

Office of the President

TO MEMBERS OF THE COMMITTEE ON HEALTH SERVICES:

ACTION ITEM

For Meeting of November 15, 2012

ESTABLISHMENT OF A LIMITED LIABILITY CORPORATION WITH DAMERON HOSPITAL, STOCKTON, AND UC DAVIS MEDICAL CENTER, DAVIS CAMPUS

EXECUTIVE SUMMARY

UC Davis Medical Center (UC Davis) seeks to strengthen its network of regional hospitals and physician groups by creating a limited liability company (LLC) with Dameron Hospital Association, for the purpose of owning and operating a 202-bed general acute care facility in Stockton, California. This collaboration will create a financially self-supporting enterprise and will result in an increase in the number of tertiary and quaternary cases treated to meet UC Davis' medical education, research, and clinical care missions.

RECOMMENDATION

The President recommends that the Committee on Health Services recommend that the Regents:

1. Approve the University forming and participating in a Limited Liability Company (LLC) with Dameron Hospital Association under the following terms:
 - A. The LLC shall be a two-member nonprofit entity.
 - B. The University shall have a 25 - 30 percent interest in the LLC.
 - C. The University shall have a right to appoint 50 percent of the LLC's Board of Managers and shall serve as Chair of the Board of Managers. In the event of a deadlock among the Board, the Chair will cast the deciding vote.
 - D. The University may contribute up to \$10 million in cash to the LLC, as well as the University's brand, trade name, programs, and expertise. Any further capitalization contribution, loan, or loan guarantee by the University must be approved by the Regents. The University will have no further obligation to contribute capital to the LLC or to fund working capital or pay for debts or other liabilities of the LLC.

- E. Dameron Hospital Association shall contribute hospital assets worth approximately \$97.5 million to the LLC.
 - F. The LLC's formational documents shall provide that both members of the LLC must consent to a sale, exchange, or disposition of all of the LLC's assets; a sale, merger, or consolidation of the LLC; a dissolution of the LLC; receipt of financing other than non-recourse; and any requirement that the members contribute additional capital.
 - G. The LLC's formational documents shall provide that the first \$10 million of net cash generated by a sale of assets in the event the LLC is dissolved will be paid to The Regents.
 - H. Any distributions to the members shall be in proportion to the members' ownership.
- 2. Authorize the President or his designee to withdraw from the transaction prior to closing if Dameron's Hospital business, assets, or liabilities are not acceptable to the University.
 - 3. Authorize the President or his designee, following consultation with the General Counsel, to execute any documents reasonably required for the University to form and participate in the LLC.
 - 4. The University shall have access to all legal and financial records maintained by the LLC. UC Davis shall provide the President or his designee an annual report of the LLC's performance.

BACKGROUND

Dameron Hospital Association (Dameron) currently owns and operates a 202-bed acute care hospital located in Stockton, California on approximately eight acres of land with buildings and equipment that constitute the hospital campus. UC Davis Medical Center (UC Davis) and Dameron propose creating a non-profit limited liability company (LLC), to be called Dameron Davis Management Company LLC that would own and operate Dameron's hospital campus. This collaboration will create a financially self-supporting enterprise that furthers the common and unifying charitable health care and educational missions of both organizations.

The UC Davis five-year strategic plan calls for an increase in the number of tertiary and quaternary cases treated to meet UC Davis' medical education, research, and clinical care missions, as well as to respond to the impact the federal Patient Protection and Affordable Care Act and the California Health Benefit Exchange will have on the delivery and financing of clinical care and, in turn, the ability to subsidize the research and teaching missions. A critical tactic for developing a broader referral base is to deepen existing and form new partnerships and more formal collaborations with community hospitals and physician groups in Northern and Central California.

UC Davis has a history of successful collaboration with community hospitals through its primary care network, cancer care network, and telemedicine network. Some of those collaborations resulted in the formation of jointly owned limited liability companies that the Regents have approved over the last 20 years. Acquiring an equity interest with governance participation in a community hospital approximately 45 miles from UC Davis Medical Center would allow for new clinical opportunities in the Central Valley, a key geographic region to UC Davis.

Proposed Transaction

Dameron will contribute approximately \$97.5 million of net assets to the LLC, including the hospital, certain office buildings, real property used in the operation of the hospital, cash, furnishings, and equipment. Dameron will retain \$30 million in marketable securities to assume liability for \$12 million in outstanding bonds and to establish a fund for indemnification for any pre-closing liability. UC Davis Medical Center will contribute \$10 million cash and \$29.8 million in kind for its brand, programs, and expertise, as calculated by an external valuation firm. The immediate goal is for the LLC to develop sufficient credit worthiness to reinvest in buildings needed for seismic compliance and information systems technology. The specific elements of the equity interest and investment in the LLC are identified in the proposed Contribution Agreement to be executed and delivered by UC Davis and Dameron. The proposed Operating Agreement of the LLC identifies management responsibilities, rights, and obligations of the proposed collaboration.

The relative ownership of the LLC will be approximately Dameron, 71 percent; UC Davis 29 percent, with the exact percentages to be determined based on appropriate adjustments made to the valuations at the time of closing. The LLC would be jointly and equally managed by UC Davis Medical Center and Dameron Hospital Association. In the event of a deadlock or material dispute, the Chair of the Board of Managers shall have the deciding vote.

The LLC model has been used in other transactions over the last twenty years and serves to limit the liability to the University.

Description of Dameron Hospital

Dameron Hospital is a fully accredited, independent, not-for-profit, non-sectarian 202-bed general acute-care community hospital in Stockton, California. With more than 1,200 employees and over 400 affiliated physicians, Dameron serves the rural, agriculture communities of San Joaquin County and adjacent areas, providing adult and pediatric acute medical and surgical care since 1912. Dameron offers a broad range of medical, surgical, and emergency care with programmatic strengths in orthopedics, neonatology, and cardiovascular services. The hospital ranks as one of the leading providers for deliveries in the county and is an essential provider of emergency care to the community with more than 38,000 annual visits to the Dameron Emergency Department in recent years. In addition to Dameron's historical and continued valued healthcare presence in the community, it is one of the largest employers in the city of Stockton and within San Joaquin County.

Dameron has held a competitively firm place in its market, capturing approximately 22 percent of the market share within its primary service area (PSA), which includes the cities of Stockton, Farmington, Linden, Lathrop, and French Camp, all located in San Joaquin County. Eighty percent of the hospital's discharges are from its PSA. The rate of growth for the marketplace is expected to increase, with an estimated compound annual growth rate within Dameron's service area slightly higher than the growth rate of the State of California. Growth specifically for the 65-and-over population is more significant.

Dameron is embedded in a region with unique healthcare needs and comparatively poor health statistics. The San Joaquin County and Valley region has significant health inequities compared with other areas of the state. According to the California Department of Public Health's "Health Status Profile for 2011," San Joaquin County ranks 46th among the state's 58 counties for all cause mortality; 51st in liver disease; 55th in heart disease, and 56th in diabetes. Current social determinates of poorer health include an uninsured rate of 18 percent (California Health Interview Survey, 2009) and a Medicaid rate of 25 percent, which is five percent higher than the state average. (California Department of Health Care Services, 2010) The county has a significant ethnic concentration with a minority level of 74 percent. County statistics fairing worse than state averages include 11.7 percent of families who are at or below the poverty rate, 16.1 percent of the county's population is unemployed, and the average household income is only \$66,000 (Nielsen Claritas, 2011).

After careful consideration of financial demands, market changes, and future viability of providing high quality care, Dameron executives determined in early 2011 to seek a strategic partnership as a means to strengthen its commitment to meet the unique healthcare needs of the community. Dameron chose to pursue exclusive discussions with UC Davis after receiving an initial letter of interest in response to the Dameron Request for Proposal.

In 2011 and continuing into 2012, Dameron has experienced an erosion of its average daily census. It also lacks certain economies of scale in its operations. Significant operational changes will need to be made to restore financial viability. A business plan has been developed jointly with UC Davis to improve the financial position. Material portions of the hospital buildings do not meet SB 1953 seismic compliance and will need to be replaced. Dameron has completed its due diligence and submitted a comprehensive master site plan to the Office of Statewide Health Planning and Development (OSHPD) for seismic compliance. Dameron has submitted its application for extension of time to comply with those requirements. A top priority of the LLC will be to build credit worthiness to allow financing of certain buildings to comply with seismic requirements. The LLC would only pursue non-recourse financing for this project.

Benefits of the proposed transaction

- Strengthens UC Davis' ability to participate in commercial health insurance products after commencement of the California Health Benefits Exchange.
- Prepares UC Davis to manage a larger population of patients as an accountable care organization necessary to thrive under the federal Patient Protection and Affordable Care Act.

- Helps preserve UC Davis' financial ability to continue cross-subsidizing the research and education missions of the University.
- Complements UC Davis' land-grant mission to identify and help meet society's most pressing needs.
- Builds a broader tertiary and quaternary referral base that will expand clinical services, enrich medical education, and access a diverse population for research clinical trials
- Provides UC Davis with a 25 to 29 percent ownership and 50 percent governance of a strategically important hospital.

Joint Venture Objectives

The LLC will focus on improving the hospital performance indicators related to patient care quality, volume and profitability with the goal of developing a state-of-the-art community healthcare organization.

The anticipated strategic objectives include:

- Attract, develop, and retain the best physicians and staff
- Collaborate with physicians to increase clinical, professional, and technological integration
- Achieve excellence in patient safety, quality of care, service, and clinical outcomes
- Provide patient-centered, efficient, and timely care
- Build strong core services to deliver more care locally
- Strengthen selected programs to differentiate the LLC in the market
- Position the LLC to manage the health of populations
- Leverage UC Davis expertise in tertiary and quaternary care and in clinical research

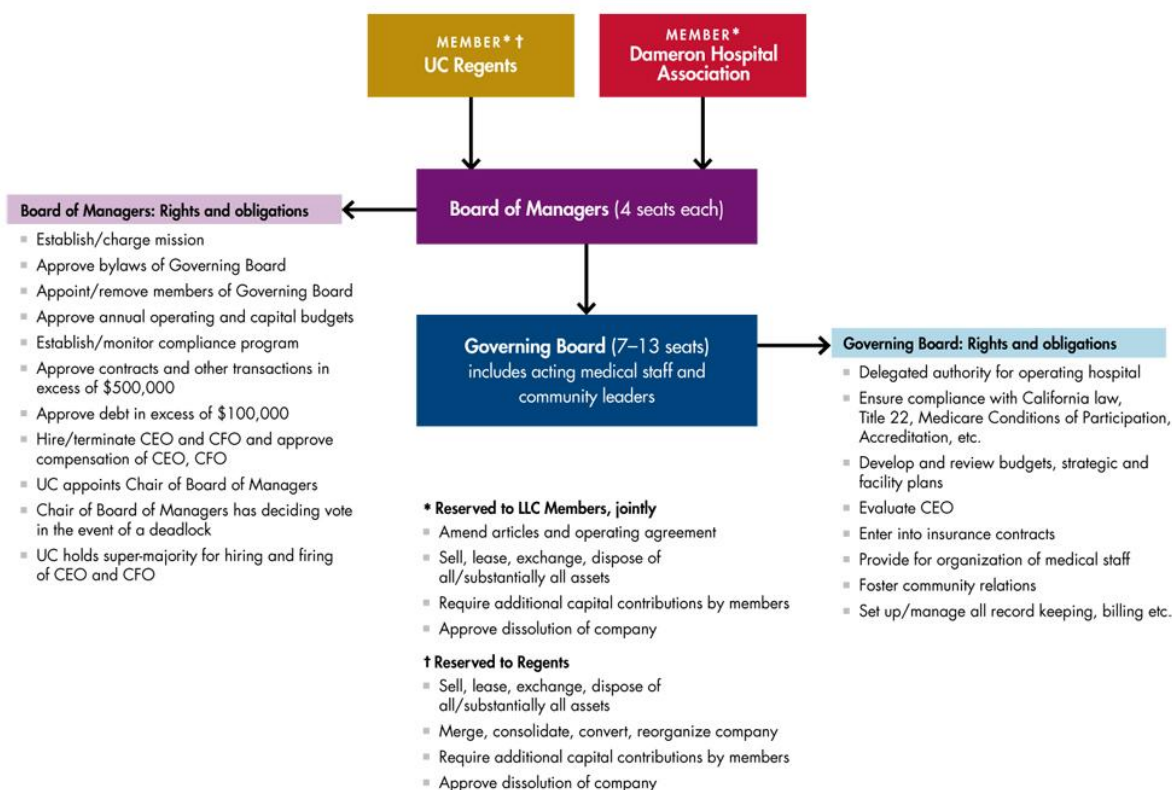
Recommended initiatives that correlate with each of these objectives have been mapped out and are expected to lead to successful and sustainable growth and stability as a market-share leader in San Joaquin County.

Several of the key collaborations between UC Davis and Dameron will focus on planning and executing short- and long-term initiatives for specific clinical program development in areas of strategic importance to the LLC. Other collaborative priorities will focus on branding, cost-efficiency, and contracting.

Governance Structure

The LLC, a non-profit entity, shall have two members, UC Regents and Dameron Hospital Association, which shall have equal votes in all matters. Specific powers shall be reserved to the Regents and the Dameron Hospital Association Board, which shall include the rights to sell, exchange, or dispose of all the LLC's assets; the sale, merger, or consolidation of the LLC; requirement of additional capital contributions from the members; or dissolution of the LLC. If the University is asked by the LLC to authorize any of these actions, the Regents' specific authorization shall be requested. The two members shall delegate governance of the LLC to a board of eight managers, four of whom are appointed by UC Davis Medical Center and four of whom are appointed by Dameron Hospital Association. The Board of Managers shall exercise authority over and be responsible for the operation of the LLC. In the event of a deadlock or material dispute, the Chair of the Board of Managers shall have the deciding vote. The Board of Managers shall appoint a Governing Body that meets the organizational requirements of California Code of Regulations Title 22 (Volume 30) for active medical staff and community representation to oversee day-to-day operations. The Governing Body shall be vested with the authority to meet all licensure and accreditation requirements of state and federal government, as well as compliance with the Joint Commission.

Organizational Structure, Responsibilities of LLC Members



Financial Projections

Several financial projections were developed by Health Strategies & Solutions, working with UC Davis Medical Center, Dameron Hospital Association, Kaufman Hall and UC Office of the President. These projections considered a wide variety of changes to Dameron's service lines, operating expenses, and physician relationships that could improve overall financial performance, many of which are referred to above.

It is anticipated that the joint venture and various initiatives associated with collaborative clinical-program development will increase Dameron Hospital's inpatient and outpatient volumes and earnings growth, leading to a positive operating margin by the third year of joint venture activity.

Initiatives Considered for Financial Projections

Over the course of several meetings and a review of referral data, market share, physician workforce availability, and demographics, the following specific initiatives have been selected for collaboration to restore Dameron's financial viability and create sufficient cash flow to qualify for bond financing needed to address seismic compliance. These activities also relate to the amount of downstream activity that would be expected to be seen at Davis.

1. Set up telehealth services in Dameron, for example, telestroke to reduce neurology transfers out of area.
2. Join UC Health group purchasing organization for greater discounts on supplies.
3. Implement a joint ad campaign to redirect local care to Dameron and UC Davis.
4. Develop clinical pathways for more efficient care to reduce length of stay and cost.
5. Work with hospitalist group to reduce cardiology transfers to other hospitals.
6. Support new commercial insurance projects in San Joaquin County.
7. Strengthen specialty physician practices in Obstetrics/Gynecology, General Surgery, Neurology, Cardiology, and Cardiothoracic Surgery.

Quality Assurance

UC Davis and Dameron will ensure that the hospital provides high-quality patient care. An ongoing quality assurance program will monitor the care and systematically evaluate and maintain quality assurance and quality assessment activities. Activities will focus on the hospital's practices, effectiveness, and outcomes as they relate to the delivery of patient care. In coordination with hospital administration, the LLC will require regular analysis and reporting, including performance and benchmarking with quality metrics. Reporting will include identification and correction of deficiencies or improvement of the hospital's quality of care. Policies and procedures, orientation, and continuing education will include specific and regularly updated attributes to inform staff of and support compliance with established standards of practice and quality control measures. Quality assurance activities will assure that staff, supplies, equipment, and facilities will be sufficient to provide services and be of a type, quantity, and quality necessary to provide safe and effective patient care. The LLC will hold the hospital

accountable to following current medical and ethical standards and providing quality healthcare in a manner that is medically appropriate and efficient.

Due Diligence

Extensive due diligence has been conducted over the past 15 months, including:

- Independent financial valuations of the hospital operation and all real property, buildings, and equipment
- Legal and financial review, including external legal consultation, of contracts, debts, and receivables, to assess actual and potential liabilities
- Interviews with Dameron board members, management, health plan representatives, and community physicians
- Financial assessments and modeling of potential initiatives by nationally recognized experts in healthcare finance and strategic planning.

Mitigation of risk in the transaction

- Utilizing the LLC model limits the University liability
- UC Davis has two decades of successful experience in using Regent-approved LLCs with other community hospitals
- Limited financial investment in the venture
- Multi-faceted plan for increasing financial performance of the hospital

Exit Strategy

Extensive financial and legal due diligence has been executed in partnership with both parties to identify and mitigate potential risks. UC Davis' initial capital contribution of \$10 million could be at risk if the LLC fails. If the LLC were to realize a sustained negative cash flow where additional capital contributions would be required, the Regents would be asked to approve such contributions.

In the event that certain conditions indicate failure of the LLC or otherwise signify considerable risk to the University, UC Davis and Dameron could mutually agree to dissolve the LLC, or UC Davis could sell its interest in the LLC. The first \$10 million of net cash generated by a sale of assets in the event of dissolution shall be paid to The Regents.

Rationale and Benefits to UC Davis and Stockton Community

UC Davis Medical Center and the faculty physicians in the UC Davis School of Medicine operate as a hub for specialized care in a 33-county service area in inland Northern California. UC Davis Medical Center operates a 619-bed acute care adult and pediatric hospital that provides the region's only burn center, level 1 adult and pediatric trauma centers and full-service Children's Hospital. UC Davis Medical Center is nationally recognized for its NCI designated Comprehensive Cancer Center and advanced use of telemedicine. It also provides robust primary care through its vast network of primary care clinics in 11 locations across the region, serving as a medical home to more than 60,000 patients. UC Davis has a widely successful regional affiliation strategy with major joint ventures and partnerships within the UC Davis Cancer Care Network and the UC Davis Center for Health and Technology. The Cancer Care Network includes two LLCs that were approved by the Board of Regents in 1998 and 1999, which continue to be strong examples of successful and very stable regional partnerships. The UC Davis Health and Technology Center supports more than 100 sites with telemedicine connections, providing many communities their only link to specialized care.

UC Davis has a significantly pertinent history in San Joaquin Valley. UC Davis specialty physicians provide expert care via telemedicine consultations and medical residents train and graduates work in the valley's hospitals and clinics. Collaboration in the area includes work with UC Merced to train new physicians to work in rural communities through the UC Davis San Joaquin Valley PRIME (Programs in Medical Education) Program. Other major UC Davis programs that extend into the valley include Public Health Sciences, Agricultural and Environmental Sciences and Veterinary Medicine. Affiliated facilities include the San Joaquin County Cooperative Extension, Robert J. Cabral Agricultural Center, San Joaquin Valley Aerosol Health Effects Research Center, and the Turlock Laboratory. Extensive UC Davis research studies within the valley involve agriculture, veterinary and animal sciences. Marketing survey analysis of the Stockton area suggests that the community perception of UC Davis Medical Center is very strong and that entering the area will likely be viewed as a welcomed and valued development.



The benefits of relationships in this area further the community engagement mission of UC Davis to improve the quality of health care in the Central Valley. The expertise associated with ongoing quality improvement within UC Davis Medical Center and the School of Medicine helps deliver evidence-based advances in clinical care to Central Valley patients and families. UC Davis is uniquely prepared to address rural health and examine and improve the impact of health disparities and social determinates of health in the Central Valley. This collaboration will create more educational opportunities for medical students and residents to train in a high-quality

community-based setting. This affiliation will also assist with workforce development by providing a catalyst for recruitment of needed physicians and other health professionals.

The city of Stockton lies approximately 40 miles south of Sacramento, and is the second largest population center within UC Davis' clinical enterprise service area. The close location and significant size of this population contribute to the strategic sensitivity of the San Joaquin County area for UC Davis. Considering the Sacramento region's market consolidation activity and the need for UC Davis to pursue opportunities for additional financial stability, a successful partnership with Dameron Hospital Association is expected to provide several strategic benefits. By having a direct presence in Stockton, the LLC will strengthen core medical services to deliver more care locally while increasing the referral base for tertiary and quaternary cases important for UC Davis' clinical and teaching missions. This collaboration will provide a vehicle for large, diverse populations to gain access to clinical trials. Furthermore, it will enable UC Davis to serve a larger patient population, strengthening its ability to be successful under health-care reform's emerging emphasis on cost reduction and population management. Pursuing a direct presence in areas outside its immediate service area enhances recognition of UC Davis and increases the relevancy of the UC Davis missions to people in Northern California. Leveraging fundamental UC Davis strengths in telemedicine and primary care will provide significant benefits to the joint venture and local community.



This partnership opportunity complements the UC Davis land-grant mission to identify and help meet important societal needs and provides a pathway for achieving the goal of being relevant to the health concerns of all Californians and advancing innovation in care delivery. The joint venture and objectives to improve quality of care and access align with UC Davis' mission to improve lives and transform health care, as well as the health system's 2011-2016 Strategic Plan, which incorporates specific objectives to establish a regional care network of hospitals, clinics and physician groups through partnerships and affiliations. Growth in primary care will be pursued through exploring communitywide solutions to provide care to the communities and populations served. Building diverse partnerships and leveraging an integrated delivery system to coordinate care across all settings and an individual's life span will provide differentiating value to patients, their families, and caregivers.