The Regents of the University of California

COMMITTEE ON HEALTH SERVICES
March 15, 2000

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

Members present: Regents Atkinson, Davies, O. Johnson, Khachigian, Kozberg, Lansing, Leach, Montoya, Preuss, Sayles, and Vining; Advisory member Kohn

In attendance: Regents Bagley, Bustamante, Hopkinson, S. Johnson, Lee, Moores, Nakashima, Pannor, and Taylor, Regent-designate Miura, Faculty Representatives Coleman and Cowan, Secretary Trivette, General Counsel Holst, Assistant Treasurer Young, Provost King, Senior Vice President Kennedy, Vice Presidents Broome, Darling, Gomes, and Gurtner, Director Nation representing Vice President Hopper, Chancellors Berdahl, Bishop, Carnesale, Cicerone, Dynes, Greenwood, Orbach, Vanderhoef, and Yang, Laboratory Directors Browne and Shank, and Recording Secretary Bryan

The meeting convened at 10:00 a.m. with Committee Chair Khachigian presiding.

1. APPROVAL OF MINUTES OF THE MEETING OF JANUARY 19, 2000

   Upon motion duly made and seconded, the minutes of the meeting of January 19, 2000 were approved as submitted.

2. APPROVAL OF UCSD MEDICAL CENTER AND DEPARTMENT OF PSYCHIATRY TO PARTICIPATE AS A MEMBER OF A CALIFORNIA NONPROFIT PUBLIC BENEFIT CORPORATION, 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 documents necessary to allow The Regents, on behalf of the UCSD Medical Center and the Department of Psychiatry (UCSD), to be a founding member of the Children, Youth and Family Network of San Diego (CYFN-SD), a California Nonprofit Public Benefit Corporation, tax exempt under §501(c)(3) of the Internal Revenue Code.

   It was recalled that, since 1994, UCSD Healthcare, including UCSD Medical Center and the UCSD Department of Psychiatry, has operated an inpatient child and adolescent psychiatric service (Service) pursuant to a contract with the County of San Diego (County). This Service is critical to the training program of the UCSD Department of Psychiatry. More than 90 percent of the patients using the Service are referred from and sponsored by the County.
The County recently proposed changes to its system of mental health care and social services for children and adolescents. These changes, which will have a significant impact on the County patient base for the Service, result from a three-year planning process conducted by the County Health and Human Services Agency (CHHSA) to develop a coordinated and integrated system of care for severely emotionally disturbed children and adolescents. As conceived, the new system – the Heartbeat Children’s Mental Health System of Care (Heartbeat System) – will focus on the collaboration among three sectors: the public sector (government and schools), the private sector (health care providers and community resources), and the family sector (parents, surrogate parents, and youth).

The County intends to distribute a Request for Proposal (RFP) to solicit bids from organizations to manage the Heartbeat System. To ensure the greatest chance of continuing to serve the patient base in question, UCSD seeks approval to participate with other nonprofit behavioral health care organizations in San Diego in the formation of a network of providers to be called the Children, Youth and Family Network of San Diego, a California Nonprofit Public Benefit Corporation. The network will be included in a response being submitted by Children’s Hospital and Health Center (CHHC), as lead agency. The lead agency will be responsible for implementing and providing the required services for the Heartbeat System, including organizing and managing a network of health care providers capable of providing a full continuum of services to these children and adolescents. CHHC will contract with PacifiCare to provide the administrative services required under the RFP.

CYFN-SD also contemplates contracting in the future with other third-party payors, one of which would be schools, to provide social, mental health, and juvenile justice services to children and adolescents. These additional contracts will be pursued even if the contract with the County is not successful.

The nine founding members of CFYN-SD are Children’s Hospital and Health Center; University of California, San Diego; Community Research Foundation; Mental Health Systems; The Escondido Youth Encounter; North County Lifeline, Inc.; San Diego Youth and Community Services; South Bay Community Services; and SAY San Diego, Inc. All founding members are nonprofit healthcare entities with long-standing records of distinction in providing behavioral healthcare services in San Diego County.

CYFN-SD will be governed by a board of directors comprised of at least nine but no more than eleven directors. Each member of the corporation shall appoint no more than one member of the board, with two additional seats available for community representation. The community members will be nominated and selected by the founding member representatives. Subject to the powers under the California Nonprofit Corporation Code reserved to members, the board will have ultimate decision-making authority with regard to corporate matters.
CHHC, as the lead agency, will contract with CFYN-SD to serve as the network of service providers. It will also contract with PacifiCare Behavioral Health, Inc. to provide administrative services.

The corporate bylaws allow for the payment of dues by its members. To date, however, the costs of setting up the corporation have been covered by a grant from a nonprofit funding agency. Should the County select CFYN-SD to provide services to the Heartbeat System, costs thereafter will be covered by the County contract. Should the members choose not to pay corporate membership dues required by the board, if any, the member may resign from the corporation and still be a service provider. CFYN-SD’s bylaws also provide, with limited exceptions, that the corporation shall indemnify any director, officer, employee, and agent of the corporation who is a party or is threatened to be a party to any proceeding by virtue of the fact that the person is or was an agent of the corporation.

Benefits and Risks

Participation as a founding member of CYFN-SD is intended to provide UCSD with the highest potential for sustaining its County referred and funded inpatient child and adolescent patient base. An added benefit is the anticipated referral of non-county children and adolescents from the other CYFN-SD co-members and from public and private community organizations participating in the Heartbeat System.

The County HHSA will maintain oversight responsibility during the initial stage of implementation and operation of the new system of care and will continue to be the payor of services delivered by providers. As a result, service delivery financial risk will be no more than that to which UCSD is already subject. CYFN-SD may not bind UCSD or other providers to agreements with the County. Furthermore, under the California Nonprofit Corporation Law, members are not financially liable for debts of the corporation. In addition, the corporation may not require members to provide capitalization other than dues; contributions would be optional. CFYN-SD will maintain complete books of accounts that will be open to inspection and copying by each member of the corporation on reasonable notice during normal business hours. At the end of each fiscal year, the books of CFYN-SD will be closed and examined by the corporation’s certified public accountants. Copies of the audited financial statements will be given to all members within 120 days of the end of each fiscal year. In addition, all members will receive, not less frequently than each calendar quarter, copies of financial statements for the quarter and the year-to-date. UCSD Medical Center and the Department of Psychiatry together will appoint a senior representative to serve on the board of CFYN-SD. This representative will keep the UCSD Vice Chancellor, Health Sciences apprised of all business and financial matters related to CFYN-SD. The CYFN-SD corporate bylaws have been reviewed by General Counsel and accepted with minor modification.

Regent Hopkinson noted that the bureaucracy that must be formed to effect this program has the potential to grow very large. Dr. David Bailey, Dean of the medical school,
agreed but emphasized that under the RFP the University is required to contract with an entity for administration. Chancellor Dynes believed that because all the board members will be concerned about controlling the growth of the bureaucracy, they will be willing to work together to that end.

Regent O. Johnson sought assurance about the limits of The Regents’ liability. Dr. Bailey noted that the medical center may resign from the corporation by not paying dues and may still be a service provider. He noted also that there cannot be a call for capital and that by law The Regents is not liable for the debt of the corporation.

Regent-designate Kohn asked how the operating expenses of the corporation will be subsidized. Chancellor Dynes reported that they will be supported by dues. Vice President Gurtner explained that it is not unusual for a county to create a contracting entity outside the county structure to take responsibility for delivering healthcare. The arrangement being recommended is slightly unusual in that nine entities are involved. He believed that the arrangement will be more readily understood when the RFP is completed and the entities involved have determined a specific structure for the corporation. He agreed to report further after that has been accomplished.

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

3. UPDATE ON MEDICAL CENTER, LOS ANGELES CAMPUS

Provost Levey reported that it has been a challenging year for UCLA’s School of Medicine and Medical Center. The turbulent health care system in California and the nation has had profoundly negative effects on academic medical centers. Declining reimbursement by Medicare, as reflected in the Balanced Budget Act of 1997, and other third-party payors has necessitated unprecedented cost-cutting measures by UCLA’s medical enterprise. On a more positive note, the strong support for biomedical research and the National Institutes of Health by Congress has led to substantial increases in the NIH budget, and UCLA’s research programs have thrived. UCLA’s medical student programs remain strong. Of 700 students, approximately 10 percent are in the Medical Scientist Training Program, which leads to the conferral of both the M.D. and Ph.D. degrees. A significant number of students are entering M.D./M.B.A. and M.D./M.P.H. programs.

Hospital System Operations

Over the past five years, the hospital volume has grown dramatically. Commensurate with the increases in volume, earnings increased to a peak of $51 million in 1998; however, since 1997 the UCLA Medical Center has experienced a 5.2 percent decrease in reimbursement rates that translates to a $73 million decrease in net patient revenue. Almost half of the decrease occurred in the current fiscal year, resulting in a $4 million net operating loss for the first seven months of this year and a significant decrease in cash to approximately $7 million as of January 31, 2000.
Hospital earnings are a function of reimbursement, payor mix, volume, acuity, and cost structure. The UCLA Medical Enterprise is focusing on each of these areas and their respective effects. Efforts in this area began in the fall of 1999 and continue. Initially the focus has been on expenses and has resulted in a decrease in the full-time equivalent staffing of 300 and annual savings of $31 million.

Research

The UCLA School of Medicine continues its strong record in research. NIH grant support has increased from $136 million in 1996-97 to $160 million in 1998-99. Total research support over that time increased from $190 million to $228 million. According to statistics released by the Association of American Medical Colleges, UCLA’s total research support ranks second among all U.S. medical schools. Following an intensive strategic planning process, including a view of medicine in the future, an intertwined clinical and research agenda has been developed that will focus on the following areas of excellence for the 21st century: genetics and gene therapy, cardiovascular diseases, Positron Emission Tomography scanning, transplantation, vaccines, cancer, women’s health, geriatrics and gerontology, health services research, bioinformatics, neurosciences, AIDS, and immunology.

Provost Levey reported that the focus of management has been upon the maintenance of the academic mission and the preservation of clinical excellence. Substantial cost reductions have been made, including $20 million in cuts to clinical departments. Every phase of the business is being examined to ensure that the medical center’s financial situation is thoroughly understood. On the positive side, the hospital is busy, and fund raising is going well. The ongoing capital campaign has raised $630 million for medical sciences, $200 million of which is directed toward the hospitals. As mentioned, research funding has increased sufficiently to place UCLA second in the country in research support. Dr. Levey believed that the strategic plan and the cutting-edge research programs in which the medical center is investing will keep the hospital and medical school healthy in the years ahead.

Regent Hopkinson commented that she had hoped to hear more at this meeting about how the medical centers operate as a system. Vice President Gurtner responded that systemwide opportunities will be discussed at the May meeting, as well as the interface between the schools and the hospitals. Dr. Levey emphasized the importance of understanding the relationships of the schools to the medical centers. He characterized the academic medical centers as the engines for the medical schools, and he expressed the hope that the Regents will lobby in Washington in an attempt to expand interest in Congress for increased financial support. Assistant Vice President Sudduth reported that some headway had been made in building support with a few members of Congress. Controversial proposals have been discussed, including setting up a general revenue fund out of appropriations to support some of the academic medical mission, an arrangement that would subject the University to an annual appropriations process. He noted that the presidents of many A.A.U. institutions may form a task force to work with Congress to identify alternative sources of funds for academic medical centers.
Regent Sayles observed that, as inadequate reimbursements are the heart of the current financial problems at the University’s medical centers, it is unlikely that enhancing revenues will solve anything. Dr. Levey agreed that further cost cutting would damage the institutions. He emphasized, however, that every aspect of the business is being examined to check for new ways of saving money. Vice President Gurtner observed that the problem is not limited to revenue. At its base is the question of how medical education will be paid for in the future, a problem that has been sidestepped through the use of reimbursement programs. He believed that finally facing the basic issue of who will pay for medical education will be a positive step for the country. In the short term, however, the problem must be dealt with on an expense, not a revenue, basis.

Regent Leach agreed that the basic problem is in Washington. He believed that it was wise to have created the position held by Vice President Gurtner because it has provided the medical centers with resources with which to help themselves. He noted that there has been good cooperation between the Office of the President and the campuses on hospital issues. Chancellor Carnesale stressed that the University’s administration is dedicated to preventing any reduction in the quality of care. He hoped that if that level does decline at some point, the administration will not be reticent to publicize the fact. Regent Preuss commented that anecdotal information suggests that it has declined substantially already. Dr. Levy agreed that patient surveys indicate a growing level of dissatisfaction, but he believed it was with the country’s healthcare system in general rather than with the specific care that patients had received at the medical center. President Atkinson believed that the nation’s academic medical centers have been fundamental to the groundbreaking advancements in treatments and that they could be destroyed by the current trend in federal policy.

Regent Lee noted that, considering the current financial problems at UCLA Medical Center, the time that had been spent on fund raising had been worthwhile. Chancellor Carnesale emphasized that fund raising for the medical enterprise had not lowered the level of funds that have been donated to the campus.

Regent Kozberg asked what could be learned from the administration’s experiences at UCLA. Dr. Levey stated that, if he had it to do over, he would have started cutting costs earlier. He noted, however, that working in a crisis mode made people accept that drastic steps were necessary in order to address the financial problems. He believed that the kind of analysis of every complexity of the system and the vigilance concerning efficiency that have become necessary have increased everyone’s general knowledge base and armed them for the future.

Regent-designate Kohn stated that the University has been complaining publicly for decades about the lack of government funding for academic medicine. He asked whether the $20 million in budget cuts to clinical programs would compromise their quality. Dr. Levey believed that, although it will be difficult for departments, it will strengthen them by rooting out inefficiencies and that it will not have an appreciable effect on programs. He noted, however, that this is the last round of cuts that can be sustained.
Regent S. Johnson believed that, in the midst of its problems with reimbursement, the success of UCLA in garnering medical research money should be acknowledged.

Regent Lansing agreed with Regent Sayles that the University will never be able to raise private funds sufficient to cover the problem of inadequate reimbursements. She believed that the Regents must lobby at the State and national levels to prevent one of the world’s best healthcare systems from being destroyed. Committee Chair Khachigian informed her that efforts are under way to carry that message to those in government.

Chancellor Carnesale pointed out that more is threatened than the quality of patient care. In the past, the hospitals have made an important contribution in income to support medical research. Their financial condition threatens biomedical research, the training of new doctors and scientists, and service to Medicare and indigent patients.

Chancellor Bishop reported that UCSF is undergoing a transition from a recovery plan designed by The Hunter Group for the merger to a recovery plan designed by The Hunter Group for UCSF alone. The plan envisions reaching break-even status by FY 2002. A vital step toward reaching that objective is to reconstitute the leadership of the medical center, which emerged from the merger with no chief executive officer, operating officer, or chief financial officer. He observed that the fact that UCSF offers uncompetitive salaries has impeded the search.

Acting Hospital Director Stone reported that a business plan for UCSF Medical Center is near completion. Costs associated with the unwind are significant and will be shared equally between UCSF and Stanford. It is not currently known what the final financial outcome will be. The absence of a key management team also makes it difficult to predict how successful the recovery plan can be in the short term.

Mr. Stone reported that the medical center’s financial losses, although significant, are expected to be contained following the end of the windup and with the closure of the Mt. Zion Hospital. A slight increase in revenues is expected, and expenses will continue to be managed. Although there are not many cost-cutting opportunities in patient-care areas, expense reductions are still possible in support areas as well as in clinical resources such as supplies. The medical center expects to lose $25 million in 2001 and hopes to break even in 2002. He observed that, considering the trend in reimbursement levels, without additional revenue or a better mix of payors it will be impossible for the medical center to make a profit despite ongoing high occupancy rates.

Regent Bustamante asked what effect layoffs have had on reducing costs. Mr. Stone explained that most of the employees who were laid off were support staff, not patient care staff, working in areas that could be outsourced. The approximately 150 people were promised reinstatement if and when comparable jobs opened up. Those laid off in areas such as the business office were not promised new jobs. He pointed out that more than half of the overall reduction in FTEs was accomplished through decreasing work hours. Regent Bustamante was concerned that those laid off by UCSF Stanford Health Care and rehired by UCSF could lose benefits. He asked to receive further details on the rehiring arrangement.

Regent Lee suggested launching a marketing campaign to attract overseas patients to UCSF. Mr. Stone believed that the medical center’s doctors were its best source for marketing. He noted that many patients from the Middle East and the Pacific Rim come to the medical center for treatment.

Regent Hopkinson stated that she was expecting more detailed information about the budget. Vice President Gurtner believed that, until audited figures are available, a thumbnail sketch of the numbers that could be expected was the most helpful. Regent
Hopkinson expressed her hope that the numbers would be available in May. Regent Leach noted that until UCSF Medical Center has senior management in place, it was unlikely that the campus would be able to produce any meaningful numbers. Regent Vining observed that the auditors who will be preparing the final information on UCSF Stanford Health Care are also the auditors for Stanford Medical Center. He noted that even after the Regents receive final numbers in April, there will be substantial, lengthy negotiations before everything is settled.

Regent Leach agreed with Regent Lansing’s previously-stated concerns about the lack of federal support for academic medical centers. He suggested that the University lead an effort to get long-term issues addressed in Washington. Assistant Vice President Sudduth reiterated that such an initiative is under way and that he would welcome the help of Regents.

5. ASSUMPTION OF DEBT BY ESTABLISHMENT OF INSTRUMENTALITY, MEDICAL CENTER, SAN FRANCISCO CAMPUS

The President recommended approval of the establishment of UCSF Finance Corporation, a California nonprofit public benefit corporation, to act with The Regents as replacement borrower for the 1998 Series A Bonds issued by California Health Facilities Financing Authority for the benefit of UCSF Stanford Health Care in accordance with the terms of the 1998 Series A Indenture, subject to the following:

A. The activity of UCSF Finance Corporation shall be limited to serving as replacement borrower with The Regents for the assumption of 1998 Series A Bonds.

B. UCSF Finance Corporation shall be dissolved as soon as practicable following the earlier of the final maturity of the 1998 Series A Bonds or the date when the California Health Facilities Financing Authority statutes are amended to qualify The Regents acting alone to assume the 1998 Series A Bonds.

C. The Officers of The Regents be authorized to execute all documents and agreements as may be necessary in connection with the above.

It was recalled that in November 1999, The Regents authorized the Treasurer to take the necessary steps to permit assumption of the 1998 Series A Bonds issued by California Health Facilities Financing Authority (CHFFA) for the benefit of UCSF Stanford Health Care. Approximately $104.7 million Series A Bonds are outstanding, with an average interest cost of 5 percent. Given the current financial condition of UCSF Stanford Health Care and the current level of long-term interest rates, it would not be possible to achieve equivalent interest rates with new bond issuance; therefore, it is beneficial for The Regents to assume the 1998 Series A Bonds in accordance with the terms of the Series A Indenture. The ability to assume the debt is dependent on two factors: certification that UCSF Medical Center financial projections for the fiscal year ending June 30, 2001 meet certain financial tests, and the Series A Bonds must be assumed by a borrower eligible under the CHFFA Act.
The Camden Consulting Group (CCG) was retained to provide a projection of the income statement and balance sheet for the UCSF Medical Center for the fiscal years ending June 30, 2000 and 2001. Based on the CCG analysis, the Treasurer’s Office has determined that the UCSF Medical Center can meet the financial tests required by the 1998 Series A Indenture.

CHFFA is authorized to issue financing on behalf of qualified participating health institutions, which includes private nonprofit corporations. The Regents is a public nonprofit corporation, and therefore acting alone is not an eligible “participating health institution” under the CHFFA Act. The Regents could seek amendment of the CHFFA Act specifically to qualify The Regents to act alone as an eligible participating health institution for the purposes of assuming the 1998 Series A Bonds, but that process could take up to one year or longer.

The General Counsel, working with The Regents’ external bond counsel, Orrick, Herrington & Sutcliffe LLP, has determined that the most efficient way to assume the 1998 Series A Bonds would be to establish a new nonprofit public benefit corporation (“UCSF Finance Corporation”) that will exist solely for the limited purpose of joining with The Regents as a party to the Series A Loan Agreement and the Replacement Master Indenture and providing in a lease-leaseback transaction those UCSF healthcare facilities which were constructed or acquired with the proceeds of the Series A Bonds to The Regents within the meaning of the CHFFA Act. These facilities include several floors in Moffit and Long Hospitals which were renovated in the early 1990s, the newly constructed Mt. Zion Cancer Center, and various equipment which was installed at UCSF Medical Center sites. At no time will The Regents relinquish ownership or control of these facilities.

To preserve the tax-exempt status of the 1998 Series A Bonds, UCSF Finance Corporation must either obtain a 501(c)(3) ruling from the IRS or qualify as an instrumentality of The Regents. Obtaining a 501(c)(3) ruling would take several months beyond the April 1 date established for unwinding UCSF Stanford Health Care. Therefore, UCSF Finance Corporation will be structured in a manner that will qualify it as an instrumentality of The Regents for the purposes of federal income taxes. Its function will be limited to serving as the replacement borrower under the 1998 Series A Loan Agreement and Replacement Master Indenture.

Action will also be undertaken concurrently in Sacramento to amend the CHFFA Act to qualify The Regents acting alone to assume the 1998 Series A Bonds. As required by The Regents’ action above, steps will be taken to dissolve UCSF Finance Corporation after the CHFFA Act is amended.

Associate General Counsel Lundberg stressed that the corporation to be formed will be governed and controlled by The Regents, and when it is dissolved, the assets will return to The Regents. The corporation will exist only to be a party to the new loan agreement separating Series A from Series B, which relates to Stanford. The new corporation will be a party to the new master indenture and will enter into a lease and
leaseback arrangement in order to meet certain statutory language requirements. The new corporation will not control the finances or operations of UCSF.

In response to a question by Regent Davies, General Counsel Holst reported that the board of UCSF Stanford Health Care must be kept operating until the dissolution is complete. The existing directors will be relieved of their responsibilities as UCSF Stanford ceases operations and operational responsibility is moved to UCSF and Stanford. It is proposed that a smaller board, with two members from each entity, carry out the final steps. Authority for this action comes from Regental action in January of this year. He recalled that in September 1997, the action of the Board required a vote of the full Board of Regents in order to exercise reserve powers, including amendment of the bylaws. In January 2000, the President was authorized to take all steps necessary to carry out procedures for winding up the merger. He interpreted that resolution as authorizing the President to request that the Regents who are otherwise authorized to act as the representatives of The Regents as a member of UCSF Stanford Health Care amend the bylaws to reduce the number of directors to allow for efficient operation moving towards full dissolution.

Mr. Lundberg reported that issues remain that are dependent upon receiving opinions from the Internal Revenue Service and the Department of Labor concerning the merged entity’s benefit plans. There are accounts payable left in the corporation that must be paid over time, and there are also some lingering personnel issues. He believed that the corporation would need to be left in place for one or two years.

6. ACTIVITY AND FINANCIAL STATUS REPORT ON HOSPITALS AND CLINICS

Vice President Broome described the most recent financial operations. She reported that the trend in reimbursement for all the medical centers is downward. Although inpatient and outpatient activity are up, additional revenue is negated by the rise in expenses caused by caring for more patients. It is a trend that is expected to continue. Cash balances have decreased at all centers, and accounts receivable have increased.

Vice President Gurtner emphasized that the Balanced Budget Act has forced the medical centers to focus on cutting costs and being as efficient as possible. It will be challenging to succeed in doing that without damaging the University’s mission of teaching, research, and patient care over the next few years.

Vice President Broome noted that accounting principles governing affiliations require that an expense of another member of the affiliation with the University should not be recorded as a University operation but rather as an equity transfer to that other member of the group. It is planned to conform the various current practices of the medical centers to this principle, effective July 1. She noted that the effort to create standardized reporting is continuing. Vice President Gurtner believed standardization will make it possible to see more clearly the operations of the medical school and hospitals individually.
Regent Vining was concerned that when the nature of the University’s reporting methods is changed, it may present a financial picture of the hospitals that is misleading. Ms. Broome agreed and explained that management is working with the University’s external auditor to determine the best approach to illustrate the relationship between the hospitals and the medical centers and how revenues from the hospitals are used to support academic programs. Committee Chair Khachigian commented that it would be interesting to have a report to the Regents on the financial relationship between the hospitals and the medical schools. Vice President Gurtner responded that such a report was planned for the May meeting.

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

The meeting adjourned at 12:50 p.m.

Attest:

Secretary