

Office of the President  
June 12, 1996

TO MEMBERS OF THE COMMITTEE ON HEALTH SERVICES AND COMMITTEE  
ON FINANCE:

**ITEM FOR DISCUSSION**

For Meeting of June 20, 1996

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

**OVERVIEW:**

The following discussion has been prepared in response to concerns stated and questions asked during the meetings of the Committee of the Whole and the Committee on Health Services on May 15, 1996 and subsequent to that date. The categories addressed are: Public Comment Period Concerns, Regental Concerns, Student Concerns.

**I. CONCERNS EXPRESSED DURING MAY PUBLIC COMMENT PERIOD**

**1. Can the University's medical centers really be bought and sold? Is it legal to make a gift of public funds? Is there a conflict of interest? Is NEWCO consistent with the University's mission? California's taxpayers have a right to retain their enterprise.**

Under Article IX, section 9, of the State Constitution, The Regents is vested with the legal title and the management and disposition of the property of the University and of property held for its benefit and has full powers of organization and government, including the authority to convey assets to a nonprofit organization as part of the contemplated merger. There will be no gift of public funds as the assets will be dedicated to the support of the University's education, research, and charitable mission. Therefore, the people of the State of California will continue to benefit directly from the activities of NEWCO. In the event NEWCO is dissolved, ownership of NEWCO's assets would be transferred to The Regents and the Stanford Trustees in accordance with a mutually agreed distribution plan. The transaction will be structured to avoid any potential conflict of interest.

**2. Employees have not been included in the planning. The nursing staff and employee organizations have been denied access to information. The public has been given insufficient information.**

UCSF has solicited the views of employees both in the town meeting and in the campus' publications on this matter. However, at this stage the University is still in the process of analyzing the interest of the employees, and we are consulting with the other parties to the transaction and within the University regarding how the employees' interests will be served by this transaction. Once that initial analysis is completed, the University will go to the

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employees and consult with them and their unions. However, at this time wide-spread consultation is premature.

To the extent that employee organizations have sought records which are public, they are in the process of being provided. In addition, Systemwide Labor Relations has met with the various unions to provide information and updates on the potential merger. Should there be a firm proposal to enter into a merger, the University will fulfill all of its obligations under collective bargaining agreements, policy, and applicable laws and regulations. Moreover, the University has consulted with members of the Legislature and with City and County of San Francisco officials regarding the proposed merger.

In addition, public discussion of some aspects of the proposed merger is precluded by the terms of a confidentiality agreement executed by the parties earlier this year. As part of the merger discussions, the parties need to exchange sensitive, nonpublic information regarding financial and other matters. The confidentiality agreement ensures this information will remain confidential.

Attached is some of the information disseminated to the public regarding the proposed merger.

**3. Has the merger been discussed with the Mayor and legislators?**

The UCSF Chancellor and Director of UCSF Medical Center met in early May with Mayor Brown. Representatives from the campus, the Office of the President, and the General Counsel's Office have also met with legislators, including chairs of committees responsible for health and finance matters.

**4. Who is writing the business plan for NEWCO?**

The senior managers of UCSF Medical Center and Stanford Health Services, working with a consultant, have developed the business analysis that outlines the major economic benefits of NEWCO.

**5. Will research efforts be jeopardized? San Francisco General Hospital provides the University with research space such as for the AIDS Research Institute. Would that be lost? Would the research mission be affected adversely by the elimination of duplication, resulting in a loss of federal grant money?**

The Dean of the UCSF School of Medicine has made the following statement on the opportunities for research posed by the proposed merger:

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.

The combined intellectual power and creativity of the two faculties creates unprecedented opportunities for productive and innovative interactions with the pharmaceutical and biotechnology industries. It is likely that this benefit will prove to be one of the most important and rewarding by-products of the merger.

UCSF research efforts will not be jeopardized by the merger of clinical facilities. Research programs are currently the responsibility of the School of Medicine and will remain so after the merger. Research space at San Francisco General Hospital will not be affected by the merger. Since the research programs are activities of the School of Medicine, elimination of clinical duplication will not adversely affect the research mission or result in loss of federal grant money.

#### **6. How will the high quality of care be maintained?**

The medical staffs of the four licensed hospitals will continue to be responsible for their medical quality assurance functions. Increased collaboration between the faculty physicians in San Francisco and Palo Alto should encourage the sharing of best clinical practices. Nurses at both sites will also have an opportunity to develop collaborative quality assurance functions for nursing.

**7. San Francisco County has no real county hospital. What will be the effect on public health in San Francisco?**

The City and County of San Francisco owns and operates San Francisco General Hospital (SFGH). The formation of NEWCO has no effect upon the UCSF School of Medicine's century-long agreement to provide professional services at SFGH through its faculty and house staff. The formation of NEWCO will contribute to the public health of San Francisco by improving the long-term viability of UCSF Medical Center and UCSF/Mount Zion. San Franciscans account for more than 40% of UCSF's 25,000 annual admissions and 400,000 outpatient visits. They receive services from primary care to the highly specialized treatments for complex and rare conditions.

**8. Can the current challenges be addressed without dismantling the faculty/administration/staff team that has enabled UCSF to rise to prominence?**

The formation of NEWCO will not dismantle the faculty who will remain within the School of Medicine. There will be changes in the administrative leadership of the clinical services as NEWCO selects a single senior management team from administrators at both sites and elsewhere. The NEWCO management team is expected to share the same commitment to excellence in patient care, teaching, and research that has been central to UCSF's and Stanford's success in recent years.

**9. Staff have observed areas where huge savings can be made? Why are they not listened to?**

Over the years UCSF has strongly encouraged staff to generate ideas that lead to more cost-effective care. The administration remains anxious to receive input. Staff members should discuss their ideas initially with their work team and supervisors. They should communicate with more senior managers if they feel that good ideas are being ignored.

**10. Why are there no human resources consultants at work on the transition?**

There is no decision yet made to establish NEWCO; therefore, there is nothing to "transition." If a decision is made to establish NEWCO, it is anticipated that NEWCO would hire a human resources director who will begin establishing NEWCO's personnel policies.

**11. Residents and fellows will be barred from collective bargaining because they are declared students under the National Labor Relations Act. There will be a general loss of representation, resulting in lower wages.**

This question assumes that residents and fellows will become employees of NEWCO. This is not expected to be the case.

**12. Loss of jobs and lower wages will have a negative effect on the State and local economy.**

Any staffing reductions under NEWCO are likely to be less than might otherwise occur if UCSF Medical Center and Stanford Health Services continue as stand-alone institutions.

**13. The best educated and experienced professionals will not be rehired to avoid paying their high salaries.**

It is anticipated that NEWCO would hire the best educated and experienced professionals.

**14. How many jobs may be lost; in what departments?**

The planning process has identified certain opportunities for cost savings through consolidation of services, particularly in support areas such as finance, human resources, information systems, and materiel management. A single administrative structure would result in substantial reductions in executive and management positions. If NEWCO achieves the planned increase in patient care volume, it will require an increase in staffing in the clinical areas. If the planning assumptions and financial projections are accurate, staffing levels are not likely to increase or decrease by more than a few percent. The exact number of positions available will not be identified until NEWCO defines its staffing plan.

## **II. REGENTAL CONCERNS**

### **A. The Basic Premise**

**1. A portion of the University is being removed from Regental control; we are getting rid of one of our campuses; there is a perception that we are giving away UC.**

NEWCO will be a corporation of equals with the Board of Regents and the Trustees of Stanford sharing ultimate control. The assets conveyed to NEWCO will be continued to support the University's education, research, and charitable missions, and the clinical enterprise of NEWCO will be coordinated with the activities of the UCSF School of Medicine. Presently it is contemplated that The Regents would retain ownership of the land and buildings with conveyance by way of long-term lease. Additionally, representatives of both parties are discussing ways of protecting The Regents' and trustees' assets by permitting either to take action should there be significant financial problems.

**2. Define what is meant by the term privatizing? Are we doing that?**

An exact and universally agreed upon definition of "privatize" does not exist. NEWCO will not be a public agency or entity and in that sense will be private. However, The Regents and Trustees of Stanford University will share ownership and control of NEWCO, and NEWCO

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will have a purpose consistent with The Regents' responsibility to support the research, educational and charitable mission of the UCSF School of Medicine.

B. Governance

**1. The legislative and public perception of our transferring a University of California hospital to an entity over which The Regents would not have complete control. What has been the reaction of elected officials?**

In early May representatives from the campus, the Office of the President, and the Office of the General Counsel met with elected officials, their staffs, and State finance and health administrators in Sacramento. In addition, the University continues to respond to specific information requests from individual legislators. Based on the discussions to date, it appears that the proposed governance structure is perceived to be adequate to assure that the new entity will serve the University's academic and public service missions.

**2. A detailed understanding of whether The Regents can, or should, divest themselves of voting control over the new entity. The President of the University must be on the NEWCO board, in part, to maintain an appropriate reporting relationship/structure with the campuses. Why should UC not have a 50 percent representation in the new corporation if it retains the responsibility for financing the medical school?**

The Regents and Trustees of Stanford University will share in the ownership and control of NEWCO. NEWCO is expected to execute agreements with both Universities to support the schools of medicine. An affiliation agreement would require NEWCO to support the academic programs of training, and serve research programs of the School of Medicine at UCSF as well. In addition, a Professional Services Agreement would provide that NEWCO would pay for the professional services of the faculty and house staff at UCSF. The make up of the Board would respond to a number of concerns: appropriate representation of Regents and Trustees; leadership at UCSF and Stanford; and appropriate community representation as well. In addition, Board composition was intended to strike appropriate balances so as to maintain the private character of NEWCO. The present plan contemplates that the President of the University will be a member of the NEWCO Board.

C. Funding/Financial/Asset Transfer

**1. The effect of the transaction on the availability of funds for UCSF, both State and Federal, and also the transferability of any such funds, particularly as they relate, directly or indirectly, to patient care.**

State Funding Issues

The State provides support in the form of faculty and instructional support dollars to the UCSF School of Medicine and other health sciences programs. The University will urge the State to

continue its support for these programs through the UCSF School of Medicine which would retain its separate identity within the University of California. Its medical students, residents, and other health sciences students would continue to be identified as University of California students.

The State also appropriates funding to the University for the teaching hospitals in the form of Clinical Teaching Support (CTS). These funds are used chiefly to provide financial support for patients who are essential for the University's clinical teaching program, but are unable to pay the full cost of their hospital care. CTS is also used for teaching costs in the hospitals and clinics. NEWCO is expected to continue to support the University's clinical teaching programs at UCSF Medical Center. The University has proposed that CTS funding be directed to the UCSF School of Medicine where it will continue to be used to assure that a diverse patient population is available for the instructional program and to support other teaching costs. The University will work with the State to assure that CTS funding for the San Francisco campus continues.

#### Federal Funding Issues

UCSF Medical Center receives federal funds through Medicare and Medicaid patient care revenues. To remain eligible to receive federal payments for care of individual patients, NEWCO would need to complete appropriate "change of ownership" paperwork to assure continuing certification and reimbursement. UCSF also has two NIH-grant supported clinical research centers. The formation of NEWCO should not affect those research centers which are funded through a competitive grant process.

**2. Determine the extent to which UCSF and/or Stanford endowment funds can be transferred to the new corporation and assure ourselves of the specific legal authority for such in order that The Regents and/or Stanford do not violate any existing agreements with respect to such funds.**

The Office of the General Counsel is working with the UCSF Budget Office to identify endowment funds whose purpose is to support patient care activities. General Counsel will review the terms and conditions of each gift to assure that only appropriate transfers are made and consultation with the Charitable Trust unit of the California's Attorney General's office will be undertaken. The endowments that could potentially be transferred to NEWCO total less than \$10 million. The NEWCO consolidated financial statements do not include those endowments, and the financial projections do not include their income.

**3. How will revenue be apportioned by UCSF and Stanford?**

Since NEWCO will operate institutional or technical services as one entity, institutional revenue will not be apportioned. As Item 403X (pp.5-6) describes, the professional services revenue will flow to the Schools based on their own workload units. It is anticipated that a NEWCO Executive Group (which is expected to include the CEO and the two deans) will

allocate institutional funds for new program development, medical direction, and other priorities based on the needs and opportunities of both sites.

**4. UCSF is just finishing a capital campaign of \$533 million. What is the effect of the merger on future campaigns, current pledges, community feelings for UCSF?**

The campaign has not focused on raising money for patient care directly, and a very small portion of the dollars pledged benefited the Medical Center. As a result, it is unlikely that the merger will have a significant impact on current pledges. With regard to future campaigns, NEWCO would conduct its own fundraising for patient care services, including continuing efforts to attract substantial philanthropic support to its children's services. To assure that NEWCO's efforts would be carefully coordinated with the development programs of the two universities, the President of Stanford University and the UCSF Chancellor are drafting principles to propose to NEWCO that would govern this relationship.

With regard to community feelings about the merger, there is general support for taking appropriate actions to preserve and enhance UCSF's clinical programs.

**5. A specific breakdown of assets to be transferred to the new corporation, including any facilities at Laurel Heights.**

The current plan contemplates that both Universities would lease clinical facilities to NEWCO. At UCSF such property would include Regents-owned facilities that are wholly or largely used by the Medical Center such as Moffitt, Long, and Mount Zion hospitals, the Ambulatory Care Center, and the medical offices buildings at Mount Zion as well as designated space for clinical activities in other UCSF buildings such as Millberry Union and Mission Center. Regents' leases of third-party owned clinical space would be assigned to NEWCO. With regard to Laurel Heights, UCSF Medical Center currently occupies about 19,000 assignable square feet. Such space would be leased to NEWCO for as long as those functions remain at Laurel Heights.

As part of the due diligence process for facilities, the interim NEWCO management would work with the Assistant Vice President-Facilities Administration to develop the detailed listing of all facilities which currently have patient care-related uses. The UCSF campus maintains a comprehensive inventory of space by tenant (Medical Center, School of Medicine, etc.) and by use (patient care, research, etc.). This listing will be validated as part of the process to specify the facilities to be transferred. The Medical Center's equipment inventory will also be confirmed.

**6. Will the transfer of assets affect any existing leases, and will assignments of contracts (related to leases) be affected?**

As part of the due diligence process the parties will identify those leases and contracts which will be assigned to NEWCO. Where necessary, the consent of other parties to such leases and



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contracts will be obtained. It is anticipated that NEWCO will assume, without substantial modification, all of the obligations of each respective University under the terms of the leases and contracts which are transferred to NEWCO.

**7. An update by independent auditors of the Stanford-Packard combined operating figures for the current fiscal year through April, at least.**

Peat Marwick is performing due diligence on Stanford Health Services' financials through February 1996. Audit workpapers and interim financial statements are being reviewed. UCSF management is reviewing April 1996 year-to-date financials. Full year audits will occur after Stanford's August 1996 year end.

**D. Legal**

**1. The effect, if any, of the legal fact that the University of California is a separate constitutional body constituting a public trust pursuant to Section 9 of Article IX of the Constitution of the State of California, and in turn, whether in such capacity The Regents have the authority to transfer State-owned assets to a nonpublic institution, whether it is a new 501 (c)(3) corporation, or as mentioned in Item 403X, the transferee might be the present Stanford hospital.**

Under Article IX, section 9, of the State Constitution, The Regents has full powers of organization and government, including the authority to convey assets to a nonprofit organization, whether the nonprofit organization is a newly created 501(c)(3) entity or Stanford Health Systems.

**2. There are significant legal impediments; is a declaratory judgment by a court of competent jurisdiction required?**

Under Article IX, section 9, of the State Constitution, The Regents has full powers of organization and government, including the authority to convey assets to a nonprofit organization. The University will consult with the State Attorney General to ensure the Attorney General concurs with this view. Since this is a transaction without a precedent, a declaratory relief action may be advisable; the General Counsel is prepared to initiate such an action following consultation with the Attorney General.

**3. Consideration should be given to seeking outside counsel, particularly as legal opinions are likely to be challenged.**

Outside counsel will be used as circumstances require for specific issues. Most of the necessary legal work, including supervision of any outside counsel, will be the responsibility of the Office of the General Counsel.

**4. How may The Regents be assured that initial agreements will not be changed by the new board?**

Each agreement entered into by The Regents in connection with the formation of NEWCO (whether such agreements are with NEWCO or Stanford) will contain a provision which ensures that the agreement cannot be changed without the written consent of The Regents. In addition, any change to the Articles of Incorporation or Bylaws of NEWCO will require approval by The Regents.

**E. Labor and Human Resources**

**1. How will the merger affect the relationship of the School of Medicine, faculty researchers, and hospital?**

Along with the NEWCO CEO, the deans of the two schools of medicine, the chief medical officer, and three other physician faculty leaders are expected to serve as a NEWCO Executive Group. The Executive Group will advise with respect to the overall strategic direction of NEWCO, policy-setting, and administrative oversight. This mechanism should help assure that the interests of the faculty and the objectives of NEWCO remain complementary.

The formation of NEWCO will undoubtedly change the orientation of the faculty and hospital leadership from its former focus on a single academic medical center to a broader view of the possibilities and problems posed by both sites. Chairs and other faculty leaders at the two sites will be encouraged to collaborate on the new development of new clinical programs, to share best clinical practices, and to engage in collaborative clinical research projects. The Dean's statement in Item 404 describes the benefits of the formation of NEWCO for teaching and research.

**2. Will Stanford and UC be affected proportionately by downsizing?**

The initial cost reductions are most likely to occur in administrative areas, including substantial reductions in executive and management functions as a single management team is established. As NEWCO organizes these functions, former Stanford and UC hospital staff are likely to be assembled into new units. There is no structural reason why there should be a disproportionate impact on one or the other former hospital staffs. With regard to patient care, NEWCO is expected to continue to operate hospitals in both San Francisco and Palo Alto with a broad array of services available at each site. The staffing levels at either campus are not likely to increase or decrease by more than a few percent.

In the future, NEWCO is likely to consider proposals to consolidate certain clinical programs, including some relocation of existing activities. In reviewing these proposals, NEWCO will consider factors such as: impact on the educational programs; impact on research; market and financial viability; availability of facilities, personnel and external funding; compatibility with existing programs; and disparate impact on the Schools. To assure that there is not a

disproportionate impact on the Schools arising from individual program decisions, the affiliation agreement will provide for an annual program review by the deans and the rest of the Executive Group to identify any problems and work out solutions.

F. Academic Enterprise

**1. A complete clarification, in order to prevent professional medical disruptions, of a combined organizational chart identifying by individuals the various departmental and divisional personnel, including the respective Chairmen and Chiefs thereof. What happens to tenured faculty if departments combine?**

The UCSF and Stanford Schools of Medicine will remain independent entities. The formation of NEWCO does not, at the outset, affect the current organizational structures of the two schools. Over time, the deans expect to review opportunities for joint appointments as new clinical program opportunities present themselves and as administrative vacancies occur. For instance, the two deans are contemplating the joint recruitment and appointment of an individual to lead a comprehensive cancer center that would be formed through the efforts of the two schools and NEWCO. Neither University has yet applied for NIH-designation as a comprehensive cancer center, and this would be a new position.

The formation of NEWCO itself should not have a direct impact on tenure. Even though clinical departments may be combined with NEWCO, the faculty will remain employed by the respective schools. Issues relating to faculty employment will continue to be addressed by the respective schools. One of the primary purposes of NEWCO is to sustain appropriate levels of funding to the school of medicine for existing and future faculty employment. Academic medical centers nationally are struggling with how reductions in faculty size, necessitated by reductions in research or clinical support, will be managed within the current systems of academic appointments.

**2. A determination as to whether the University of California may be subject to any possible losses in the new entity as a result of our doctors' involvement. Will the revenues and the substantial contributions that the academic medical centers make to the medical schools continue? Is that assured when there is a revenue shortage? What is the long-term commitment of NEWCO to maintain funding for the academic enterprise?**

In this respect, what rental would be received for the UCSF hospital, and also the rental for the Stanford facilities?

School of Medicine Revenues The parent universities will remain financially responsible for the Schools of Medicine. There will be four potential payment streams from NEWCO to the Schools to compensate for physicians' services: a professional services agreement covering billable physicians' services; other direct support from institutional funds for new program development, medical direction, and on-going support for certain clinical activities with less than adequate third party compensation; incentive payments for cost-effective clinical resource

management and for excellent patient service; and profit-sharing between NEWCO and the schools if NEWCO exceeds its budgeted capital contribution. As part of the professional services agreement, it is expected that NEWCO will return to the deans the academic assessment (Dean's tax) imposed by each school on professional revenues.

The proposed professional services payment methodology is described in some detail in Item 403X. By enforcing appropriate productivity standards and by prudent salary setting, clinical departments should be able to avoid deficits arising from professional services during the year if NEWCO assumes the risk for changes in external payment rates and internal expenses that might occur during the fiscal year. Clinical departments would be able to adjust faculty compensation for the next year based on prior year actual experience. As part of the annual budget process, NEWCO's physician group, the Dean's Office, and NEWCO management will all have the opportunity to review any projected shortfalls in clinical departments and make recommendations to the involved chairs on potential remedies. If there is sufficient justification, NEWCO can choose to underwrite the clinical losses for a defined period of time.

In addition, the two hospitals currently provide support to the Schools for new clinical program development, faculty recruitments, medical direction, and support for other institutional priorities. It is expected that the affiliation agreement will state NEWCO's intent to maintain the level of support from institutional funds to the schools, as measured by a proportion of net revenues. Just as the two current academic medical centers vary their academic support to the Schools based on their overall financial condition, NEWCO would need to retain the flexibility to propose changes in this institutional support. NEWCO would, however, be asked to commit to reviewing alternative cost reductions before proposing reductions in support to the Schools. The decision-making process is expected to include the deans as part of the NEWCO Executive Group.

Lease Costs The lease costs are proposed to cover the costs of operating and capital improvements for those designated clinical spaces. There would be no further consideration.

**3. Under the Master Plan for Higher Education, UC has a monopoly among state institutions on the provision of professional education in medicine and other fields. Does this new arrangement represent a further disengagement from UC's role as a public, tuition-free provider of professional education?**

At UCSF, the University provides professional education in medicine through the School of Medicine. Since the School will not be merged with Stanford, the new arrangement does not represent any disengagement from UC's role as a public, tuition-free provider of professional education. Instead, by stabilizing the clinical enterprise, the merged entity should assure that this critical educational tool and resource will be available for the School's future programs.

**4. Please separate out the Medical Center from the Medical School and show in NEWCO how each would function.**

At both Stanford and UCSF, the Medical Center and the Schools of Medicine are organizationally distinct and functionally separate. The major change at UCSF will be that NEWCO will "lease" the professional services of the faculty in clinical departments. Financial and operational responsibility for faculty clinical practices, both inpatient and outpatient, would move to NEWCO. Currently UCSF Medical Center is responsible for most, but not all outpatient practices, and does not operate the functions necessary to provide and bill for most inpatient professional services.

**G. Information Systems**

Discuss and understand why UCSF cannot, by contracting with our major Laboratories--including Berkeley, Los Alamos, and Livermore--implement centralized control and information systems, as referred to on Page 32 of Item 403X.

One option available to NEWCO would be the installation of systems that capitalize on major developments in computer technology from several sources, including the UC Laboratories. The Laboratories would be particularly helpful in transferring technologies to health care applications. High speed networking and data storage systems, prototyping new information models, and techniques to safeguard information security are some areas that may be beneficial.

Nonetheless, the complexity of patient care and financial systems for health care require software applications that are proven in the industry, scalable, and transportable since they form the basic building blocks needed for effective patient management and financial control. These application products are best obtained from established vendors who constantly update their software products to reflect changes in Federal and State law and regulations.

In addition to collaborating with the Laboratories, we envision that NEWCO can derive information systems benefits from combining the existing UCSF and Stanford systems departments. Benefits normally accrue by merging any two information systems departments supporting a common business (i.e., reduction in management, single software licenses, and a single data center). NEWCO will provide the additional opportunity for UCSF to align with the Stanford Medical Informatics program, a nationally renowned program in informatics education, research, and development. Stanford's relationships with Silicon Valley also offer possible strategic partnerships with firms that would allow NEWCO information systems to take better advantage of emerging technologies.

#### H. Legislative

**Will the establishment of the new entity create a false sense in Sacramento that the problems in management and finance of medical education have been solved and no longer require immediate attention?**

University representative have met with legislators and State health and finance officials to describe what Stanford and UCSF can do together to respond to external pressures. The conversations have emphasized, however, that academic medical centers cannot solve the problems that they face alone, no matter how bold or creative their response. The Federal and State governments, along with private payors, must address the financing of care for the indigent and uninsured, and must also create a means for all payors to share in the support of the academic mission.

#### I. Impact of Health Care Reform

**Does the proposed merger adequately contemplate possible changes in the national health care industry, such as the establishment of universal health insurance? Will UC be able to reassert its control over its clinical enterprise should universal health insurance or other comprehensive health care reform be enacted?**

The need for the proposed merger would not disappear, even if the financing of health care were to change dramatically. Universal health insurance, if enacted, would improve access, but would not reduce the pressure for cost-effective provision of services. By forming the new corporation, current operating expense can be reduced, and future costs can be avoided, particularly those associated with capital acquisition. Academic medical centers will have to demonstrate their ability to restrain cost while providing high quality, responsive patient care under any future funding scenario.

The University of California will be one of two members of the newly formed nonprofit corporation. The specific and primary purpose of the corporation will be to manage and operate health care facilities in cooperation with the Schools of Medicine to provide competitive health care services in an environment suitable for the highest quality medical education and research. If the corporation fails to fulfill its purpose, the members will have the authority to dissolve the corporation.

#### J. Patient Care

**1. Will the new arrangement exacerbate inequities in the State's health care system by furthering the rationing of medical services for the underinsured?**

Both UCSF and Stanford have a long history of serving the underinsured and indigent. Despite grossly inadequate payment from the Medi-Cal program, both institutions provide a broad range of primary and specialized services to Medi-Cal enrollees. Each institution's

capacity to serve these populations is threatened as operating margins erode. To the extent that the merger improves financial performance, it will make it possible to continue their traditional indigent care role.

**2. Who decides which departments move to which campus? Discuss the problems with physicians that we have, e.g. I am a UCSF physician treating a cancer patient, and the cancer facilities are moved to Palo Alto--what happens to the patients. Which school will be assigned to do what major care?**

It is unlikely that whole departments will consolidate on a single site. For clinical conditions as common as most cancers, NEWCO is highly likely to continue to provide services in both San Francisco and Palo Alto even if there were a common cancer center organization. Chemotherapy, radiation therapy, and surgery will all need to be available to serve the local population centers of San Francisco and the South Bay. NEWCO is only likely to consolidate services in very specialized areas where patients are already willing to travel at least 40 miles to receive the service and services where the fixed costs are very high or scarce, expert personnel are needed. It is anticipated that, after reviewing the proposals of the involved chairs and faculty, the NEWCO Executive Group, including the CEO and the two Deans, would make decisions whether to consolidate such programs, provided that the consolidation maintained or enhanced the teaching and research programs.

#### K. Alternatives

**What other plans have been explored? If NEWCO is not feasible, then what?**

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 health care 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 and financial incentives to manage capitated care more effectively; (5) revamping the provision of referral care to other capitated medical groups and systems to meet their changing needs; (6) increasing the value of UCSF's patient care services by improving service while reducing costs; and (7) seeking appropriate Federal and State funding for the costs of medical education and indigent care. UCSF Medical Center's 1995 Annual Report to The Regents describes these major strategies in some detail.

Despite the success of many of these initiatives, the Chancellor, the Dean of the School of Medicine, and the Medical Center Director have concluded that the UCSF clinical enterprise must partner with others to assure its continuing competitiveness. To meet UCSF's needs for a connection to a strong local primary care network, the San Francisco campus is joining with California Pacific Medical Group to create a new managed care medical group to serve San

Franciscans. To enhance its academic mission, to strengthen its regional referral role, and to create a more cost-effective academic medical center, UCSF has proposed Stanford as its partner.

If the proposed merger with Stanford does not proceed, UCSF is likely to attempt to create more fully integrated partnerships with Sutter/CHS, Kaiser Permanente, and Catholic Healthcare West. UCSF has developed alliances with these integrated delivery systems which are founded upon referral relationships for specialized care.

L. Other

**1. Setting a precedent--What is the likelihood UC's other hospitals will follow this lead?**

Given the unique nature of Stanford as a partner, the chances of other UC hospitals presenting such a proposal are slim. However, each institution must view its partnering opportunities in light of the competitive structure of their region. It is highly likely that other institutions in our system will present similar options consistent with their local environment.

**2. Are we heading for an outcome similar to what has happened in San Diego?**

While UCSF is projecting a positive bottom line for the next several years as a stand-alone institution, the projected margin ranges from only 1.6% to 2.3% of net revenues. These projections assume that UCSF will be able to make \$10 million in new cost reductions each year. Such a narrow margin affords little protection against Federal and State cutbacks in Medicare and Medicaid (which account for half of UCSF's revenues), price roll-backs by major employers and payors, and a fluctuating census. UCSF has managed to avoid operating losses to date through expense management and through marketing and contracting efforts to increase patient volume and maintain reasonable prices for highly specialized services. It has become increasingly difficult to continue to make cost reductions while providing the intensity of care required by UCSF's very complex patient population. Even if UCSF were able to manage to a break-even position in the face of payor cutbacks or census drops, it could not sustain itself long without having the profit to fund the capital investments in equipment and facilities necessary to support its highly specialized services.

**3. Can we wait until after seeing the results of the CPMG acquisition before proceeding further?**

The combination of UCSF Medical Group and California Pacific Medical Group is expected to benefit UCSF by providing additional local volume for teaching in primary care and secondary specialties. It will also allow the new group to reduce its average cost of managing "risk-based" contracts for primary and comprehensive care.



The new local medical group does not provide a solution to UCSF's needs to reduce its costs overall, to build regional referral volume, to create more cost-effective ways to teach in a clinical environment, and to improve its operating margin to permit re-investment in critical technology. The merger with Stanford meets those needs and would provide immediate benefits to UCSF. If the decision were postponed, the new enterprise would lose the benefit of the cost reductions that might be achieved over the next year and of the market opportunities to develop referral relationships and build volume now.

**4. What are the expected sources of increased patient volume? Exactly how can we "downsize" expenses, particularly with respect to how the combined entities will accomplish this as distinguished from remaining separate?**

Increased patient volume. A major target market for NEWCO is expected to be medical groups and integrated delivery systems that now accept financial risk for enrolled populations under capitation. These groups must not only deliver services, but must function as "mini-insurer" for their covered lives. A second target market is likely to be regional HMOs. Both the capitated medical groups and the regional HMOs are seeking to reduce the complexity and cost of their managed care operations by restricting outside referrals to a limited number of vendors and by contracting at predictable prices for complex care.

There will be a window of opportunity to contract for highly specialized care as community medical groups pressure their local hospitals to accept lower capitation rates for routine medical care. Those hospitals will no longer be able to staff at a level necessary to provide the occasional highly specialized care. For instance, there appears to be growing reluctance by local hospitals to support small pediatric inpatient units. NEWCO's Children's Services will be a very cost-effective alternative to "making" pediatric services locally. As more Medicare patients enter senior HMOs over the next five years, there will be a significant opportunity to channel patients needing complex care to NEWCO.

While UCSF has been successful in attracting volume from these groups over the last year (admissions are up 2%), NEWCO has an even better opportunity to bid to become a "sole source" vendor of referred services because of the comprehensiveness of its service offering, its geographic coverage including outreach sites, its high volume of complex services which facilitates more favorable clinical outcomes and more cost-effective care, and the ability of a large institution to assume risk under new contracting arrangements. Furthermore, medical directors of these groups will no longer have to struggle with the divided UCSF/Stanford loyalties of their referring physicians if both are encompassed within NEWCO.

Downsizing. The medical centers have each made significant budget reductions, including staffing cut-backs and re-design of current positions, without creating acute labor problems by: carefully explaining the business necessity of workforce reductions or changes; meeting and conferring with affected staff and union representatives, as appropriate; and following lay-off

policies established through policy and collective bargaining agreements. It is likely that NEWCO would adopt policies and procedures to deal openly and fairly with staff reductions in ways that are at least as effective as the current practices in place at Stanford and UCSF.

NEWCO has more opportunities for cost reduction than either individual institution because it can eliminate administrative services that are duplicated at both campuses. In addition, by sharing financial risk across both sites, faculty and staff are more likely to be motivated to adopt the best clinical and administrative practices available at one site or the other.

**4. What about the other schools, including collaboration on projects?**

The current plan will be to propose affiliation agreements between NEWCO and the UCSF Schools of Dentistry, Nursing, and Pharmacy. Because Stanford does not have the other health sciences schools, NEWCO represents opportunities to continue existing programs and to create new programs in clinical care, research, and teaching in the Palo Alto setting.

**5. If we merge two hospitals with low census, we still have too many beds and haven't solved that problems. What will be the next move?**

The four licensed hospitals within NEWCO have already taken steps to operate only as many inpatient nursing units as are necessary for the current demand. Most of the "lost" admissions have been converted to demand for 23-hour stays, infusion units for chemotherapy, and ambulatory surgery. Other "lost" days at the end of hospital stays have been converted to demand for skilled nursing and home care. NEWCO can be expected to continue to expand its role in outpatient care and post-acute care, including use of former inpatient facilities to house such activities.

**6. Long-term Viability**

**How likely is it that the merged institution will survive; if not, then what?**

The financial projections for the merged institution show a significant improvement in the financial position of the two enterprises between 1997 and 2000. The increased margin would buffer threats from the external environments, such as Federal and State budget cutbacks, but the merger cannot guarantee the financial success of the enterprise if there are catastrophic changes in government or private insurance payment rates or methods. The new enterprise is likely to look first to efforts to increase indigent care funding and all-payor support for educational costs. If those efforts do not succeed, the enterprise would probably explore other options to ally with surviving health care systems.

### III. STUDENT CONCERNS

1. **Students have not been included in the planning. The UCSF student governments and the systemwide Student Association have been denied access to information.**

Up to this time, planning has dealt with the basic structure and business planning for the new clinical organization. Because the Schools of Medicine remain within their parent universities and retain responsibility for educational programs, NEWCO planning has not focused on student educational planning. When this topic is discussed, students will be included in the process.

2. **Have the impacts on the various professional and graduate programs at UCSF been assessed in terms of the quantity and quality of clinical opportunities for students?**

Dean Debas' summary of the academic justification for NEWCO in Item 404 describes in general terms the impacts on the undergraduate and graduate programs in medical education as follows:

Undergraduate Medical Education An adequate patient base is a critical requirement for training medical students in the acquisition of clinical skills. With the expanded focus to train more generalists, and to produce physicians that are appropriate to the changing health care delivery, it has become important to expose students to patients early, from the first year of medical school, in order to provide them with longitudinal clinical experience. It is also increasingly necessary to move clinical teaching from the inpatient to the ambulatory care site. These requirements have increased the need for an expanded patient base for teaching. Both medical schools are confronting difficulty in providing adequate clinical rotations to third and fourth year students in several disciplines. To the extent that the merger will increase the patient population in the new hospital system, the clinical teaching of medical students will be made more robust.

The new merged clinical entity will have the capacity to be a strong partner to health maintenance organizations, such as Kaiser, and to integrated physician group practices in the community. The result will be an expanded opportunity to secure appropriate primary care teaching sites for students. This strategy will be important in exposing students to physician office practice, to community-based medicine, and to clinical practice in managed care. In the final analysis, the ability of the two universities to successfully compete for the best and brightest students depends, at least in part, on the quality of the clinical training. The creation of an economically strong merged enterprise is, therefore, an important strategy to sustain the academic excellence of both medical schools.

Graduate Medical Education The merger sets the stage for the country's premiere training programs that will produce the country's future leaders, as well as informed broadly-based providers of care. The combined effect of the California state mandate to reduce the training of specialists combined with market forces that have reduced the popularity of certain medical and surgical specialty careers, has had a severe impact on several residency programs. At each site, some residency programs, such as Neurosurgery and Dermatology, have contracted to critically small sizes. The merger creates the opportunity to combine such programs into outstanding residencies. The recent residency match results clearly demonstrate a national decline in the popularity of Anesthesia, Radiology, and Ophthalmology as career choices. Several residency programs in these specialties either did not match at all, or failed to fill all their positions. As these national trends increase, the newly merged academic medical center 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.

Program-specific opportunities to strengthen the training programs will be reviewed after the formation of NEWCO when chairs in the two schools of medicine have more latitude to discuss the strengths and weaknesses of their current clinical training experience.

### **3. How will the merged corporation deal with the different educational requirements of the two universities' various programs?**

The clinical programs of the new entity are expected to be aligned with all levels of educational programs at each university. To assure this result, the deans of the two Schools of Medicine would formally review the effects of proposed changes in clinical programs on educational programs.

**4. How will the merger affect our ability to recruit and retain the most promising students?**

Dean Debas's statement in Item 404 noted the relationship between the development of a strong clinical enterprise and the recruitment and retention of a strong faculty and outstanding students:

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 strategy for both institutions, one that will enable them to maintain their positions as leading academic health centers. A compelling case has been made that in a stand-alone mode, neither institution will likely be able to sustain its present clinical activities into the future.

The quality of the faculty is not only important to the success of the clinical enterprise itself, but, consistently, students and residents make their choice on what medical school to attend or train at based on the fame and accomplishments of their prospective teachers.

As described above in the question on impacts on educational programs, the formation of NEWCO also offers opportunities to attract excellent students to newly developed joint graduate medical education programs in certain specialties and to other programs with new rotations. The proposed merger is the best way to insure faculty and program quality and thus preserve UCSF's ability to attract the best students.

**5. Will NEWCO be able to impose any fees on UC students?**

NEWCO will have no authority to impose any fees on UC students.

**6. Will Stanford faculty or administration have any authority over UC students?**

Both schools of medicine will maintain their own teaching and residency programs. However, joint programs between the two schools of medicine may be established with joint supervision by Stanford and UCSF faculty.

**7. Will Stanford students be entitled to any sort of standing within UC?**

See answer 6 above.

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**8. How will students be represented on NEWCO's board and in NEWCO's policy-making process?**

Medical students will continue to be students of the respective schools of medicine. The UCSF School of Medicine will continue to provide for appropriate student representation and involvement at the school. NEWCO will support the activities of the school, as such activities are influenced by student representation and involvement.

(Attachments)