

The Regents of the University of California

COMMITTEE ON HEALTH SERVICES

November 15, 2000

The Committee on Health Services met on the above date at Covell Commons, Los Angeles campus.

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

In attendance: Regents Fong, Hopkinson, Leach, Miura, and Montoya, Regents-designate T. Davis and Morrison, Faculty Representatives Cowan and Viswanathan, Secretary Trivette, General Counsel Holst, Assistant Treasurer Young, Provost King, Senior Vice Presidents Darling and Mullinix, Vice Presidents Broome, Drake, Gurtner, Hershman, and Saragoza, Chancellors Berdahl, Bishop, Carnesale, Cicerone, Dynes, Greenwood, Orbach, and Yang, Vice Chancellor Desrochers representing Chancellor Tomlinson-Keasey, Executive Vice Chancellor Grey representing Chancellor Vanderhoef, Laboratory Directors Browne, Shank, and Tarter, and Recording Secretary Bryan

The meeting convened at 8:45 a.m. with Committee Chair Kohn presiding.

1. APPROVAL OF THE MINUTES OF PREVIOUS MEETINGS

Upon motion duly made and seconded, the minutes of the meeting of September 13, 2000 were approved, and the minutes of the meeting of July 20 were approved as amended with the modification that Regent Kohn excused himself from any discussion regarding the amalgamation of Children's Hospital of San Diego and the University of California, San Diego Medical Center in order to avoid any question of a conflict of interest based on his membership on the medical staff executive committee of Children's.

Committee Chair Kohn turned the gavel over to Committee Vice Chair Lee, noting that as a member of the medical staff executive committee of Children's Hospital of San Diego he wished to avoid any question of a conflict of interest.

2. **APPROVAL FOR UCSD TO CONSOLIDATE CHILDREN'S SERVICES IN SAN DIEGO WITH CHILDREN'S HOSPITAL-SAN DIEGO AND ITS AFFILIATED PHYSICIANS, 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 the following:

- A. A Master Affiliation Agreement and Managed Care Agreement between The Regents of the University of California and Children's Hospital and Health Center (CHHC), a California nonprofit public benefit corporation, and Children's Hospital of San Diego (CHSD), whose sole corporate member is CHHC.
- B. A Medical Group Affiliation Agreement and Medical Group Managed Care Agreement between The Regents of the University of California and Children's Specialists of San Diego (CSSD), a medical group.

It was recalled that, for almost 30 years, Children's, which includes CHHC and CHSD, along with its affiliated physicians, including the Children's Specialists of San Diego Medical Group, had participated in the training of UCSD medical students, residents, and fellows. Given the long-standing affiliation, consolidation of children's services in one location is the logical next step in expanding the existing relationship.

UCSD, Children's, and CSSD are committed to the concept of a unified program because it will yield synergy between three outstanding organizations in pediatric education, research, and patient care opportunities. UCSD believes that the consolidation will increase the volume and mix of available patients, which in turn will improve the quality of medical research and education offered by the School of Medicine. Children's and CSSD believe the consolidation will be beneficial because it will solidify an affiliation with an academic entity which has a reputation for excellence as a research institution, a provider of tertiary care, and a leader in subspecialties, including molecular biology and human genetics. The consolidated program will create a center of excellence in pediatric care for the benefit of the entire San Diego community.

In July 2000, the Regents were provided with an introduction to the proposed transaction. The parties have now reached substantive agreement on the principal terms and conditions of the affiliation. Negotiations are continuing on a few specific items. The principal terms of the master affiliation agreement with Children's follow.

Principal Terms of the Master Affiliation Agreement with Children's

Transfer of Clinical Programs

UCSD will transfer most of the pediatric programs presently at UCSD Medical Center to Children's. Renal dialysis, outpatient primary care, adolescent medicine, and the General Clinical Research Center will continue on the UCSD campus until such time as a suitable location on the Children's campus can be made available for these services. Because of their uniqueness or because of the natural links to other services, neonatology, the newborn nursery, the burn unit, and ophthalmology will remain at the UCSD Medical Center. In addition, the UCSD Medical Center at Hillcrest will continue to provide comprehensive emergency services for pediatric patients as needed. Inpatient child and adolescent psychiatry, currently housed at Alvarado Hospital through a lease agreement, will remain there.

All programs that relate to pediatric patients will be coordinated between UCSD and Children's to ensure appropriate continuity of care during the transition. Following the consolidation, UCSD and Children's may jointly analyze the programs retained by UCSD both from a financial and a clinical viewpoint to see if the future transfer of additional programs to Children's would be in the best interest of pediatric patients.

Governance

The consolidation will be contractual, with CHHC, its affiliates, and UCSD retaining their respective corporate identities. However, articles of incorporation, bylaws, and other governing documents of Children's and its affiliates will be amended to reflect the new governance structures outlined below and to set forth that one of the purposes of the corporation is the clinical, research, and academic mission of UCSD Health Sciences, as it relates to pediatrics, and to indicate that CHHC and its affiliates are UCSD Health Sciences' primary pediatric teaching venues.

CHHC Board. Children's Hospital and Health Center, the parent organization, is governed by a 14-member Board of Trustees, serving staggered three-year terms. This board has primary responsibility for decisions regarding long-term policy, strategic direction, site development, external financing, fund raising, and other decisions that have broad implications for the entire organization.

Upon the closing of the proposed consolidation with UCSD, the CHHC corporate bylaws will be amended to expand the board to 18 trustee positions, of which six positions will be designated as University trustees. The bylaws will reflect that at all times one-third of the board will be University trustees. The University trustee positions will include three ex officio voting positions:

- Chancellor of the University of California, San Diego campus (Chancellor);
- Vice Chancellor for Health Sciences/Dean of School of Medicine (VCHS/Dean);
- Vice President for Clinical Services Development, or another representative of the University of California, Office of the President.

The remaining three University positions will be filled with trustees approved by the President of UC.

CHSD Board. Children's Hospital, San Diego is a California nonprofit public benefit corporation whose sole corporate member is CHHC. CHSD is governed by a 15-member Board of Directors, serving one-year terms. This board has responsibility for decisions on accreditation, medical staff credentialing, quality assurance, peer review, patient services, and contracting.

Upon the closing, the CHSD board's bylaws will be amended to provide that at all times one-third of the Board of Directors will be representatives of the University. The CHSD Board will have five University directors, including two ex officio positions: the Physician-In-Chief/Chair and the VCHS/Dean of the School of Medicine. The remaining three University positions will be filled with directors approved by the President of UC. In addition, the amended bylaws will create two ex officio nonvoting board positions, one for the President of CSSD of San Diego and one position appointed to represent the Office of the President of UC.

Nomination Process. The non ex-officio University trustees and University directors will be nominated and recommended by a nominating committee consisting of the President of CHHC, the Chairman of the Board of Trustees of CHHC, the Chancellor, and the VCHS/Dean of the School of Medicine. The CHHC board will elect the candidates nominated, subject to approval by the President of UC.

If either CHHC or CHSD establishes an executive committee, or other committee empowered to act in lieu of the board, at least one-third of the members of such Committee will be University trustees/directors.

In the event of a merger, consolidation, acquisition, or affiliation of CHHC or CHSD with another entity, the University trustees/directors may elect to support a change in the board structure. If a transaction is approved by an affirmative vote of a majority of the CHHC board or the CHSD board, as well as a majority of the University trustees/directors serving on the board, the University's designated governance percentage may be changed to allow for representation by the new entity according to a dilution plan agreed upon by the parties. If, on the other hand, a majority of University trustees or directors do not vote affirmatively, the University percentage representation on the board may not be diluted.

The bylaw amendments implemented cannot be amended, repealed, or removed without the majority vote of the University trustees, in the case of CHHC or a majority of the University directors, in the case of CHSD.

Physician-in-Chief/Chair of the Department of Pediatrics

In recognition of the new relationship and the commitment to patient care, teaching, and research, a new leadership position will be created at Children's, the Physician-In-

Chief, who will also be the Chair of Pediatrics at UCSD. The position will be filled through a joint recruitment by the Vice Chancellor for Health Sciences/Dean of the School of Medicine and the President of CHHC. The Physician-In-Chief/Chair will report jointly to the President of CHHC and to the Vice Chancellor for Health Sciences/Dean, with each organization providing 50 percent of the funds necessary for this position and the required support of the office. The Physician-In-Chief/Chair will be a UCSD tenured faculty member and will also be a part of the senior leadership at Children's. The Physician-In-Chief/Chair will provide the principal link between the organizations.

Children's Hospital, San Diego Medical Staff Governance

The CHSD Medical Staff Executive Committee unanimously passed a resolution regarding faculty participation on the medical staff which will be approved by the entire medical staff membership. This resolution provides that faculty physicians, fellows, and chief residents, employed by the University but who are not already members of the CHSD medical staff, will have the opportunity to join the medical staff of CHSD. Length of service as a University faculty member will be applied toward satisfaction of the requirements of membership on the CHSD senior staff. University faculty will have meaningful representation on all medical staff committees, including the Executive Committee, Quality Improvement Committee, Bylaws Committee, and Cancer Committee. As evidence of the ongoing relationship between UCSD and Children's, a number of UCSD faculty members currently serve in leadership positions at CHSD.

Financial Commitments

As an integral part of the consolidation, Children's has agreed to provide financial support to the UCSD School of Medicine, and in particular the Department of Pediatrics, to cover costs associated with resident support, pediatric primary care clinical site costs, and supplemental academic program support. The UCSD Medical Center provides a portion of its net income to support academic programs of the Department of Pediatrics and the Dean of the Medical School. With the transfer of pediatric programs to Children's, however, the UCSD Medical Center will no longer generate income derived from these services and therefore will no longer be able to provide the related financial support. Historical UCSD School of Medicine academic support to the Department of Pediatrics will continue.

Children's has committed to establishing an academic fund that replaces the financial support which UCSD Medical Center has traditionally provided to the UCSD School of Medicine Department of Pediatrics. Sources of revenue for the fund are as follows:

- the historical financial support provided by Children's to UCSD to cover costs of residents and fellows;
- a portion of the funds Children's receives from Medicare and Medi-Cal in support of medical education;

- 1 percent of Children's net patient revenue;
- other funding agreed to by the parties.

The academic fund will be used to support the costs of training residents and fellows, the funding of medical directorships, and academic support of the UCSD Department of Pediatrics. The academic fund will be under the control of the Physician-in-Chief/Chair of the Department of Pediatrics. The fund will continue to be provided for the duration of the contract term. It is the University's position that the budget will be annually reviewed and approved by the VCHS/Dean of the School of Medicine and annually reviewed by the President of CHHC.

Children's Capital Improvements

Children's will provide physical facilities, personnel, and services on or near its campus for all clinical services and programs transferred pursuant to the Affiliation Agreement. Children's has developed a campus master plan that includes Children's commitment to replace or repair existing inpatient facilities in order to meet all seismic requirements.

Research Program Policies and Cooperation

UCSD and Children's intend to enhance and restore the quality of life and health of children through joint research into health promotion and the prevention, cause, and treatment of childhood diseases. The parties have agreed to collaborate with local, regional, and national academic centers, governmental institutions, and biotechnology industries promoting pediatric focused research; foster extramurally-funded, peer-reviewed research; continue the current research presently undertaken by University and Children's, while developing new programs; and cooperate in good faith in the development of a fiscally responsible joint research program.

In support of this collaborative research process, UCSD and Children's intend to cooperate in the development, funding, and construction of a research building located on or near the main campus of CHSD. The research building will provide state-of-the-art facilities for interdisciplinary pediatric research using a variety of approaches and technologies. Planning to determine the precise square footage, location, secondary site improvements, and costs will begin once the Affiliation Agreements are signed by both parties, with the intention of occupying the facility within five years. The location, size, cost and use of the building will be approved by both parties.

Children's has agreed to provide \$5 million towards the cost of the facility. It is the University's position that if the site selected is on the Children's campus, CHHC will provide the land at a nominal annual rent. Subject to future Regental approval, UCSD will be responsible for payment of all remaining costs of the facility through a combination of gift funds and debt financing. It is anticipated that the required debt financing will use research revenue bonds under which the debt service and the operating costs of the facility will be paid from the indirect cost funds derived from new

contract and grant research conducted in the facility. UCSD will assess rent monthly to cover the costs of space occupied by Children's researchers.

Teaching Affiliation

Following the consolidation, Children's will become the primary teaching site for pediatric services for the UCSD School of Medicine. The School of Medicine will continue to be responsible for the direction, quality, and content of its teaching programs conducted at the Children's site. All patients in Children's facilities will, consistent with the parent's and patient's wishes, be considered teaching patients participating in relevant academic clinical programs.

University medical students, residents, and fellows shall be assigned by UCSD to Children's. The number and training levels of University trainees will be determined annually by mutual agreement of the VCHS/Dean of the School of Medicine and President of CHHC, or their respective designees. Trainees sponsored by the University who are assigned for clinical instruction and experience at Children's are subject to the supervision and direction of physicians holding faculty appointments at the School of Medicine. This includes physicians who are members of CSSD who hold voluntary faculty titles and who are ultimately responsible for patient care.

Staff Transition

The parties recognize that certain UC employees will be affected as a result of the consolidation. It is the intent of the parties to minimize the impact of the transfer of programs on UC employees as well as on Children's employees. Children's and UCSD have agreed to accommodate employees through one of three mechanisms:

- UCSD employees who wish to be considered for positions at Children's will be eligible for consideration through a special recruitment period. Agreements have been reached between the two organizations regarding transfer of seniority and other rights and/or benefits of employment.
- Employees nearing retirement, as defined by age and length of service thresholds, will be offered continued UC employment at Children's through a lease arrangement. The lease arrangement will be offered to employees meeting the following criteria: greater than or equal to 50 years of age, plus greater than or equal to 5 years of service; or greater than or equal to 40 years of age, plus greater than or equal to 10 years of service; or greater than or equal to 15 years of service.
- Employees who are not offered positions at Children's will be offered comparable positions within UCSD.

Through the application of these mechanisms, no individual will be without the same or an equivalent position as a result of the consolidation. Discussions are in process with

the respective labor unions representing the employees likely to be involved in the transition.

Insurance and Indemnity

Each party will provide for professional liability, comprehensive general liability, worker's compensation, and employer's liability at acceptable levels. Children's will also carry directors' and officers' liability insurance coverage at acceptable levels. Either party may provide for any and all of this coverage through a program of self-insurance. The parties have also agreed to mutual indemnification in the event of claims for injury or damages arising out of or related to each party's performance under the affiliation agreement. It is not intended that either party will take on new or expanded insurance or indemnification responsibilities.

Dispute Resolution

Disputes will be subject to resolution by the VCHS/Dean of the School of Medicine and the President of CHHC. If they are unable to resolve the dispute within an agreed-upon period of time, the matter will be referred to the Chancellor of UCSD and the Chairman of the Board of CHHC to recommend a solution. If otherwise unable to resolve a dispute, the matter will be submitted for mediation. Should the parties be unable to resolve their dispute at the conclusion of mediation, either party may, at its option, pursue remedies in court.

Term and Termination

Subject to the termination events described below, the term of the affiliation agreement will be of unlimited duration. There will be limited provisions for termination of the contract. The University's position with regard to these provisions is that in the event of a material breach by either party, a period of 180 days will be provided for each party to cure the breach. In the event that the breach is not cured, the injured party may terminate the contract. The party in breach will be obligated to pay liquidated damages in the amount of \$12 million as compensation for loss, expense, and damage. The contract may not be terminated, except for cause, during the first five years of the agreement. After the fifth anniversary, either party may request termination with written notice of at least five years prior to the date of termination. In the event of a without-cause termination, CHHC will pay UCSD \$6 million to offset the costs the University will incur to rebuild its pediatric program. In addition, the agreement provides that in the event a research building has been constructed at the point of termination, at the option of the University, Children's will be obligated to purchase the building.

Managed Care Agreement

An additional agreement, which will be part of the Master Agreement, has been developed to allow for integrated managed care contracting. To allow for full service contracts with health plans, UCSD may continue to contract with payors for both adult and pediatric services. Children's will enter into mutually agreeable sub-contracts with UCSD for the provision of pediatric services for those services for which UCSD is financially responsible under its managed care agreements.

Principal Terms of the Medical Group Affiliation Agreement

Children's Specialists of San Diego is a private California professional medical corporation that provides subspecialty services to patients, primarily at Children's. The clinically active pediatric specialty physicians of UCSD Medical Group and CSSD will be members of CSSD under the terms of a Medical Group Affiliation Agreement.

Membership

Though faculty physicians cannot technically become shareholders of CSSD, they can become members, attend and vote on certain issues at shareholders meetings, have the right to become directors of the corporation, and have lengths of employment with the University used for determining participation in corporate matters. UCSD-paid faculty will continue to be employees of the University and will receive compensation through the UC Health Sciences Compensation Plan.

Governance

CSSD is organized with a division director for each medical or surgical specialty having a physician member. Directors for divisions with three or more members will hold a seat on the Board of CSSD. University faculty will participate in the governance of this organization through participation as directors of a number of divisions. In addition, CSSD will have an executive committee of the board that will consist of ten board members: (1) the President of Children's Specialists; (2) Physician-In-Chief/Chair; and (3) eight division directors (medical and surgical divisions). Of the eight division directors at-large, six will be from the original CSSD medical group and two will be UCSD faculty. The Physician-in-Chief/Chair and the two pediatric faculty division directors will be referred to as University Directors.

Three years after the effective date of the affiliation, the Physician-in-Chief/Chair and President of the CSSD will evaluate whether the executive committee should be selected without regard to shareholder status or University affiliation.

Financial Commitments

Clinical services provided by members of CSSD, including UC pediatric faculty, will be billed under the medical group's provider number. The net clinical revenue, after appropriate deduction of overhead, will be distributed to UCSD on behalf of the pediatric faculty in proportion to their clinical contribution to the medical group to be included as part of the pediatric faculty's compensation. Collection and distribution of all clinical revenue for UC faculty will be in accordance with the UC Health Sciences Compensation Plan.

Research Program Policies Cooperation

Pediatric faculty and employees of the medical group will have the right jointly to conduct laboratory and clinical research. Each party will maintain rights to inventions, discoveries, patents, copyrights, and royalties arising from the research that they separately sponsor or conduct. In the event of jointly sponsored efforts, rights will be negotiated and agreed to in advance of conducting the jointly sponsored research.

Teaching Affiliation

CSSD provides pediatric educational services through its affiliation with UCSD. The medical group will continue to work closely with UCSD, under the overall direction of the Physician-in-Chief/Chair, and continue to further teaching programs, goals, and objectives. Employees of CSSD will be encouraged to seek voluntary faculty appointments with UCSD.

Insurance and Indemnity

Each party will provide for professional liability, comprehensive general liability, and worker's compensation and employer's liability insurance coverage at acceptable levels. Either party may provide for any and all of this coverage through a program of

self-insurance. The parties have also agreed to mutual indemnification in the event of claims for injury or damages arising out of or related to each party's performance under the affiliation agreement. It is not intended that either party will take on new or expanded insurance or indemnification responsibilities.

Dispute Resolution

Disputes will be subject to resolution by the VCHS/Dean of the School of Medicine and the President of CSSD. If they are unable to resolve the dispute within an agreed upon period of time, the VCHS/Dean of the School of Medicine and the President of CSSD may appoint a joint committee to review the matter and recommend a solution. If otherwise unable to resolve a dispute, the matter will be submitted for mediation. Should the parties be unable to resolve their dispute at the conclusion of mediation, either party may, at its option, pursue remedies in court.

Term and Termination

The term of the affiliation agreement will be of unlimited duration. Either party may give notice of termination without cause, after the initial three-year period, and at least one year prior to the date of termination. If the agreement is terminated for any reason, both UCSD and CSSD will cooperate to provide continuing care to all patients who were actively under care or were undergoing treatment at the time of termination.

Managed Care Agreement

UCSD pediatric specialist faculty will access managed care contracts through CSSD. In addition, UCSD primary care faculty will participate in managed care contracts through the Children's Health Network. To allow for full service contracts with health plans, UCSD may continue to contract with payors for both adult and pediatric services. CSSD will enter into mutually agreeable subcontracts with UCSD for the provision of pediatric services for those services for which UCSD is financially responsible under its managed care agreements.

Risks

The affiliation proposed is a major undertaking for UCSD, Children's, and CSSD. Though the faculty who deal primarily with children enthusiastically support the consolidation, they are aware of the changes which such a transaction will bring. The teaching program must adapt to an environment that UCSD will influence but not completely control. The parties acknowledge and agree that once this Agreement is executed and implemented it will be extremely difficult and expensive to unwind the affiliation. In particular, UCSD will face extreme hardship and expense in trying to rebuild its pediatric teaching program. In the event of termination of the relationship, UCSD will be obligated to relocate the pediatric services to the UCSD campus, which will require capital investment in facilities or negotiate a new partnership with another hospital in the San Diego area.

Discussion

Dr. Edward Holmes, Vice Chancellor for Health Sciences, Dr. David Bailey, Interim Dean of the School of Medicine, and Dr. Kenneth Jones, Interim Chair of the Department of Pediatrics, presented highlights of the proposal.

Regent Preuss noted that the affiliation will legitimize the status of a situation that already exists at San Diego. He recommended the proposal strongly.

Regent O. Johnson asked how it will be determined which staff move to Children's, how staff will be retrained, and who will pay for that retraining. Dr. Bailey explained that employees will be free to make individual decisions as to whether they wish to move to Children's. There will be ample opportunity for employment there. The UCSD Medical Center will pay for any retraining outside of pediatrics that may be necessary. He reported that during the last fourteen months there have been regular meetings with staff, led by the hospital director, the director of nursing, and the director of pediatrics, in order to receive input and to keep staff informed. Additionally, there are quarterly open forums that will continue as a means of promoting active dialogue with staff. In response to a further question, Dr. Bailey explained that parents will be free to elect to see physicians at several sites. Plans for accommodating an overflow of patients if Children's Hospital and Health Center were full are being discussed. It may be that space at UCSD Medical Center or at other sites can be used for that purpose.

Regent O. Johnson then asked what is planned in the event of dissolution. Vice President Gurtner reported that there is no firm dissolution plan in place, although conditions are set under which it can occur. These include the establishment of a five-year notice period.

Regent Khachigian asked about the basis for complaints that there has been a lack of community participation in the planning process. Dr. Bailey stated that the community has been actively involved. There have been meetings with elected officials, and the media have been kept informed. Chancellor Dynes noted that similar proposals have been discussed for the past 25 years. He believed that the faculty overwhelmingly support the current proposal.

Regent Leach asked whether the fact that there will be two payment systems for the physicians involved could be troublesome. Dr. Holmes reported that no concerns about the compensation arrangements had been raised during numerous meetings with faculty. There seemed to be general satisfaction with the payment structure.

Regent Lansing questioned the University's limited representation on the governing board, noting that if problems emerge, the University will not be in a position to control the destiny of the entity. Vice President Gurtner responded that the affiliation is not a merger of systems; it includes only a narrowly focused group of faculty and staff whose missions are identical at a facility where the University already provides much of the service. He believed that it will be a symbiotic relationship that will reflect a

commitment to the University's academic mission. The relationship is structured so as to move any issues that could risk the University's mission to the board level for action, where the University will be in a position to defend its principles. Chancellor Dynes pointed out that he expected to be a member of the governing board, which will also include a vice chancellor and a Regent.

Regent Hopkinson, while supportive of the concept, expressed a number of concerns about the details of the agreement. These centered around the University's minority representation on the governing board, the nominating process for its trustees, the University's contribution to the construction of a new facility, the resolution of disputes, and the retention of UC's identity when operating in a non-UC facility. She believed that the University may have compromised too heavily in order to secure an agreement. Mr. Gurtner observed that the agreement followed many months of negotiations and was far more detailed than could be conveyed in the time allowed. He stressed that the basic tenet is that there will be a financial commitment, embodied in the academic fund, that will be held at Children's and used solely to support the University's academic mission. The first half of that revenue stream will be used for traditional resident training support; the remainder will be under the control of the Physician-in-Chief, who will also be the Chair of the Department of Pediatrics and a UC employee appointed in accordance with University policies for the appointment of tenured professors.

Chancellor Dynes also addressed some of the concerns raised by Regent Hopkinson. He stressed that the University already has many faculty working in Children's. Their daily lives may not be affected by the agreement, the goal of which is to expand the current joint programs. Dr. Bailey noted that the University's doctors have attending privileges at Children's but also at other hospitals. Their paychecks come through the University's compensation plan; they are subject to certain rights and privileges as University faculty, and in those ways will retain their separate academic affiliation and identity.

Chancellor Dynes reported that plans for the construction of a research facility are not final. The vision is for the University to have a research presence at Children's, but until decisions are made as to the potential for using space in existing facilities, the size and configuration of a new facility cannot be predicted.

Mr. Dynes took note of the concern expressed by Regent Hopkinson and also Regents Kozberg and Miura that responsibility for future seismic work apparently was not spelled out in the agreement. Deputy General Counsel Lundberg reported that there is a covenant in the institutional agreement that requires Children's to adhere to its strategic plan, which for capital improvements includes seismic upgrading to meet State requirements both in 2013 and 2030. The question of whether Children's could demand that the University participate in capital improvements is not addressed, although Mr. Lundberg noted that neither could there be any interpretation of the language that could make the University liable. He supported the suggestion of including a provision that would obligate Children's to pay for any seismic upgrades.

General Counsel Holst addressed Regent Hopkinson's concern that the University's interests were not sufficiently protected by the provisions for resolving disputes. She had noted that the University could be precluded from terminating the agreement in a timely way in the event that Children's merged with another entity or was sold. Mr. Holst explained that the provisions for dissolution were extensive. The agreement provides for an acceleration of the five-year stop-gap by mutual agreement. Also, if a majority of the University trustees or directors on the board does not vote affirmatively on a modification of the proportional representation, the University's percentage may not be diluted.

Regent Leach asked for clarification regarding the accounting arrangements for the consolidated entity. Mr. Gurtner explained that the entity will be a department within Children's, supported by a revenue stream from Children's that will be restricted to specific uses. Children's will keep the books, but the board members will have access to them. The new research building will be financed jointly but will belong to the University.

Regent Davies recalled that there has been community pressure for this alliance for 20 years. He believed that the consolidation should be welcomed and viewed as a great achievement. Committee Vice Chair Lee reported that his recent visit to the facility convinced him that it will provide a special environment in which to care for children.

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

[For speakers' comments, refer to the minutes of the November 15 morning session of the Committee of the Whole.]

At this point, Committee Vice Chair Lee returned the gavel to Committee Chair Kohn.

3. **FINANCIAL UPDATE, MEDICAL CENTER, SAN FRANCISCO CAMPUS**

It was recalled that UCSF Stanford Health Care closed the Mount Zion emergency department, skilled nursing facility (SNF), acute rehabilitation, intensive care, and general acute care units in December 1999 in order to reduce operating losses experienced at the site. The rationale for the closure was the high cost of operating a small, full-service inpatient hospital. Mount Zion's average daily census was 93 in FY99, excluding the SNF and acute rehabilitation. The projected SB1953 seismic upgrade costs at Mount Zion were \$3 million by 2002 and \$32 million by 2008. On the other hand, UCSF Parnassus had excess capacity. Projections made at the time were that half of the Mount Zion inpatients would move to UCSF Parnassus and half would likely go to other hospitals in San Francisco.

Outpatient surgery and other outpatient programs remain active at Mount Zion and are growing. Growth is expected to continue with the opening of the new UCSF Comprehensive Cancer Center in November 2000 and the relocation of UCSF's

Women's Health National Center of Excellence in early 2001. However, the initial projections did not anticipate a 28 percent increase in operating room use at UCSF Parnassus this year. This new volume has come from a combination of sources: increased emergency room activity at Parnassus, new surgical faculty at UCSF, and increasing numbers of patients being referred to UCSF faculty surgeons by physicians throughout central and northern California and Oregon.

As positive as this growth has been, the increased surgical patient volume has created serious operational problems for UCSF. The 22 main operating rooms at Parnassus, in addition to four ambulatory care operating rooms at Parnassus and ten at Mount Zion, are so heavily used during the week that elective surgical cases are frequently canceled and rescheduled at the last minute in order to accommodate urgent and emergency cases. As a result, UCSF has had to delay and even turn away patients whose physicians have wished to transfer them to UCSF for care.

In the near term, UCSF's operating room and bed capacity constraints are expected to worsen. A three-year \$18 million project to add four operating rooms and new pre-op and recovery areas has been initiated at the Parnassus campus. To accommodate the construction activity, one or two of the existing operating rooms will need to be closed during the three-year construction, resulting in an additional displacement of 400 to 800 surgical cases per year. Also, demand for operating rooms and beds is expected to increase with the pending recruitment of at least nine new surgeons in the next year.

Actions Under Way

To address these space problems, UCSF is pursuing a number of initiatives. As noted above, a three-year operating room expansion project has been initiated. Two additional operating rooms are now being staffed on Saturdays for elective cases. Use of these after only one month is running at fifty percent. The hospital has reduced length of stay and accelerated early discharges. Efforts are under way to evaluate downsizing or eliminating selected services and programs. Although these efforts have incrementally increased capacity at the Parnassus campus, the operating room construction project will further reduce its ability to meet short-term demand for operating rooms and inpatient beds.

A team of faculty and staff was asked to evaluate the potential of using the operating room capacity and some number of general acute care inpatient beds at Mount Zion for the purpose of accommodating current and expected patient demand. This team has recommended that, under specific conditions, UCSF move some surgical programs from Parnassus to Mount Zion where existing and complementary outpatient programs and physician practices already exist and are expected to grow. These programs include breast surgery, gynecologic surgery, plastic surgery, endocrine surgery, some orthopedic surgery, and urology. Intensive care services and emergency room services will not be available, and patients developing complications requiring intensive care will be stabilized in the Mount Zion recovery room and then transferred to the Parnassus campus

by ambulance. Patients with medical complications and those requiring more complex surgery will continue to be admitted solely at the Parnassus campus.

The plan will involve a relatively routine change in licensure status of approximately 30 beds by activating them from suspended status on the UCSF consolidated license. The financial and utilization implications will be evaluated against the business plan quarterly, in cooperation with Clinical Services Development in the Office of the President. Fully implemented, this program can both correct the acute care bed shortage and effectively increase the operating room capacity at Parnassus.

Financial Implications

While the use of the operating rooms and acute care beds at Mount Zion will address the space problems that currently inhibit patient referrals to UCSF, the financial rationale for making this move must be carefully considered. Approximately forty-four additional staff will be hired at Mount Zion, along with adding anesthesia coverage, for an estimated incremental salary expense at Mount Zion of about \$3 million per year. Additionally, approximately \$4 million in capital investment will be required to support programmatic moves and to meet SB1953 requirements. The impact will be to increase surgical capacity at Parnassus by two operating rooms, which will accommodate existing volume displaced during the three-year operating room construction project as well as program growth. The two additional operating rooms are projected to generate an average of \$5.3 million in annual contribution margin. Consequently, over the anticipated three-year horizon, the proposed project is projected to generate approximately \$3 million in incremental contribution margin. However, one of the key considerations in closing Mount Zion to inpatient activity last year was the anticipated need to comply with SB1953 – the Alquist Seismic Safety Act. Making the large seismic improvements for 2008 is not considered feasible under any scenario. For that reason, the proposal to expand the use of Mount Zion in this fashion must be considered short-term.

It is proposed to use facilities at Mount Zion to meet short-term capacity constraints until construction can be completed at Parnassus to accommodate increased patient demand. It is not proposed to reopen the emergency department, skilled nursing facility, acute rehabilitation, intensive care units, or general acute care services for any non-surgical service. By virtue of the 2008 seismic upgrade requirements, the use of Mount Zion will be limited by time. No long-term commitments of any type will be implied by this use of the facilities, so should demand fall or sufficient operating room time become available at Parnassus, management will move to re-consolidate services at Parnassus.

The risks of taking this action are primarily that the capital investment in the facilities will not be recovered, that additional patient care activity at Parnassus will not develop, or that demand for medical services provided by UCSF will fall. The risks of not taking this action are that patient referrals may be lost permanently to Stanford and other hospitals, that surgeons may be required to practice at other facilities during the OR

expansion project and potentially for a longer period of time, and that the medical center's competitors could be strengthened as a result.

Over the next two months, UCSF will continue to investigate the feasibility of this initiative, including consultations with State of California regulatory agencies and the initiation of an application to remove beds from "suspend" status, if necessary. Pending the outcome of this further investigation, UCSF plans to present an item, including a comprehensive business plan, to The Regents in January, 2001 for approval to implement the proposal.

Discussion

Chancellor Bishop recalled that emergence from the merger with Stanford has been harrowing. The campus has converted a full-service community hospital to an outpatient and short-stay surgical facility, negotiated the return of its employees to its own payroll, and recruited a new CEO. Beyond these immediate objectives, the medical center faces large challenges. During the second year of its operation under the merger, it was recognized that the UCSF Medical Center was operating in considerable deficit and that the billing and information systems were dysfunctional. It returned to independent operation on April 1, under a new business plan prepared by The Hunter Group. Despite its difficulties, the medical center is experiencing an unprecedented demand for its services, particularly in surgical referrals.

Director Laret recalled that in May he had reported his impressions of the challenges he identified in his first month at UCSF. He had predicted that it might take four years for the medical center to return to strong financial performance. He was hopeful that it will be possible to accelerate that timetable.

Mr. Laret reported that Moffitt-Long Hospital is frequently full. Patients are being turned away. The sponsor mix of patients is acceptable; about one-fifth are Medicare, one-quarter are Medi-Cal, and just over half are commercially insured. However, their acuity is high, reflecting a large volume of surgical and transplant procedures. In spite of this patient activity, sponsor mix, and high case mix, the medical center remains in a weak financial condition. Through the first quarter of this year, the medical center lost \$2.7 million on revenues of \$130 million, which, although not good, was consistent with budget projections for the year. On September 30, however, it had only \$28.8 million in the bank, representing fewer than 20 days of cash on hand. Days of revenue in accounts receivable were 92 compared to a target of 97.

Mr. Laret observed that the management team continues to deal with issues related to the merger. While it has made strides in reducing the high level of employment following the merger, he believed that labor issues will dominate its agenda for several years and that labor expenses will continue to rise. Improvements have been made in core operating systems including purchasing, accounts payable, registration, billing, medical records, and clinical information systems, but further improvement is needed

if the operation is to become efficient. Making investments in these systems will increase expenses before any results are seen.

Mr. Laret noted that facilities and infrastructure at the medical center are in very poor condition. Beyond emergency repairs and seismic upgrading, basic capital needs approach \$50 million per year for the next five years. The emergency department, operating rooms, radiology suites, and many other patient areas are substandard.

Mr. Laret pointed out that the medical center files an annual Medicare cost report. Last month, following the completion of an audit of the medical center's 1997 report, Medicare determined that an overpayment of \$5 million had occurred. Medicare is deducting that amount from current payments to the medical center. There are eight more cost reports in audit and eight under appeal. In a separate review, Medicare determined that UCSF Medical Center and UCSF-Stanford Health Care may have made mistakes in the past by incorrectly reporting where their residents were working at any one time. Tracking the location of residents is important financially because hospitals receive payments from Medicare when residents are at that hospital. Medicare's preliminary data show that UCSF may have been overpaid by \$4 million for each of the past three years.

Finally, Mr. Laret noted that, as the audit for April through June is nearing completion, problems have been identified with the medical center's internal controls, a reportable condition. This condition of inaccurate reporting is the result of the way in which the medical center has had to estimate expenses and revenues due to many of the limitations of its systems.

Mr. Laret discussed his plans for responding to conditions at the medical center. He reported that capital plan and cash projections for this fiscal year will soon be final. In the second half of the year, an improved capital and cash forecasting system will be implemented. This will result in a three-year capital and cash projection. Given its large capital needs, the medical center will likely face some important policy issues in the coming months and years about how it appropriates capital for internal uses, how much is appropriated, and whether to access working capital through the Short Term Investment Pool. A series of actions has been implemented to reduce days of accounts in receivable to 85 by the end of the year. Also, the two greatest contributors to the accounts receivable problems have begun to be addressed. Negotiations are under way to simplify confusing and hard-to-adjudicate managed care contracts, and a training program has begun for all patient registration staff to reduce errors. Regarding the Medicare audits, adjustments are being made to reserve accounts and internal systems to audit the location of residents for Medicare cost report purposes. An outside firm will be engaged that specializes in managing Medicare cost report audits and appeals.

Concerning operations, Mr. Laret reported that there is a push to increase revenue. Full-risk HMO contracts have been or will be terminated, and the medical center has put other contractors on notice that their contracts will be terminated also unless major reimbursement increases are forthcoming. Vice President Gurtner has been asked to

attempt to negotiate a major increase in Medi-Cal reimbursement. On the cost side, purchases are being standardized and steps are being taken to assure internal compliance with purchasing agreements. Regarding financial reporting, steps are being taken in conjunction with the auditors to resolve the reportable condition. Work is going on to separate medical center and medical group financial reporting and to develop financial reporting models that provide management, the Office of the President, and the Regents with a better understanding of the medical center's financial performance.

In answer to a question by Regent Lee, Mr. Laret reported that UCSF is using Stanford's mainframe computer to produce its financial reports. An effort is being made to get a system set up at UCSF to take over that task. He noted also that the Medicare audits that have revealed overpayments cover time frames pre-merger, during the merger, and post-merger.

Regent S. Johnson asked about faculty morale post-merger. Dean Debas answered that immediately after the merger, morale was low. The hospital was being run by The Hunter Group, which was viewed by the faculty as not being primarily interested in the mission of the institution. With the recruitment of Director Laret, the morale of the faculty has increased, and there is a high level of optimism about the future.

Regent Leach noted that the medical center has lost \$2.7 million year-to-date. He asked what the budget was for the year. Mr. Laret explained that there are two budgeted numbers. One is a loss of \$25 million that includes the medical center and medical group. The \$2.7 million loss is the medical center only; on that base, a loss for the year of about \$9 million is projected. A return to profitability will depend on efforts to increase revenue, on events in Washington, and on Medi-Cal and managed care contract negotiations. There is a concern that revenue increases may not cover the rate of expense increases due to labor costs.

Regent Kohn asked about the origin of the auditor's reportable condition. Vice President Broome recalled that in the first year of the merger, Arthur Andersen had issued a management letter indicating the existence of material weaknesses, the most severe situation possible. The next level of severity is called a reportable condition. From its initial year, UCSF Stanford Health Care had both. The current situation at UCSF represents a continuation of the systems and control flaws that existed in the combined entity. She believed it would be unreasonable to assume that such a serious condition could be corrected quickly.

4. **STRATEGIC INITIATIVES IN RESPONSE TO CURRENT CLINICAL SERVICE CONDITIONS, MEDICAL CENTER, SAN FRANCISCO CAMPUS**

Medical Center Director Laret noted that UCSF Medical Center has two clinical sites: the Moffitt-Long Hospital on Parnassus Avenue and the Mount Zion Hospital about three miles away. In December 1999, UCSF closed certain programs at Mount Zion, including the emergency department, skilled nursing facility, acute rehabilitation, and inpatient units, in order to stem large financial losses. Other programs, including

outpatient surgery, the breast center, and the cancer center remained open and are flourishing. UCSF Medical Center on Parnassus has seen a remarkable growth in the number of patients who are either being referred to or are choosing to come to UCSF for their medical care. Much of this growth was expected when the inpatient services at Mount Zion were closed, but some is the result of other factors, including the fact that new faculty have been recruited who have established referral practices. Also, patients are demanding referrals to specialists more frequently, many competing medical specialists have left the Bay Area as the result of the high cost of doing business in the area, and the population generally is growing and aging. The growth in patient activity has created problems within the medical center. The intensive care unit beds are full about five days a week, and when they are full, those patients must be cared for in the emergency department and the surgical recovery area until beds become free. General acute care beds are full several days a week. The patient volume at Parnassus is at its highest level in eight years. The 22 main operating rooms are so heavily scheduled that some elective procedures are delayed until late at night. The number of surgical cases has grown 21 percent in the past year, and the number of operating room minutes has jumped by 28 percent. The situation has compromised the ability of the medical center to serve those physicians and hospitals in central and northern California that depend on UCSF to care for their most seriously ill patients, who are being transferred to competing facilities.

Mr. Laret reported that the medical center has been taking many actions to address the capacity problem, including carrying out the long-planned expansion of the intensive care units and operating room suite at Moffitt-Long. In the near term, however, capacity problems are likely to worsen. It is proposed to expand the outpatient surgery at Mount Zion to include low-acuity inpatient surgery. By moving some low-acuity surgery from Parnassus to Mount Zion, the medical center could get through the planned operating room construction at Parnassus and allow the accommodation of more transfer patients and the immediate needs of new faculty. Some parameters have been set for the limited use of Mount Zion. The plan must make reasonable financial sense and be structured to enable quick response in case demand for services falls. It should be consistent with the original goals of avoiding operating two partially full hospitals and avoiding 2008 seismic upgrading expenses at Mount Zion.

Mr. Laret described the detailed business and operating plan developed as a basis for the proposal. The business plan proposes that 30 beds be reactivated at Mount Zion from suspense status on UCSF's license. Three of the Mount Zion operating rooms will be staffed to serve patients not requiring intensive care. A process would be put in place for managing complications that may develop. It is also planned that no other services be opened at Mount Zion and that a sufficient number of cases be moved from Parnassus to free up two operating rooms there. The plan will require an investment of \$3 million in seismic upgrades to meet 2002 requirements, but upgrades for 2008 will not be considered. Additional capital of about \$1 million and annual operating expenses of about \$3 million are anticipated at Mount Zion, but because of the incremental revenue, it is likely that the investments and incremental expenses will be

covered, with an estimated full payback of the seismic investment in about two-and-a-half years.

Mr. Laret believed that the risks in not taking any action to solve the space crisis are greater than those of taken the actions listed. The referral base that has been developed over the past decade could be eroded, and the medical center will be unable to provide its faculty with the facilities they need for their practices.

Dr. Debas, Dean of the College of Medicine, reported that two significant circumstances led to this proposal. First, UCSF Medical Center has become extremely busy and is unable to cope with its increased business. Referrals are the lifeline of the hospital and are key to supporting physician training programs. On top of this, the cost of housing has risen precipitously, and low reimbursement rates for physician and hospital services in the Bay Area have peristed. Hospitals from other parts of the state are attempting to recruit UCSF's faculty. It is imperative that the medical center do all it can to remedy the situation as quickly as possible. The expansion of surgical activity at Mount Zion will relieve the pressure on the Moffitt-Long Hospital. Because post-operative patients may be kept at Mount Zion no longer than 23 hours currently, many patients who have simple procedures that need to be hospitalized for longer are being admitted to Moffitt-Long. If patients requiring no post-operative intensive care may be cared for at Mount Zion, capacity at Parnassus will be increased for accepting referrals and meeting the pent-up demands of surgical faculty. Increasing capacity at Mount Zion is critical during the next two years as additional operating rooms are constructed at Parnassus.

Chancellor Bishop believed that every possible cost had been taken out of the medical center and that the way out of its current crisis was to expand programs. He emphasized that the University runs hospitals to serve its missions of teaching and research. The ability to recruit and retain top-quality faculty is vital to serving these missions.

Regent-designate Seymour asked about the condition of the Mount Zion facility. Mr. Laret responded that the hospital is attractive from a patient's standpoint. It will require some bracing of its infrastructure to meet 2002 seismic requirements, but this can be done during operation. He reemphasized that there is no intent to meet 2008 seismic requirements.

Regent Khachigian asked whether the medical center's physicians are in favor of the proposal. Dean Debas believed that, although it is inconvenient for surgeons to see patients at two locations, the faculty is in agreement about the need to expand to Mount Zion.

Regent O. Johnson asked about the post-merger employee situation. Mr. Laret reported that a major charge of The Hunter Group was to decrease the number of employees roughly to match pre-merger levels. Searches have been initiated for key employees, and offers have been made. He hoped that soon those positions will be filled, and there will be no further need to retain members of The Hunter Group who have been functioning as interim senior managers.

Regent S. Johnson was concerned about giving hope to those who want Mount Zion returned to its former status. Mr. Laret commented that he had made it clear to community leaders that Mount Zion will not accommodate emergency care, general medicine, or skilled nursing.

Regent Preuss noted that the cycle time between Mount Zion's being in deep financial trouble and being needed to support programs had been very short. He sought more assurance that there is no plan to keep expanding it. Mr. Laret reported that Chancellor Bishop has appointed a committee to examine the long-term future for inpatient care at UCSF, given that Moffitt Hospital will need to be torn down by 2030. He was hopeful that within the year a long-term plan for all inpatient activity will be in place. He recalled that Mount Zion was closed because it was losing money. He believed that it would have continued to lose money as long as it was operating under the same parameters. The new plan will maintain a low-margin business while adding to it a high-margin business.

President Atkinson noted that there was considerable support on the Board for the proposal. He asked whether approval in advance of the January meeting would be advantageous. Mr. Laret reported that operations could proceed at Mount Zion as soon as Board approval was received. Regent S. Johnson suggested that when the proposal is ready for action, a decision be made as to whether to seek Regental approval during a teleconference or as an interim item.

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

Vice President Broome reviewed the activity and financial status report for the first quarter of FY2001, noting that no comparative data for UCSF Medical Center were yet available. She reported that patient days increased at the other four medical centers, admissions increased at all except Irvine, and outpatients increased at all except Davis. There was a slight increase in profitability overall, some of which was attributable to patient activity and some to nonoperating items. All centers met or exceeded their budget targets. Days in accounts receivable increased at all centers except Los Angeles.

Ms. Broome recalled that Regent Leach had requested a breakdown of the category labeled "health system support," which represents the cost of academic initiatives that benefit the enterprise, and that this had been done. She pointed out that the reporting of this category cannot be totally consistent because the Davis medical center has no payments in it. Its medical group is part of the medical center for reporting purposes.

Regent Hopkinson believed that "health system expenditures" was a better term than the sometimes-used "transfers" was for these expenditures because it did not imply any judgment about their appropriateness. Ms. Broome noted that, although there are many subtleties in this category, the goal is to reflect where spending occurs as accurately as possible. Mr. Gurtner added that reporting in this category is intended to inform decisions about future expenditures.

[For speakers' comments, refer to the minutes of the November 15 morning session of the Committee of the Whole.]

The meeting adjourned at 11:30 a.m.

Attest:

Secretary