



HEALTH SERVICES AGENCY  
ADMINISTRATION

# COUNTY OF SANTA CRUZ

## HEALTH SERVICES AGENCY

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August 3, 1998

AGENDA: August 11, 1998

### BOARD OF SUPERVISORS

County of Santa Cruz  
701 Ocean Street  
Santa Cruz, CA 95060

RE: Report back Regarding Watsonville Community Hospital Sale

Dear Board Members:

### Background

In 1997, Watsonville Community Hospital (WCH) began seeking either a partner to join them in the management of their hospital or an entity which would purchase the hospital from them and assume ownership. The decision to seek a partnership or sale was based on an assessment of the difficult financial future facing the hospital if they remained independent. The WCH Board, with the assistance of consultants, initiated a process in which they solicited proposals for either a partnership alliance or an outright sale. After considering a number of options, the hospital in late 1997 made a preliminary decision to sell the facility to an organization from Brentwood, Tennessee, by the name of Community Health Services, Inc. CHS operates approximately forty hospitals throughout the country, with one of the forty located in Barstow, California. WCH would be their second California facility.

Watsonville Community Hospital has been operated for a number of years as a not-for-profit organization under relevant California statutes. When the hospital made the decision to sell to CHS, a process was triggered which requires the California State

Attorney General to monitor the sale to be sure that the public benefit is protected. This conversion monitoring process is the result of State legislation several years ago which initiated the public oversight after concern was expressed from a number of quarters about the sale of not-for-profit hospitals to for-profit entities.

During the time between the decision to sell to CHS and now, the hospital and CHS have been engaged in a variety of activities associated with the sale. These have included an extensive appraisal process, various due diligence activities by both parties, and finally the preparation of an elaborate Attorney General required document setting forth the various terms and conditions of the sale and responding to a number of point-by-point inquiries required by State law.

The "sales document" submitted by Watsonville Hospital to the Attorney General is encompassed in five separate volumes totaling more than three thousand pages. A subsequent amendment to the original submission alone exceeds several hundred pages in length. County staff have read portions of the submission and a consultant retained by HSA has also reviewed certain portions to advise on areas of concern and additional areas which may require clarification.

These documents were submitted provisionally to the Attorney General in May. The hospital indicated then, and continues to so indicate, their wish to move the matter forward as rapidly as possible. They have a planned close date for the sale of October 1, 1998, and are anxious to resolve all outstanding issues during the interim. Because the Attorney General has a sixty-day statutory minimum time of review, the hospital was eager for the Attorney General to accept the report and start the sixty-day review period. For this to happen, the Attorney General had to deem the application as "complete" which occurred, effective July 8, 1998. Thus, the sixty-day period could expire in early September, 1998, although the Attorney General has the authority and **discretion** to extend the review period.

#### Recent Events

Since the submission to the Attorney General occurred and was deemed complete, a number of events have occurred. The Attorney General scheduled and held a hearing on Saturday, August 1, 1998, in Watsonville to receive testimony from community representatives and other interested persons. On behalf of Santa Cruz County, I made comments outlining areas of concern of the County and indicating that HSA would follow up with a written report to the Attorney General during the sixty-day comment period. A number of other individuals made presentations. The content ranged from general support of the proposed sale to outright opposition, with many opinions in between.

The issues, both in the community and from the County's point of view, fall into several broad categories. They are as follows:

### **1. The deal.**

There is concern that the sale of the hospital to CHS be a “fair deal” for the community. Determining exactly what is a fair deal, however, is complicated. The proposal from CHS is to buy out the hospital entirely and to liquidate all WCH debts. There are some exceptions to this, however, including a proposal that a portion of the sale proceeds be retained in an “escrow account” which will remain in existence for several years as a hedge against uncertainties associated with outstanding WCH cost report settlements.

### **2. How the new hospital will operate, the kinds of services to be provided, labor force issues, and other matters.**

The County’s concern in this area has been focused primarily on seeking assurances that the hospital, under new ownership, will continue to provide care to indigent persons, that the scope of medical services will be essentially the same or greater than now provided by Watsonville Community Hospital, and that the emergency room will continue to operate as it has prior to the sale. A number of assurances have been forthcoming from both the seller and the buyer that suggest that these issues will resolve to the County’s satisfaction, though some specific control language is still pending.

### **3. How the net proceeds from the sale will be used to benefit the community.**

This community benefit conversion issue is a complex one, but one upon which a great deal of progress has been made in recent weeks. Initially, the hospital proposed to convert their existing Board into a community based entity that would manage the proceeds of the sale for the benefit of the community. A great deal of community concern was expressed over this approach and, through a series of negotiations, the hospital Board has agreed to sponsor the creation of a successor community based health benefits trust organization, which will begin operation at the time that the deal closes with CHS. An agreement has been reached upon how the new organization would be formed, its size, and on how initial Board membership will be determined. The overall structure will be specified prior to the close, but the specifics will be left to the new organization to develop themselves. In general, the organization will be structured with a twenty-person Board of Directors, the majority of whom must live in the hospital’s service area which includes Watsonville and at least some areas on the Monterey County side of the Pajaro River; that the proceeds from the sale will be held in trust with only the interest earnings to be used for community grant purposes; that broad health endeavors will be the focus of their granting authority; and that the Board of Directors must reflect the community served, including ethnicity, gender, and other demographic elements.

While these three issues are the main topics of concern, there are some persons who have expressed concern over the sale itself and have suggested that it should not go

through. Others have suggested that there should be additional requirements tied to the sale to do with labor force, organizing activities and matters of this nature.

While all aspects of the sale appear to be under the purview of the Attorney General, the general stance of the Attorney General's office suggests that they will concentrate on several significant points. First of these is an assessment of the financial aspects of the transaction to determine that it is fair to the community. In this regard, they have secured an independent financial firm from San Francisco that is reviewing the financial documents and who will report directly to the Attorney General. The Attorney General has also secured the services of a health assessment consultant to assess the potential impact on health services as a result of the sale. This consultant is gathering information now, has interviewed a number of persons in the community including County representatives and is expected to provide a report within several weeks. They, too, will report directly to the Attorney General and are selected and engaged to be independent of either the seller or the buyer.

The Attorney General will also comment and possibly provide structure to the community benefit conversion process, including proposed uses of proceeds of the sale. At this juncture, that aspects continues to be under review, and is a point of intervention in which County staff are active. The County wishes to have the result of the community benefit conversion be of such a nature that the community has the greatest possible flexibility in determining its health needs now and in the future, and that the organizational structure be as broad-based as possible.

#### Additional Comments

One of the more challenging aspects of this sale has been trying to determine exactly what might be available for the community when the sale finally concludes. The net benefit could be as low as \$5-\$6 million or as high as \$16-\$18 million. The current conventional wisdom is that the benefit will finally settle out in the range of \$10-\$15 million. One complicating factor is that the community will receive directly some resources which have substantial value, but which are not included as part of the deal between Watsonville Hospital and CHS. One of these is the property located at Hoolihan Road and Green Valley Road where the "old hospital" is located. While this facility suffered significant damage in the Loma Prieta earthquake and has little value as a health care facility, it still has potential for being converted to other useful purposes. In any event, the ground upon which it sits has a substantial value. That property has an appraised value of about \$600,000 based upon the bare land alone, but some real estate professionals have suggested that it probably has a net value in the range of \$2 million.

In addition, the proceeds of the Watsonville Community Hospital Foundation will inure to the benefit of the newly formed health trust. The exact value of this depends upon just how and when the conversion finally occurs. This, however, could be in the range of several hundred thousand dollars. Finally, the proceeds of the escrow account, after

all the cost settlements occur in the next year or two, will be returned to the community benefit foundation. This is somewhat of a speculative matter and, in fact, there could be no proceeds if some of the cost report element outcomes are adverse, but there is a general sense of optimism and expectation that there will be some resources resulting from this.

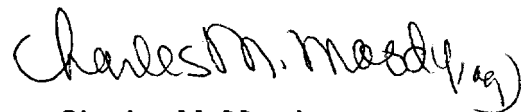
As you can see, the issues associated with the proposed sale are varied and complex. Health Services Agency intends to return to the Board with on August 25, 1998, with an update summarizing the Attorney General's concerns and an additional status report.

I am prepared to discuss more details of this matter with the Board in open session or to provide briefings to Board members and staff upon request.

It is therefore RECOMMENDED that your Board:

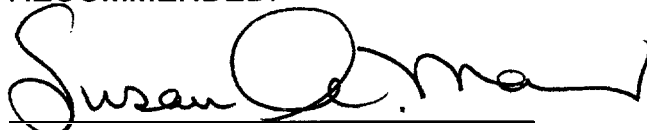
1. Accept and file this report regarding the Watsonville Community Hospital sale, and
2. Direct the HSA Administrator to return on August 25, 1998, with a progress report on the proposed sale covering the Attorney General's concerns.

Sincerely,



Charles M. Moody  
HSA Administrator

RECOMMENDED:



Susan A. Mauriello  
County Administrative Officer

CMM/amg

cc: CAO  
Auditor-Controller  
County Counsel  
HSA Administration