

The Regents of the University of California

**COMMITTEE ON HEALTH SERVICES**

September 17, 2009

The Committee on Health Services met on the above date at UCSF – Mission Bay Community Center, San Francisco.

Members present: Regents De La Peña, Island, Johnson, Lansing, Nunn Gorman, Pattiz, Ruiz, Stovitz, and Zettel; Ex officio members Blum, Gould, and Yudof; Advisory members Cheng and Powell

In attendance: Regents Bass, Bernal, Garamendi, Kieffer, Kozberg, Makarechian, Marcus, Schilling, Varner, and Wachter, Regents-designate DeFreece and Hime, Faculty Representative Simmons, Secretary and Chief of Staff Griffiths, Associate Secretary Shaw, General Counsel Robinson, Chief Investment Officer Berggren, Chief Compliance and Audit Officer Vacca, Interim Provost Pitts, Executive Vice Presidents Darling and Taylor, Interim Executive Vice President Brostrom, Senior Vice Presidents Dooley and Stobo, Vice Presidents Beckwith, Duckett, Lenz, and Sakaki, Chancellors Birgeneau, Block, Blumenthal, Desmond-Hellmann, Drake, Fox, Kang, Katehi, White, and Yang, and Recording Secretary Harms

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

**1. APPROVAL OF MINUTES OF PREVIOUS MEETING**

Upon motion duly made and seconded, the minutes of the meetings of February 4 and March 19, 2009 were approved.

**2. HEALTH SCIENCE AND SERVICES UPDATE**

Rady Children's Hospital/UC San Diego Medical Foundation Partnership

Vice President Stobo announced that the Rady Children's Hospital/UC San Diego Medical Foundation Partnership represents the culmination of eight years of work between the hospital and UC. Its purpose is to consolidate, coordinate, and integrate pediatric activities between the two entities. The activity creates a foundation that can provide support to pediatric physicians who will be employees of UC San Diego. Dr. Stobo informed the Regents that Thomas Jackiewicz, Associate Vice Chancellor and Chief Financial Officer at the San Diego campus, was present to answer questions about the affiliation and about the creation of the foundation.

Regent De La Peña asked if the contracts between the physician groups of Rady Hospital and the University had been signed. Mr. Jackiewicz responded that, to date, 76 of the 140 individuals in the pediatric group had signed employment contracts with the University. Regent De La Peña asked whether Rady Hospital or UC San Diego would determine the contracts to pay the physicians. Mr. Jackiewicz informed the Regents that the physicians would be paid by the University through the same process used for other faculty members in the health sciences. Their salaries would be subject to the health sciences compensation plan; their overall compensation would be determined by the chair and the dean.

Regent Zettel asked if the new physician employees had been made aware that they would be contributing to their pension plans starting in April. Mr. Jackiewicz said that they were informed about the increasing pension contributions and were amenable to them.

President Yudof requested clarification regarding the current structure of compensation for Rady Hospital's physicians and administrators. Mr. Jackiewicz explained that the hospital strives to place the physicians' compensation between the 50th and 60th percentile of the United Healthcare (UHC) benchmarks, essentially forming a combination of UHC and Association of American Medical Colleges benchmarks. For the pediatric group, the hospital will use a slightly different benchmark, with a long-term goal of reaching the 75th percentile. President Yudof stated that the hospital pays a base salary and then uses benchmarks in what is, in effect, a performance plan. Mr. Jackiewicz affirmed that is the case. The President asked if this policy was the norm for the healthcare industry in California and in the nation. Mr. Jackiewicz stated that it is considered standard practice and that the goal is to have much of the clinical compensation for physicians based on productivity. Twenty percent is the minimum, but Mr. Jackiewicz noted that the hospital would like it to be higher for those in the higher-paid specialties. President Yudof asked if the hospital would be competitive in the industry without incentives, and Mr. Jackiewicz stated that it absolutely would not be.

Regent Zettel inquired if quality-of-care issues are part of the incentive benchmarks, and how they are established. Mr. Jackiewicz explained that benchmarks are based on a blend of clinical productivity and other elements –such as education, research, and quality of care – as a way to measure a faculty member's overall performance.

#### Martin Luther King, Junior Hospital

Dr. Stobo reminded the Regents that the Martin Luther King Hospital (MLK) was closed in 2007. Eighteen months ago, the Governor requested that UC work with his office and with Los Angeles County to explore the possibility of reopening MLK. Dr. Stobo reported that the University has been working closely and collaboratively with both entities. In November, he hopes to come before the Regents with an item for action.

Dr. Stobo explained that, under the proposal currently under discussion, MLK would be reopened but would be downsized; instead of almost 500 beds, it would have 120 beds

and an emergency room, but no trauma unit. One seismically-compliant building would house the 120 beds and would be retrofitted to accommodate the inpatient beds and support services. The hospital would be governed by a new, private, not-for-profit company; this arrangement would provide the greatest level of financial protection to both Los Angeles County and to UC. The creation of a new company (NEWCO) would also prevent the disruption of the current flow of federal and State public moneys to other hospitals in the area. The NEWCO board would consist of seven members, two appointed by UC, two appointed by Los Angeles County, and three appointed jointly. Individuals on the board would be required to have a minimum of 10 years' experience in healthcare or a related area.

Dr. Stobo acknowledged that questions had been raised regarding the financial liability of UC and Los Angeles County under the NEWCO structure. Specifically, there were concerns that if NEWCO met with financial difficulties, either the County or the University might be held financially liable. The University's Office of the General Counsel reviewed the arrangement and concluded that the financial liability was minimal to nonexistent. Dr. Stobo pointed out that Regent De La Peña had asked to have that opinion independently verified; the Los Angeles firm McDermott Will & Emery did so, and determined that liability to both the County and the University is remote if all the proposed safeguards and conditions are enforced. Furthermore, it determined that there has been no case in California where a person with only the power of appointment for a not-for-profit corporation was held accountable for corporate liabilities.

NEWCO would be responsible for operating King Hospital, and would contract with UC for the provision of physician services, explained Dr. Stobo. The University anticipates that 10 to 12 full-time UC physicians would oversee the main inpatient medical services. NEWCO would have contracts with other physicians in the community, such as those at Harbor-UCLA Medical Center and at White Memorial Hospital, to provide other physician services. Physicians providing services at MLK would be credentialed by a committee on which UC would sit prominently. NEWCO would hire all other employees – nurses, technicians, and others – who would not be UC employees.

Dr. Stobo noted that Los Angeles County has already received approval from its Board of Supervisors to capitalize the project, including an obligation of approximately \$209 million to build and equip the inpatient facility, \$137 million to build a nearby ambulatory care facility, and \$80 million for an ancillary facility that would hold laboratories and imaging equipment. By virtue of the proposed memorandum of understanding, Los Angeles County would commit to provide \$50 million to help capitalize initial operations. The County would also commit approximately \$63 million to NEWCO on a yearly basis; this arrangement has been assumed in putting together the hospital's proposed business plan. Furthermore, Los Angeles County has agreed to a contingency plan in the form of a \$100 million letter of credit that would be available to NEWCO if the County defaulted on any of its operational payments.

Payments to the hospital would go from the County, to the State, and then to NEWCO, and would be made on a quarterly basis. An independent paying agent, who is neither a

UC nor a County employee, would oversee the transactions. Within 15 days after a payment is due and not paid, the paying agent would contact Los Angeles County to make sure that the payment was made. If the payment was not made, the County would have an additional 15 days – or a total of 30 days – to make that payment. If the payment was not made during that interval, the paying agent would contact the bank holding the letter of credit and authorize it to make the quarterly payment to the State. The State would then draw down on that letter of credit and make the payment to NEWCO.

Because this intergovernmental transfer of funds from the County to the State for provision of Medicaid services is eligible for a one-to-one match from the federal government, the \$100 million letter of credit actually would be worth \$200 million to NEWCO. The letter of credit would be in place for five years to allow NEWCO to commence operations and establish its own reserves. Functionally, said Dr. Stobo, it actually would last for six years because NEWCO could draw down funds in the fifth year that would carry into the sixth year. The University also has a commitment from the County to fund an \$8 million reserve that would be immediately available to NEWCO to fund the physician operations if a financial mishap were to occur.

Dr. Stobo observed that the State has indicated it would provide regulatory and legislative flexibility with regard to permits and licenses. It would work with NEWCO to provide cost-based out-patient payments for the Medicaid program. UC would play an important role in developing clinical protocols and quality indicators for physicians. It would have sole responsibility for establishing and overseeing educational programs in the facility. While there are no short-term plans to initiate such programs, the long-term goal is for MLK to serve as an important part of the University's educational programs for students, staff, and graduate fellows.

Dr. Stobo reiterated that the University appears to have no financial liability under the proposal and that it would not be required to put in any capital or operating funds. The letter of credit, valued at \$200 million, provides sufficient financial backing if Los Angeles County defaults on any of its payments. He pointed out that UC is a public trust, and must act in the best interests of society. Medical needs in South Los Angeles are enormous, and in Dr. Stobo's opinion, the University has a responsibility to do what it does very well, which is provide high-quality medical care, particularly to medically-underserved populations.

Committee Chair Lansing thanked Dr. Stobo for the extraordinary work that he and his team have done on this project over the past 18 months. She thanked the members of the Committee on Health Services for their help and questions, and thanked Regent Bass, Regent De La Peña, and Los Angeles County Supervisor Mark Ridley-Thomas for their collaborative participation. She acknowledged that the University is undergoing enormously difficult times, and that the Regents have a fiduciary responsibility to protect it. Committee Chair Lansing explained that the Regents must ensure that the MLK proposal is financially sound and that UC will not be forced later to abandon the community the hospital would serve because of financial issues.

Regent Blum stated that, although Dr. Stobo recently joined the Office of the President, he has quickly made a major difference in the way UC is approaching health services. He voiced his approval for making MLK operational as soon as possible, but also noted that his financial background and his experience with the University caused him to be skeptical. He reminded the Regents that UC had a compact with the State by which it was supposed to receive \$10,000 for each additional student it enrolled, and that the Compact had not been honored. He asked if the State has an obligation to ensure that MLK would always have adequate financial support. He also wondered what legal protection the University has if the State chooses to spend the County's money elsewhere. Dr. Stobo replied that UC had received an outside opinion confirming that the payments are eligible for federal match even if they come from a letter of credit. The State is obligated to ensure that those payments are matched and returned to NEWCO as part of a waiver with the Centers for Medicare and Medicaid Services (CMS). He further explained that if NEWCO draws down \$50 million on the letter of credit the first year, then \$50 million remains to provide for four years of operation.

Committee Chair Lansing asked if it would, in fact, be \$150 million because of the matching funds. Dr. Stobo clarified that the letter of credit would go down to \$50 million but that figure would actually be worth \$100 million to NEWCO.

Regent Zettel said that the University's association with MLK is a moral imperative because UC is a service institution in the public trust. However, she voiced concern regarding the hospital's previous reputation as a facility where standards of care were repeatedly violated. She asked what UC's responsibility would be regarding the quality of care. Dr. Stobo explained that the hospital had been overseen by the Board of Supervisors, a body that has tremendous knowledge, skill, and talent, but that is not best suited to hospital oversight. NEWCO's structure affords protection through the University's ability to appoint two directors and co-appoint an additional three directors. UC can make sure that those directors understand the importance of quality care. As part of the proposed memorandum of understanding with the County, UC has made it clear that it would take the lead in determining the clinical protocols that will govern physician behavior.

Regent Zettel thanked Regent Bass for her advocacy, and thanked Supervisor Ridley-Thomas for coming to the meeting.

Committee Chair Lansing underscored that the University will provide the needed clinical services and oversight and that the operating structure would be completely different than it had been previously.

Regent Island expressed his appreciation to Dr. Stobo for his effort, enthusiasm, and commitment to the public good. He also thanked the Office of the President and President Yudof for steering the project. He urged the Regents to bring the negotiations surrounding MLK to a rapid and successful conclusion. He noted that the creation of a letter of credit was resourceful, but wondered if it served as an incentive for default by turning \$100 million into \$200 million. Dr. Stobo explained that the money would go to

NEWCO, not to the County. Furthermore, if Los Angeles County defaults, it no longer would be in the partnership. He speculated that enormous pressure would likely be brought to bear on the Board of Supervisors if the County defaulted on its payments. Regent Island concurred, and stated that the non-monetary consequences should be considered.

Regent Island said that he hoped that the Board would address the proposal in a formal way soon. Committee Chair Lansing replied that she intends to bring it forward for action at the November meeting.

Regent Johnson echoed the accolades for Dr. Stobo and the MLK project. She asked if the hospital would operate as a for-profit entity. Dr. Stobo answered that it would be a not-for-profit facility. Regent Johnson then asked if the hospital fees would be comparable to those at other UC hospitals. Dr. Stobo replied that they would be market fees. The business plan for the hospital shows it having a small positive operating margin that will enable it to build up a reserve and recapitalize equipment. That margin is predicated on 50 percent of the patients having no insurance and 50 percent being on Medicaid. Dr. Stobo did not anticipate any change in the payer mix; MLK will still serve as a "safety net" hospital for its community. Even with that payer mix and market charges, it will still be financially successful if it is operated the way it should be. Regent Johnson referred back to Regent Zettel's concerns about the quality of service and observed that UC and NEWCO will run a fine hospital with great patient care. She stipulated that she would like periodic reports on the hospital.

Chairman Gould thanked Dr. Stobo and the County representatives for their hard work. He remarked that Los Angeles County has been a very good partner in trying to work through the University's issues and concerns and respond to them. He reviewed the circumstances behind the Regents' anxiety: the Board had just spent two days considering very regrettable actions, including mass layoffs, furloughs, and dramatic increases in student fees while trying to protect the quality of UC. Chairman Gould expressed his opinion that the University could not engage in new ventures or new partnerships unless the Regents are diligent in assuring themselves that UC is not exposed to risk. All of the Regents' questions are meant to ensure that, as fiduciaries for the University, they are not only serving a public purpose, but also protecting UC. He referred back to the letter of credit and offered that the Regents might want to have a mechanism to reassess the status of the hospital's reserves and operating balance sheet before the letter expires. Dr. Stobo agreed and said he would discuss it with William Fujioka, the CEO for Los Angeles County. He noted that a mid-point evaluation might provide for an extension of the letter of credit if NEWCO is not able to accumulate the reserves predicted. Regent Lansing agreed that would be a valuable modification to the proposal.

Regent De La Peña expressed appreciation for all the work everyone involved had contributed, and recalled Regent Blum's concerns about the hospital's reserves. He expressed his opinion that a hospital needs at least six months of reserves in the bank to be secure. He asked if it was possible for MLK to immediately draw down a portion of

the letter of credit, \$75 million to \$100 million, and hold that money in the bank as protection against the funding not being available when needed. Dr. Stobo said he would investigate that option, but reminded the Regents that the hospital will have \$8 million in cash on the day it opens and will also have \$20 million in a letter of credit from the County's own reserves. Regent De La Peña expressed doubt as to the sufficiency of that funding and reiterated that the University should determine if it can draw more funds from the bank letter of credit so that the Regents would feel more comfortable with the proposal.

Regent De La Peña expressed his belief that the hospital will need more than the proposed 10 to 12 UC physicians. He recognized that MLK would also be working with Harbor and White Memorial Hospitals, and remarked that if the University is able to lead the physician credentialing process for the hospital, that it will be able to control the quality of care in a very significant manner. He asked if resident physicians at MLK would be from the University of California or Drew Medical Center. Dr. Stobo indicated that discussion of resident physicians was premature at this point and would wait until the hospital was well-established.

Regent De La Peña followed up on earlier speculation that a private individual might be making a significant philanthropic donation to the development of the hospital. He asked if this was still a possibility. Dr. Stobo and Committee Chair Lansing confirmed that it was still a possibility. Regent Bass added that she was given to understand that the individual would be meeting in the next few weeks with Supervisor Ridley-Thomas.

Dr. Stobo mentioned that if the State is successful in renewing its Medicaid waiver, the State and CMS would be obligated to provide funding to the hospital. He stated that this funding would further protect the University financially. Regent De La Peña asked if that money would be received even if a budget had not been approved. Dr. Stobo replied that a budget delay likely would have consequences other than Medicaid payments, but that he would research the issue. Regent De La Peña underscored that the hospital needs significant reserves so that it can provide reliable care.

Regent Ruiz voiced his support of the partnership and complimented Dr. Stobo, Committee Chair Lansing, and the Los Angeles County Supervisors on the scope of the project and the speed of their work. He mentioned that issues are likely still to arise, but that he was confident that the partners would be able to work through them successfully. He stressed that NEWCO would need to be free from political strife. He urged the County Board of Supervisors to protect the University from such activity and, in so doing, protect the Los Angeles residents who will benefit from the hospital. He also discussed the financial viability of the project and asserted that the University could not afford any insecurity from a financial perspective. He asked Dr. Stobo if he had any thoughts as to who might serve as the UC representatives on the MLK board. Dr. Stobo informed Regent Ruiz that the board members could not be current officers or employees either of Los Angeles County or of the University and would need to have at least ten years experience in healthcare or a related area. He stated that the University has begun identifying individuals who would meet those criteria. Regent Ruiz asked how the

Regents would be kept informed about the hospital. Dr. Stobo answered that the hospital should establish a regular mechanism to report to the Regents. He pledged to develop a proposal to share with President Yudof and Committee Chair Lansing and then with the Board.

Regent Marcus emphasized that the Regents are in the midst of the most drastic budget reduction in the history of the University and that they are dealing with complex issues on an across-the-board basis. He expressed concern that they were considering involvement in another complex institution with a partner that might not be fiscally sound. He stated that UC should avoid a situation that might result in a dispute with the County of Los Angeles, and that despite assurances to the contrary, the University might be held responsible financially if the hospital actually does not operate as planned. He acknowledged that the situation in Los Angeles is heart-wrenching and has tremendous emotional appeal. However, he stated, MLK should remain a county hospital. He offered that the University could provide consultation and physicians, but that it should not become engaged in another complex organization that could have unintended consequences. He asserted that there must be another means to revive the hospital without involving UC as a principal partner. Dr. Stobo responded that the University would have no fiscal liability in the project, but could not safeguard against political liability. Regent Marcus argued that the University would still have financial liability, especially since the letter of credit would not extend beyond five years. Furthermore, drawing on a letter of credit can quickly result in a legal dispute. He urged the Regents not to proceed with the partnership.

Regent Varner thanked Dr. Stobo, Committee Chair Lansing, and Regent De La Peña for bringing this extraordinary public service opportunity to the University. He asked if the capital expenditures for the project already had been committed. Dr. Stobo confirmed that the Los Angeles County Board of Supervisors authorized the capital expenditures for the hospital, the ancillary building, and the outpatient building.

Regent-designate Hime noted that he was pleased that the Regents consider public service as a valid part of their decision-making process.

Regent Kozberg thanked those involved for working to balance the Regents' public service and fiduciary roles. She was pleased with the contingency planning, and noted that the University is already serving as a county hospital in many locations. She asked Dr. Stobo why there would not be a trauma facility at the hospital and where the nearest trauma unit would be. Dr. Stobo said there were approximately five trauma centers within appropriate distances from MLK. He noted that a trauma center was too great of an expense for the hospital to consider at this time, but that it might do so several years from now. He agreed that UC has successfully run county hospitals, and that the planning for MLK considered experience with the three UC hospitals that had been previously county-operated.

Regent Makarechian expressed his support for the project and asked if it would be possible to get a multi-year commitment for the \$63 million from the County. Dr. Stobo

explained that this idea was the impetus behind the letter of credit. Regent Makarechian clarified that the \$63 million is for operating expenses and asked how the billable amounts were calculated since the hospital anticipates that half of its patients will not have health insurance. Dr. Stobo noted that those patients are not billed, but they are covered by an indigent care fund that is part of the Medicaid waiver. He offered to send Regent Makarechian a copy of the hospital's business plan, which incorporates several different scenarios in terms of costs and billable amounts.

Regent Bass clarified that an earlier reference made to the Compact between UC and the Legislature should have described the Governor as the other partner, not the Legislature.

Regent Kieffer observed that he hoped the County Board of Supervisors understands the caution the University is exhibiting in analyzing the proposal. He remarked that a second letter of credit should be considered. Nevertheless, he expressed pride that UC would seriously undertake this kind of public service role in the State.

Regent Garamendi stated that MLK is an extremely important program for the community of Los Angeles, and that numerous risks are involved for both the University and the County, but they are being addressed. He asked if the University would be able to leave the partnership if the County does not meet its financial obligations to the hospital. Dr. Stobo affirmed that a default on payment would automatically trigger UC's ability to walk away from the project. Regent Garamendi said that condition needed to be extremely clear because the University would be seen as undertaking a moral obligation and would be perceived as being a major partner in operating the hospital. Dr. Stobo assured the Regents that there is no contractual obligation for UC to continue if the County defaults on a payment. Regent Garamendi then mentioned the federal Medicaid waiver, which is renewed periodically and is historically contentious. Dr. Stobo informed him that his team is working on the waiver now and the renewal will take place in September 2010. He noted that the current environment of healthcare reform bodes well for renewal of the waiver. In addition, he said that MLK would not be adversely affected by healthcare reform, and is less dependent on federal money than the other ten hospitals UC has at its five medical centers.

Regent Garamendi noted that Regent Bass had just returned from Washington, D.C., and had learned that if the State's federal match under the Medicaid program rises by only a few percentage points, billions of additional dollars would come to the State of California.

Committee Chair Lansing emphasized that the team is very aware of the moral imperatives associated with the hospital and is strenuously trying to design a framework that is fiscally sound and that will allow the University to maintain the partnership.

Regent Pattiz expressed concern that UC hospitals have a reputation as world-class facilities that attract talented administrators, doctors, and researchers, and that MLK might not meet that standard of quality. Committee Chair Lansing responded that the team expects MLK to be an excellent hospital, which is why UC would be involved in

appointing the board, in oversight, and in providing physicians. Regent Pattiz observed that the healthcare professions are very competitive, and robust hospitals routinely make efforts to recruit UC staff. He wanted to ensure that the personnel at MLK would be comparable to those at other UC hospitals. Dr. Stobo said that was the intention of the team.

Faculty Representative Powell expressed his admiration for Dr. Stobo's work on the MLK project, and commented on the historic relationship between county hospitals and UC. As an example, he cited the county hospital in San Diego, which was purchased by the University but which still has effective mechanisms to secure financial support from the county. He expressed confidence that MLK will provide a good opportunity for service to the community, for teaching, and for high-quality health care.

Regent Island voiced his respect for Regent Marcus' business acumen, and noted that Regent Marcus was right to highlight the risk of this transaction. He acknowledged that risks are involved in business ventures with political bodies, but it is an obligation of land-grant institutions to participate in the larger challenges facing society. He observed that the University employs very intelligent and dedicated people who can quantify and manage risk. He offered his support for Dr. Stobo's plan and urged the Regents to refrain from attempting to negotiate for Dr. Stobo. He noted that it is fair for the Board to comment and offer opinions to Dr. Stobo; however, he cautioned that the Regents should not interfere with Dr. Stobo's authority to negotiate the best arrangement that he can. He reminded the Regents that the University has borne risks in other transactions and that it has managed them well.

Committee Chair Lansing thanked Supervisor Ridley-Thomas for attending the meeting and for the County's commitment. She also thanked Regent Bass for her strong support and Dr. Stobo and his team for their leadership. Finally, she thanked all of the Regents for their engagement, empathy, and intelligent questions throughout the process.

The meeting adjourned at 11:15 a.m.

Attest:

Secretary and Chief of Staff