Models for Organizational & Structural Reform

Larry S. Gage, President, NAPH
Partner, Ropes & Gray LLP

Miami-Dade County Hospital Governance Task Force
April 8, 2011

Agenda

- What is a “typical” public hospital?
- Why do public hospitals restructure?
- Case Studies of Structural Reforms

What is a “Typical” Public Hospital?

- Direct governance by elected/appointed officials
- Advisory board or commission
- Freestanding board with some autonomy
- State University
- Hospital District
- Hospital Authority
- Public benefit corporation
- Private non-profit corporation
- Public/private partnership

Public Hospitals in Transition

- In 1981, half of NAPH members were traditional City or County owned hospitals
- Less than 10% retain that structure today
- Restructuring is seen as one response to strategic and financial threats and opportunities

Why Do Public Hospitals Restructure?

- Financial pressures
  - Large numbers of uninsured and underinsured patients
  - Community need for money-losing services
  - Increased demand, reduced funds when economy slows
  - Disproportionate impact of Medicaid cuts and "reforms"
  - Aggressive competition for reimbursed services
  - Drain on local government resources
- Lengthy budget & decision-making process
- Limited control over revenues, expenditures
- Personnel & procurement constraints
- Under-funded medical education role
- Access to capital
- Ability to partner or compete
- Need to prepare for health reform

Health Reform: Challenges & Opportunities

- Coverage Expansion
  - Health Insurance Exchanges (29 Million New Members by 2019)
  - Expands Medicaid (16 Million New Enrollees by 2019)
- Delivery System Pressures
  - Value-based Purchasing
  - Hospital Readmissions
  - Hospital-Acquired Conditions
  - Payment Bundling
  - Accountable Care Organizations & Medical Homes
  - Primary Care Reimbursement
- Payment Reductions

Health Reform – Delivery System Reforms

- Payment Innovation Center
- Medicaid Global Payment Demonstration
- Accountable Care Organizations
- Community-based Collaborative Care Networks
- Payment Bundling Demonstration
- Uninsured Access Demonstration
- Community Health Teams Support Patient Centered Medical Homes
- Federal Coordinated Health Care Office for Dual Eligible Patients

Advantages of Public Status

- Access to county tax revenues
- Access to general obligation bonds
- Ability to make Medicaid transfers and receive supplemental payments
- OSHA, Social Security, labor, antitrust, tax and other federal and state exemptions
- Availability of cross subsidies for prevention & public health
- Sovereign immunity and eminent domain
- Access to municipal support services – pension, benefits, self-insurance fund, etc.

Checklist: Typical Goals of Governance Reform

- Reduce costs/improve operational efficiency
- Strengthen clinical integration
- Improve quality and patient satisfaction
- Enhance reimbursement opportunities/broaden payer mix
- Improve relationship with County: insulate County from future risk
- Raise capital/reduce indebtedness
- Improve ability to act competitively
- Achieve closer affiliation with other system(s)
- Prepare for health reform through creation of regional integrated system

Case Studies: Models of Governance Reform at Other Safety Net Systems

Potential Models for Governance Reform

- Independent Authority or Public Benefit Corporation
- Independent Taxing District
- Contract management
- New non-profit corporation
- Merger with existing non-profit system
- Acquisition by for-profit system

Independent Authority or Public Benefit Corporation

- Special legislation authorizes transfer of significant County services & powers
- State law may authorize County to create through resolution or ordinance
- County can appoint board
- Assets, personnel, programs, obligations can all be transferred to new entity
- Contracts and agreements between County and authority govern services, funding
- County reserve powers

Independent Authority or PBC: Examples

- Alameda County Health Care Authority
- Hennepin County Medical Center
- Nassau & Westchester Counties NY
- Denver Health & Hospitals Authority
- Hawaii Health Systems Corporation
- New York City Health & Hospitals Corporation
- Universities of Colorado, Kansas, Wisconsin

Alameda County Health Care Authority

Hospital authority with County-appointed Board

- Objectives:
  - More flexibility and autonomy
  - Greater ability to compete in healthcare marketplace
  - End County's perceived funding "drain"
- Results:
  - Revenue and productivity have improved
    - Estimated increase in revenues per patient day
  - Improved personnel recruitment and retention
  - Enhanced ability to achieve passage of new tax
  - Greater financial stability for County and ACMC
  - Still realizing potential advantages
  - "Extremely beneficial"
- May seek additional powers

Hennepin County Medical Center

- Authority with County-appointed Board
- Objectives:
  - More focused, dedicated governance
  - Greater ability to compete in healthcare marketplace
  - Reduce drain on County's property taxes
  - Restructure relationships with medical staff
- Results:
  - Improved productivity and more efficient operations
  - Volume of insured business growing
  - Improved personnel recruitment
  - Benefits of dedicated Board's focus
  - Compared with past trajectories, "very successful" financial projections
  - Serious work has begun on medical staff restructure

Independent Taxing District

- Common form of public hospital in Florida, California, Texas
- Each District established by statute in Florida
- A County may have one or more Districts
- Governing boards appointed by Governor in Florida
- Florida Districts enjoy broad powers
  - Create or purchase non-profit or for-profit facilities
  - Enter management contract for hospital
  - Transferring all or majority of hospital assets to third party
  - Create subsidiary, participate in joint venture
  - Levy taxes, issue bonds

Taxing District: Examples

- Maricopa Integrated Health System
- Dallas County Hospital District (Parkland)
- Harris County Hospital District (Houston)
- North & South Broward Districts

Taxing District: Examples

- Maricopa Integrated Health System:
  - Taxing health care district with 5 elected directors
  - County sought greater financial independence and autonomy for MIHS
  - Now benefit from greater stability, financial planning, flexibility
  - “Absolutely a net positive”
- Dallas County Hospital District (Parkland):
  - Longstanding taxing healthcare district with Board of Managers appointed by County commissioners
  - County approves the tax rate, the budget, and debt issuance
  - Recognizes health care as a business
  - Structure encourages flexibility and strong governance

Contract Management by Third Party

- Harborview Medical Center (County hospital managed by University of Washington)
- Wishard Memorial Hospital (City-County hospital managed by Indiana University)
- Brackenridge Hospital (City hospital owned by new taxing district and managed by Seton Health, part of Ascension)

Harborview Medical Center

- Details: Management contract under which Harborview Medical Center ("HMC") capital assets are owned by King County and HMC is managed by the University of Washington ("UW").
- Primary Goal: To maintain a hospital providing care for King County, while being a teaching center for UW.
- Legal Obligations:
  - HMC has own Governing Board, appointed by County
  - Determined to be an arm of state government, with state obligations.
  - All employees are considered UW employees; those who began at HMC prior to 1970 retain previously acquired county rights, including retirement benefits.

New Not-for-Profit Corporation

- Grady Health System
- Tampa General Hospital
- Truman Medical Centers
- Regional Medical Center at Memphis
- University hospitals of Florida, Maryland, West Virginia, Georgia etc.

Grady Health System

- Details: Lease and transfer agreement
  - Grady Heath System, operated by Fulton-Dekalb Hospital Authority (the “Authority”), is leased to new nonprofit Grady Memorial Hospital Corporation.
- Primary Goal: To gain more operating autonomy from two-county Authority in order to contain costs and gain access to capital & philanthropy
- Legal Obligations:
  - Grady has no responsibility for former/retired employees
  - Grady remains subject to certain public requirements
    - Open Meeting & Records
    - Financial Reports

Tampa General Hospital

- Details: Transfer of Tampa General Hospital ("TGH") from Hillsborough County Hospital Authority to new private, non-profit corporation.
- Primary Goal: Given lack of local financial support, need to compete with private hospitals in the region for privately insured, Medicare and Medicaid patients.
- Legal Obligations:
  - TGH remains subject to liberally-construed sunshine laws.

Merger or Affiliation with Existing Not-for-profit Corporation

- Great Lakes Health System of Western New York
- Boston Medical Center
- UMass Memorial Health Care System
- Fresno County Valley Medical Center
- University of Arizona Healthcare

Great Lakes Health System of Western New York

- Details: Contractual relationship between Erie County Medical Center ("ECMC"), a public benefit corporation, and Kaleida Health, a non-profit corporation.
- Primary Goal: To address excessive bed capacity, duplication of services, and economic challenges in region.
- Legal Obligations:
  - ECMC maintains its status as a PBC, and remains subject to state ethics, personnel, and procurement policies.

Boston Medical Center

- Details: Merger of the public Boston City Hospital ("BCH") with the private not-for-profit Boston University Medical Center.
- Primary Goal: Consolidation of operations and relieving BCH of governmental constraints and obligations in order to improve payer mix and compete more effectively.
- Legal Obligations:
  - BCH must file an annual report to the city on its provision of health care services.
  - BCH is no longer subject to civil service or procurement rules.
  - BCH maintains its status as a public hospital for Medicaid DSH adjustments.

Characteristics of For-profit Systems

- Narrow market focus (urban, suburban, rural)
- Narrow business focus (operating hospitals)
- Junk-rated debt – but retain ability to borrow
- Bullish on health reform!
- Intense focus on operating efficiencies
- Labor costs average 40% of total costs (compared to 53% for all non-profit hospitals under $1 billion)
- Supply costs under 16% of total costs (vs 18-20% for average community hospital)

For-profit Hospital Systems

Publicly Owned (#)

- HCA (154)
- Community Health Systems (126)
- Lifepoint (52)
- Hospital Management Associates (50)
- Tenet (49)
- Universal (25)

Privately Held (#)

- Vanguard (25) (Blackstone)
- Iasis (18) (Texas Pacific)
- Ardent (8) (Welsh Carson)
- Steward (6) (Cerberus)
- Essent (5) (Cressey, Vestar)
- Regional Care (4)
- LHP (2) (Formerly Triad)
- American Health Care Network (0) (Ascension and Oak Hill)
- Over two dozen PE firms waiting in the wings (with $$$)

What Do For-profit Companies/PE Investors Look For?

- Distressed hospitals in need of capital
- Ability to buy cheap and use leverage
- Potential to cut costs and improve cash flow
- Potential to generate scale for company
- Ability to cut deal with labor force
- Continuous growth – potential availability of other providers in market and/or state
- A viable exit strategy – sale, merger or IPO
- To be the next HCA……

Potential Models of For-Profit Acquisition

- Amarillo Hospital District (Universal)
- Oklahoma University Medical Center (HCA)
- Memorial Medical Center, Las Cruces (Lifepoint)
- Detroit Medical Center (Vanguard)
- Caritas Cristi System (Cerberus/Steward)

Detroit Medical Center/Vanguard

- DMC down to a few days cash, with aging plant and equipment, inner city location, declining utilization, poor payer mix
- State refused bailout; local systems not interested; facing closure of most facilities
- $1.267 billion “deal” closed January 1, 2011 – Vanguard agreed to assume $417 million debt, assume pension obligations and spend $850 million on capital over 5 years
- Non-profit board remains in place to manage $140 million spent annually on charity care
- Deals cut with unions

Caritas Cristi/Cerberus

- Six hospital Caritas Cristi system perceived to be failing in aggressively competitive Boston hospital market
- Both Ascension and CHI had passed on opportunity to purchase
- Cerberus agreed in 2010 to pay $895 million to assume debt and pension liability and for capital infusion over five year period
- Cerberus had no previous health industry experience and no management team – Caritas management was preserved and became “Steward”
- Deal cut with SEIU to unionize workers
- Required approval of AG, Archdiocese, state Supreme Court
- Steward has already acquired two other Massachusetts hospitals and has aggressive expansion goals – desire to “scale up” for future “event”

In Conclusion -- Issues to Be Considered

- Remember: effective governance is a tool, not a panacea
- System change requires will, ideas & execution
- Systematically identify key problems – and determine if a new structure can address them (conduct thorough preliminary assessment prior to making final decision to proceed)
- Carefully define new structure: make sure it has the resources and power it needs
- Lay out required process in detail before proceeding, e.g., authorizing legislation, referendum, board structure, services to be transferred, funding, personnel, procurement, information, accounting & financial systems, etc.
- Educate & enlist all relevant stakeholders
- Recruit an outstanding board – and let it function with sufficient autonomy to get the job done