by the University or LAC. Neither party will represent to third parties that the University or LAC is financially liable for the activities or debts of the hospital. However, the NEWCO is permitted to represent that the hospital is staffed by University physicians.

16. Both parties will acknowledge that the University and LAC are not responsible for the financial viability of the hospital, are not liable for the hospital’s debts, and that the University is not a source of capital or operating funds for the hospital.

17. The Coordination Agreement will be effective on the date it is fully executed and will continue until termination or expiration of above-referenced physician services agreement or lease agreement.

18. The Coordination Agreement provides for a variety of grounds on which the University can terminate participation in the arrangement.

19. Neither UC nor UC-employed physicians will agree to accept — or suggest to patients or NEWCO that they accept or are responsible for — the quality of care furnished (i) by non-physician hospital staff or (ii) physicians not employed by (or under contract with) UC.
Analysis

Ameliorating Legal Risks. The Office of General Counsel has opined that, so long as the foregoing constitutes an accurate and complete description of the proposed transaction, there should be minimal risk that UC would be held legally responsible under California law for debts or other obligations of NEWCO in connection with the hospital. This conclusion has been confirmed by outside counsel. UC will, however, incur liability for the acts and omissions of UC-employed physicians when functioning within the course and scope of their employment while working at the hospital.

Ameliorating Financial Risks. The pro forma for the hospital shows a positive cash flow under several different sensitivity analyses. There are, however, two principal financial risks. The first is that the County might, at some point in the future, be unable or unwilling to fulfill its commitment to make the $50 million annual transfer on behalf of the hospital. UC has ameliorated this risk by obtaining a commitment from LAC to secure a $100 million letter of credit from a major financial institution to “backstop” this commitment during the first six years of hospital operations. If LAC fails to fulfill its financial commitments thereafter, UC may terminate the Coordination Agreement. The second major financial risk is that as-yet-unknown changes to Medicaid reimbursement and funding methodologies would undermine NEWCO’s financial position. This risk is inherent in hospital operations, and any resulting losses would be borne by NEWCO — not UC.

Action

Regental approval is sought for the execution and implementation of the Coordination Agreement between LAC and UC, with the understanding that any deviation in UC’s responsibilities as outlined must be brought back to the Regents for action.

Key Elements; Letter; Financial Assumptions