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UCSF/STANFORD MERGER

**President Richard C. Atkinson
Regents' Meeting
November 13, 1996**

Members of the Board:

Today we will continue our discussion of the proposed UCSF-Stanford merger of clinical services. I would like to begin with a few remarks about my views of this proposal.

The Board has had many discussions about the revolution in the health-care marketplace and the profound implications for academic medical centers. The University of California operates its five medical centers in increasingly complex and unique markets. Each campus must develop a strategic direction that responds to its marketplace. Any such plan must provide the critical foundation to our mission of educating students, pursuing research, and providing patient care and public service.

Over the past 30 years, the University of California, San Francisco has compiled an enviable record of achievement in biomedical research, medical education, and patient care. Much of this achievement has flowed from

strategic decisions taken by the campus leadership in the late 1960s and early 1970s to build such a national resource.

Today UCSF faces another strategic decision about its future. It has pursued virtually every avenue of managerial change to adapt to its environment, including reducing tens of millions of dollars in cost. To sustain this extraordinarily productive enterprise through the next 20 to 30 years, we must decide how we will summon the resources necessary to counter the financial pressures created by a health-care financing system in turmoil. I am convinced that, strong as UCSF is, it *must* join with another regional partner to compete successfully in the health-care marketplace.

UCSF is fortunate to have within 40 miles of its campus a world-class academic medical center with the same mission and with shared needs. The union of UCSF and Stanford clinical activities has the potential to enrich the teaching and research programs of the two universities, to create extraordinary opportunities to move research discoveries to the bedside, and to provide a stronger financial underpinning for the clinical enterprise.

us leadership is committed to the success of this endeavor.
review conducted by Mr. Hellman and his team has validated
the business plan for the proposed merger.

can that every question has been answered or every
olved. We cannot answer the lingering questions about the
merger on our employees until the new corporation develops its
compensation systems. We cannot definitively answer potential
the reactions of regulatory agencies and the courts until we
selves.

strongly support the proposed merger. I have asked the Chair
d the Chairs of the Committees on Health Services and
with me and my office as an oversight group, to guide this
ship and to ensure its success.

time in the life of every enterprise when it must go out and
s future, instead of waiting for the future to happen. That is
nds itself today. There are uncertainties and risks in the
eed. But a decision *not* to proceed involves far greater

uncertainties and risks. I believe the right course is to go forward with the proposed merger, and to go forward now.

Mr. Chairman, I am pleased to recognize Mr. Warren Hellman, who will offer comments to supplement the report he made during last Friday's meeting of the Board. Following Mr. Hellman's remarks, Vice President Gurtner will provide an overview of the agenda today and ask UCSF Chancellor Martin, Dean of Medicine Debas, and Medical Center Director Kerr to comment on the items before the Board.

CHANCELLOR JOSEPH B. MARTIN, M.D., PH.D.

A century ago, a distinguished psychologist named Edward Titchener decided that it would be interesting to know how many sensations human beings could feel. After several years of analysis and lots of counting he finally settled on a figure of 45,000.

Those of us involved in these merger discussions with Stanford for the last 18 months now know that Titchener was very wrong. 45,000 sensations are an underestimate of the ups and downs that we all have felt and lived through since we began this journey.

But I am not here today to discuss our feelings as much as our future. Indeed, it was during a casual walk with Stanford President Gerhard Casper in the Spring of 1995 that this journey to the future began. As we talked informally, we both realized that we were worried about the same trends that were threatening our ability to serve the public. Health care reform had failed; federal funding for medical education was under attack and managed care was corroding the long-term prospects of our medical center budgets.

Continuing our conversation, we realized too, that there was no stopping the convergence of these political and market forces; a revolution truly was under way. But rather than merely react to these forces as we both had been doing, we took actions to master them so that we could preserve and expand our historical strengths in education, research and advanced medical care.

As you all know, we moved gradually from the philosophical to the general and then to the practical over a period of many months. In time, we widened the circle of participants to include the deans in the two schools of medicine, Haile Debas of UCSF and Eugene Bauer of Stanford; the medical center directors, Bill Kerr and Peter Van Etten and the chairs of our respective

pediatric and medicine departments, Larry Shapiro and Harvey Cohen in pediatrics and Lee Goldman and Victor Dzau in medicine, plus dozens of faculty and staff from both institutions. Our goal was to consider how we might collaborate and put forward the groundwork for how such a collaboration would take shape.

We quickly realized that UCSF and Stanford have far more in common than our friendly rivalry allowed us to believe.

We are both healthy and vigorous health science institutions.

We both are considered, and rightly so, centers of medical excellence with flourishing programs in virtually every clinical area.

Our schools of medicine are among the top-ranked nationally and our graduates among the most sought after, be it for an inner-city clinic or academic positions nationwide.

Patients at UCSF and Stanford also expect both of us to offer the latest and best in everything from primary care to cancer care.

But perhaps the biggest surprise was the common belief that we could do our most astonishing and beneficial work if we combined forces. Such combinations are not new of course; they happen constantly in the business world. But for UCSF and Stanford, institutions that developed so differently, to become partners on behalf of all Californians was an idea as powerful and revolutionary as the very forces that first brought us together. And that is why we feel so strongly that this partnership is the right choice at the right time. Simply put, with all that is arrayed against us, we will be better able to ensure superior medical education and advanced medical care together than apart. We can't turn back the clock; we can't wish the problems away. We

can only deal with today's reality and strive to guarantee tomorrow's promise. That is what the public expects and what we, as leaders, must achieve.

I like now to turn to Dean Haile Debas who will emphasize for you the important academic aspects of this proposal and then to Bill Kerr who will respond to some of the questions and issues that have surfaced.

Dean Haile T. Debas
Dean, UC San Francisco School of Medicine

Address to the Regents
November 13, 1996

Once again my colleagues and I stand before you to express our profound concern for the future of our Medical Center, to articulate a vision, and to suggest a plan to secure that future. After more than a year of focused discussions, we have proposed the clinical merger with Stanford. Like you, I am exceedingly sorry that Chancellor Martin will not be here to shepherd and guide the merger in its early years. We, his colleagues at UCSF, fully understand his desire to return to those elements of academic life that are near and dear to all of us: the students, the faculty, the curriculum and research and we wish him well. Although fashioning this merger cannot depend upon one individual, the departure of such a key person may provoke anxiety about the future of the process. Therefore, I would like to reiterate my belief in the importance of this merger and to reaffirm my commitment to the deanship for the next several years. I make this commitment to ensure the continuity of leadership that will serve you, The Regents; the president; and the UCSF faculty and students.

I am also here to tell you that the department chairs and organized research unit directors have voted unanimously and enthusiastically to support the merger and to express their confidence in the UCSF leadership. Dr. William Wara, Chair of the UCSF Academic Senate has appeared before you to express Senate support for the merger. I have met with the Academic Senate Merger Task Force and responded to their queries. Together we can ensure that any ongoing concerns are appropriately addressed, and that the faculty will have a role in the selection of the UCSF faculty representative to the Board of UCSF-Stanford Health Care.

In the endless debate and preoccupation with the business plan of the merger, we have lost sight of our original motivation. It is worth reminding ourselves that we pursued this opportunity with Stanford to stabilize the business

side of academic health care so that the educational mission of the medical schools would be preserved and enhanced. Now that the validity of the business plan that was developed by Ernst and Young has been reaffirmed by a Third Party Review group, which is sterling in its composition, I shall not dwell on this. Rather, I want to talk about the exciting educational, scientific and clinical opportunities that this merger provides.

We are fortunate in our geography to have another world-class institution of higher education to partner with. Medical schools across the country are being forced into much less attractive partnerships in order to survive. With Stanford, our students and residents will be assured of rich clinical training into the future. The people of Northern California will continue to have access to world-class, cutting-edge clinical care. I know you will all agree it is infinitely better and wiser to take control of our destiny while we can and with a like-minded partner than to succumb to a for-profit entity for whom the University name is merely a marketing tool.

As Dean of the School of Medicine my primary concerns are the medical students, the faculty, and our patients. The availability of patients is an absolute requirement for teaching. Because we are already having difficulty providing all the clinical rotations third and fourth year students need to develop their clinical skills, must increase the size of the patient population in our hospitals and clinics. I believe our chances to do this are greater with UCSF-Stanford Health Care than by cobbling together a patchwork of alliances.

The quality of students, residents and faculty reflect and inform the quality of the institution. Our success in recruiting these individuals is critically dependent on the quality and size of our clinical services. Again, I believe that the creation of UCSF-Stanford Health Care provides us with the best opportunity as we go into the future to recruit and retain the best faculty, residents, fellows and students.

To maintain leadership in healthcare we have to develop and sustain the very best clinical programs. Both UCSF and Stanford already have some of the leading clinical services in Northern California. The Third Party Review Report indicated that each of us has market leadership in six diagnostic groups. What is really

fascinating though is that the merger provides a synergy that gives us market leadership in not twelve, but twenty services!

We would be shortsighted if we restricted the vision of excellence and leadership inherent in this merger to Northern California. The merger of these two premiere institutions will enable us to develop world-class programs. An example would be the Comprehensive Cancer Center of Northern California. If you bring together the outstanding talent in cancer that exists in the two campuses, you will have the potential to develop the best Cancer Center in the country. This is not idle wishing: it is a palpable and exciting possibility. It has captured the imagination of not only our own faculties, but also that of many people in the field, both in this country and abroad.

One of the most disturbing health issues at the moment is the rapid rise of childhood respiratory illness. Neither UCSF nor Stanford alone have the resources to develop the necessary Pediatric Pulmonary Services, nor are such services available anywhere in Northern California. We believe we can develop such a program jointly after the merger. Indeed, the pediatric faculty at both universities see this as only one of many premiere clinical areas they can develop.

It is the discussion of such magnificent opportunities as these that has been missing from our deliberations. One might have thought we were merging Chrysler and General Motors instead of these two extraordinary institutions of health care and education.

In several clinical disciplines we have complementary strengths: this is true in Cardiac Surgery, Neurosurgery, Transplantation, Neurology, Urology, Pathology and several of the divisions of the Department of Medicine. Bringing the highly talented faculty in these mutually complementing programs is surely a very important strategy.

UCSF-Stanford Health Care will have a single information system -- a crucial and necessary tool for conducting clinical research. With this tool and the combined patient population of the two institutions the opportunity for clinical research is unparalleled. This is important for research and training, but it will also give the enterprise a competitive advantage in the health care marketplace.

In the future, the way academic medical centers will distinguish themselves from community hospitals is by providing cutting-edge, sometimes experimental, therapies that are the result of translational research. Although this merger involves only the hospitals, clinics, and clinical services, we all recognize that Stanford and UCSF have two of the leading basic science communities in the country. Together, our basic and clinical science faculties will provide the necessary impetus to assume leadership in translational research. Hence, we will have a strength unique in the country to bring exciting basic science discoveries to the bedside to benefit patients.

I will now conclude. I have told you of my own enthusiasm and commitment and of the unanimous support of all the UCSF School of Medicine department chairs for the merger. I have tried to emphasize the big vision and the unique academic advantages. The greatest resource a medical school has is its faculty. The recruitment and retention of the best faculty is what attracts the best students, residents and fellows. Strong clinical programs are the underpinning of great medical schools and the merger of the hospital business will help preserve the excellence of the UCSF School of Medicine, which will remain, as it is now, one of the brightest jewels in the crown of the University of California.

WILLIAM B. KERR, DIRECTOR, UCSF MEDICAL CENTER

**UCSF/STANFORD HEALTH CARE
PRESENTATION TO THE BOARD OF REGENTS**

November 13, 1996

Last November we appeared before this Board and proposed to explore the feasibility and benefits of merging our clinical enterprise with that of Stanford University. With your support we began a year long journey of in-depth analysis. We are now at a critical juncture. The decision you make today will determine the future of UCSF's clinical and academic programs for decades to come.

Dean Debas and some of the public speakers earlier have highlighted the exciting educational opportunities that will result from the proposed merger. Our business analysis, followed by extensive third party review, has confirmed the financial and programmatic benefits of moving forward. The University of California is deeply indebted to Warren Hellman and his review team colleagues for their thorough, objective analysis.

By this point the Board should have a full appreciation for both the benefits and the risks associated with the proposed merger. I am less confident that you appreciate the consequences of maintaining the status quo.

Let me remind you of the very significant financial challenges that we expect to face before the year 2000:

- The northern California market will exact major price and cost reductions from academic medical centers. Over the last three years, northern California employers have markedly cut back their premium payments for health care. The direct impact on academic medical centers has been delayed as community medical groups and hospitals took the initial brunt of reductions in their capitated HMO payments. Capitated medical groups and HMOs are now demanding comparable price reductions for referral services.

- Medi-Cal managed care will soon significantly reduce UCSF's already inadequate Medi-Cal revenues. Beginning in January, the San Francisco Medi-Cal managed care plan is expected to cut payments for care of the local AFDC population by 28%. Last fiscal year, Medi-Cal paid UCSF \$52 million less than the cost of care for its patients. I am scheduled to meet with the California Medical Assistance Commission on December 3rd to seek an increase in our Medi-Cal hospital contract rate which would offset some portion of that gap. But it is clear that under the best circumstances we will continue to carry a deficit from the Medi-Cal program of \$40-50 million.
- What of Medicare? When Congress reconvenes early next year, we must expect a vigorous bi-partisan effort to address the projected trust fund deficit. Earlier Medicare budget discussions targeted teaching hospitals to carry a disproportionate share of any reimbursement reductions. For UCSF \$40 million dollars in direct and indirect medical education support is at risk each year.

As our own financials indicate -- and the third party review reaffirms -- UCSF does not have the operating margin to offset these major losses of revenues. Nor do we have the reserves to wait out a few bad years in hopes that the entire financing environment becomes more rational.

UCSF alone cannot "grow" its way out of its future financial problems by bringing in new volume. We are actively pursuing a series of marketing and contracting strategies -- including the creation of the new Brown & Toland Medical Group with California Pacific. But even with growth in admissions last year, we still could not avoid the need for major cost reductions. Furthermore, any growth that UCSF could achieve on its own is likely to be less than UCSF and Stanford could achieve jointly. As the Hellman report indicates, acting alone UCSF and Stanford are the market leaders in 6 clinical services lines each. Coming together we would lead 20 out of 26 categories.

If growth as a standalone is not the answer, what about cost reductions? We cannot manage our way out of financial difficulties simply through more

internal cost reductions. Mr. Hellman's report noted that we are already a lower cost provider than comparable teaching hospitals. We have maintained this position through vigorous expense control which has cut \$52 million in expenses over the last four years. To date, we have been able to avoid reductions that would degrade basic services or significantly affect bedside care. We no longer have any buffer against the major revenue losses that could well occur over the next several years. UCSF takes care of very sick patients, and all of us -- from the hospital director to the nurses on the floor -- worry about the consequences of future actions by the government and private payors to reduce their financial responsibility for the care that we provide.

In contrast, the proposed merger would allow us to achieve tens of million of dollars in savings through infrastructure and management reductions -- not reductions in bedside care. It would also position us to serve a larger portion of the market, thereby offsetting the staff reductions in support areas by a growth in direct care-givers.

If UCSF and Stanford remain separate, we must expect the academic medical center arms race to continue. We will duplicate investments in costly medical technology and information systems. We will also continue to try to outbid each other for highly qualified faculty essential to the success of our individual clinical programs.

In my opinion, failure to pursue this merger will not only place UCSF in greater financial jeopardy, but it will also forego an opportunity to rationalize the distribution of high cost, cutting-edge technology. As partners we can collaborate, avoid unnecessary duplication, reduce capital expenditures, and far better serve the public's interest. Our preliminary discussions with respect to cancer services and pediatric programs confirm both the academic and clinical benefits of such a partnership.

This afternoon's deliberations will focus on the governance and capitalization of the merged clinical enterprises and you will have an opportunity to review the means by which this Board can be assured that the merged entity continues to support the academic mission. I trust you will

conclude, as has the campus leadership and the Office of the President, that the proposed merger is in the long run best interest of the University. But I also hope you recognize that it is far more than a simple adaptation to health care market forces. The merger of these two outstanding clinical enterprises presents an opportunity for unparalleled accomplishment in education, research and patient care.

For the past few months many have referred to UCSF as the crown jewel in the University system. Having had the privilege of serving as the Medical Center Director for the past nineteen years I obviously take great pride in such comments. But I have also tried to familiarize this Board with the relative fragility of our circumstance. Do not be blinded by the luster of our past performance. We are at risk, and maintaining the status quo will inevitably lead to our decline from the ranks of the nation's most highly regarded institutions. I firmly believe that this merger is the only way to sustain our preeminence in academic medicine. The citizens of California deserve no less, and I therefore urge your approval of today's action item.