Office of the President
May 8, 1996

TO MEMBERS OF THE COMMITTEE ON HEALTH SERVICES:

ITEM FOR DISCUSSION

For Meeting of May 15, 1996

UCSF AND STANFORD MERGER OF CLINICAL ACTIVITIES: CREATION OF "NEWCO" CORPORATION

In June 1996, the San Francisco campus expects to propose for The Regents' approval the major terms from a series of agreements designed to merge UCSF Medical Center, UCSF/Mount Zion, Langley Porter Psychiatric Hospital and Clinic, Stanford University Hospital, Lucile Salter Packard Children's Hospital at Stanford, and the clinical practices of the full-time faculty of the UCSF School of Medicine and the Stanford Medical School. This discussion item provides background on the rationale for such a merger, describes the new corporation (hereafter referred to as "NEWCO"), and outlines many of the issues that await resolution.

Rationale behind the Proposed Merger

Threats to the Academic Medical Center Numerous presentations to The Regents over the last several years have demonstrated that academic medical centers are imperiled by economic competition in their local markets and by significant reductions in support for medical education programs. In northern California, purchasers of insurance such as the Pacific Business Group on Health and Cal PERS have decreased employer funding of health insurance premiums by almost 20% over the past three years. Health plans have passed the risk of lower premiums on to physician groups and hospitals through lowered capitation payments. State and federal budget plans include drastic reductions in Medicare and Medi-Cal funding, with disproportionate cuts in the special payments that teaching hospitals receive. Medi-Cal managed care will shrink the dollars available to providers by 20% from historical levels that barely cover variable costs. To cope with these economic trends and the need to operate more efficiently, northern California hospitals and physicians are consolidating into systems to reduce administrative and practice costs, to assume greater risk for providing cost-effective care for enrolled populations, and to create access to capital to fund future information systems, facilities, and equipment needs.

Over the past several years, UCSF has independently pursued a series of clinical strategies to improve its competitiveness, including: (1) developing common and responsive decision-making for a clinical enterprise that encompasses the Medical Center, the Medical Group, and the School of Medicine; (2) developing stronger referral relationships with regional healthcare systems, such as Sutter Health and Kaiser Permanente; (3) creating a primary care network, including community physicians at UCSF/Mount Zion, to improve access to UCSF specialists and facilities under managed care; (4) developing internal delivery systems to manage centers, are being subjected to resource reductions and reorganization efforts that are outside of the control of their affiliated medical schools. State and federal support for indigent care are also waning, and, in turn, threatening county hospitals that provide educational and research opportunities for University of California students and residents.

The proposed merger of the clinical enterprises of UCSF and Stanford University offers the best hope to insure the future success of these two schools of medicine, and the preservation of their core functions of education, research, and clinical care. As the demographics of physician specialization change, forcing students and graduates into a narrow array of choices, this merger will stabilize training programs at both universities by maintaining the critical mass of students and faculty necessary for excellence. The merger will also offer a platform for innovation in future training.

As the healthcare marketplace becomes more demanding, resources that can be applied to innovation, a cardinal feature of the AMC, will be its pursuit of new knowledge and its translation to practical clinical uses. The opportunity for productive, innovative interactions between the new clinical enterprise and the pharmaceutical and biotechnology industries is substantial, and the merger of two strong academic institutions will open doors for further collaborations in basic research between the two schools of medicine. The shared culture of the two institutions, which has traditionally reinvested substantial portions of clinically-derived revenues into the basic and clinical science departments, will insure continued academic pre-eminence of the two schools.

The proposed UCSF/Stanford clinical merger, therefore, will be important in preserving, enhancing, and advancing all components of the academic missions of the two institutions:

Financial Support of the Academic Mission Both medical schools are dependent on financial support from their respective clinical enterprises. Funds generated from the clinical enterprise are used to provide faculty salary support and to underwrite several aspects of the academic mission. Funds generated from clinical practice support 50% of the salaries of the UCSF faculty. Clinical dollars are also used for the recruitment of new faculty; for office and laboratory renovations; as seed money for new educational or research programs; to provide bridge funding to faculty who sustain a hiatus of research funding between funding cycles; in support of students; and to bring renowned lecturers to campus, among others. The deans also use clinical dollars to support the basic science departments. For the first time, the two AMCs are experiencing a decline in their bottom-line financial performance. Thus, their ability to support the academic mission of the medical schools is threatened.

Faculty Recruitment and Retention Both UCSF and Stanford are fortunate to have outstanding teachers and clinicians in their clinical departments. Their ability to recruit and retain such faculty is critically dependent on the breadth and quality of clinical practice. Thus, the protection and expansion of quality clinical practice is a key positions. As these national trends increase, the newly merged clinical enterprise will be in the best position to plan rationally and implement practically the necessary downsizing of specialty training programs.

Another opportunity the proposed merger creates is an expanded opportunity for housestaff rotations, even in the instances in which residency programs are not merged. In this way, the strengths of the programs at both sites will be exploited to maximal advantage.

Yet another advantage of the merger is the opportunity to create new training programs that were recognized as being highly desirable by each university, but were never started because the critical mass of faculty and other resources did not exist at the individual sites. An example of this is the pediatric pulmonary programs. Childhood respiratory diseases, including the recent alarming growth rate in the incidence of childhood asthma, create a strong need to develop a training program in this area. The merger will now allow for this to happen.

Research The merger of these two outstanding academic medical centers and the integration of their faculty clinical practices creates an unprecedented opportunity for research, both clinical and basic science.

Three critical factors created by the merger will significantly advance clinical research beyond what could be achieved by each academic medical center on its own. These factors include an increased patient population base, a single information system, and integrated faculty clinical services. The possibility for creating a world-class center for clinical research exists. Systematized data acquisition will characterize the delivery of health care making continuous quality improvement and outcome studies possible. Translational research, bringing the advances of basic research to the bedside to deliver highly innovative therapies, will be a major goal of the merged clinical entity, and in this way, it will distinguish itself from community hospitals. The advances in human genetics, for example, are rapidly leading to the understanding of single and multi-gene diseases and soon definitive therapies will be available.

Because the two medical schools and their basic science departments will not be merged, the impact of the clinical merger on basic science research will not be as direct. Nevertheless, the merger creates opportunities for the basic science departments to collaborate in the acquisition of expensive equipment and facilities they require for cutting-edge research. Examples include the very expensive pieces of equipment required in Structural Biology and the increasingly costly transgenic animal facilities. In both campuses, the need of investigators for transgenic animals has increased beyond what each campus can supply. The cost of transgenic animals is one of the largest items of many research budgets. Yet, transgenic technology is the scientific advance that is creating incredible opportunities for translational research.

NEWCO would be responsible for the programs, operations, and finances of its clinical services, including the support services necessary to operate them.

Because NEWCO must create its own personnel and compensation system, it would establish its own human resources and payroll administration functions. NEWCO is also expected to create its own in-house finance department, including accounting services that UCSF currently purchases from the campus and treasury services provided by the Treasurer's Office. NEWCO might purchase other support services, from security and building services to the public information service, from either or both universities if they deliver the most cost-effective services.

The overall impact of NEWCO on existing UCSF campus services cannot be determined fully until the new NEWCO management evaluates its support service needs. Currently UCSF Medical Center purchases $22.0 million in services from the campus and $0.7 million (excluding insurance costs) from the Office of General Counsel and the Office of the President. Medical Center payments for the subset of human resource, payroll, and accounting services now total $2.3 million annually.

<u>Next Steps</u> UCSF and Stanford have each scheduled a series of conferences to present the proposed plan for NEWCO to various important constituencies. The UCSF Medical Center Director and Dean of the UCSF School of Medicine are taking the lead in briefing members of the State Department of Finance, Department of Health Services, key legislators, and their staff. The academic leaders and UCSF have scheduled a series of meeting with the clinical chairs, culminating in a June retreat. Both UCSF and Stanford have held town meetings to brief interested faculty and staff.