Effect of Purchase of USC Kenneth Norris Jr. Cancer Hospital by Tenet Healthcare Corporation on the Availability and Accessibility of Health Care Services

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I. REPORT PURPOSE, SCOPE AND METHODS

This report, prepared for the Office of the California Attorney General, assesses the potential effects of the acquisition of the University of Southern California – Kenneth Norris Jr. Cancer Hospital ("Norris"), a California nonprofit public benefit corporation, by Tenet Healthcare Corporation ("Tenet") on the availability and accessibility of health care services.

The transaction involves sale of the Norris Hospital business operations. After the transaction closes, the current Norris Hospital "real property" (land and buildings) would still be owned by USC and would be leased to Tenet.

The transaction effectively would lead to the merger of Norris Hospital and USC University Hospital, which is owned and operated by Tenet. The merger is intended to integrate Norris and USC University Hospital governance, medical staff, employees, policies and procedures, accounting records, and decision making. After a transition period allowing USC University Hospital to complete construction of a new inpatient tower and the relocation of Norris Hospital inpatients to that tower, the merger would be finalized by combining the hospitals under a single hospital license.

The Lewin Group analyzed the health impacts of this proposed transfer of ownership by performing the following tasks:

- Review of documents, including the Application for Approval submitted to the California Attorney General on October 4, 2002, the Asset Purchase Agreement dated September 30, 2002, the Applicant's Health Impact Assessment, and other materials;
- Attendance at the Attorney General's November 4, 2002 public meeting concerning this transaction;
- Analysis of data regarding Norris Hospital services and finances;
- Interviews regarding the implications of the transaction –

  Interviewees included: Board members and management staff of Norris Hospital (including members of the committee that negotiated the sale of the hospital's business operations to Tenet); representatives of Tenet; National Cancer Institute (NCI) staff; executives from other U.S. cancer centers; leadership in the Los Angeles County Department of Health Services; representatives of community organizations concerned with health and human services in Los Angeles; and consumer and advocacy organizations; and
- Development of proposed mitigation measures to reduce or eliminate the potential for adverse health effects from the transaction.

To prepare this report, we relied on data provided by the applicants (USC and Tenet Healthcare) in their application to the Office of the Attorney General for approval of the transaction. Additional data was obtained through three data requests transmitted between October and December 2002.

The Lewin Group wishes to express its appreciation to those who provided input and data for this study.

II. NORRIS HOSPITAL: BACKGROUND AND PROGRAMS

The University of Southern California - Kenneth Norris Jr. Cancer Hospital (Norris), a nonprofit public benefit corporation, is a 60-bed patient care facility (Norris Hospital) that provides tertiary[1] inpatient and outpatient clinical services for cancer patients and supports the research mission of the USC/Norris Comprehensive Cancer Center (Norris Cancer Center). USC is the sole corporate member of Norris.

The Cancer Center, a legally distinct entity, is an organized research unit (division) of the Keck School of Medicine (Keck) and is one of thirty-nine Comprehensive Cancer Centers recognized by the National Cancer Institute (NCI). Both the Norris Hospital and the Cancer Center are located on the University of Southern California (USC) Health Sciences Campus in east Los Angeles.

Norris Hospital is not a typical health care provider. Its services focus predominantly on one specialty: cancer care. Norris Hospital does not operate an emergency room. The hospital primarily has treated patients with third-party coverage (e.g., private insurance or Medicare) and has not been providing services for Medi-Cal funded or uninsured patients. Although Norris has provided community benefits and operates as a non-profit corporation, the hospital has not been a major provider of community care for Los Angeles residents.

A. History of Norris Hospital

In 1966, the USC School of Medicine received a grant from the National Cancer Institute to plan a center for cancer research, education, and community service. The Cancer Center was inaugurated as the Los Angeles County-USC Cancer Center in 1971 and recognized as a Comprehensive Cancer Center by the NCI in 1973.

Initially, clinical programs associated with the Cancer Center were provided only at Los Angeles County + University of Southern California Medical Center ("LAC+USC") and Children's Hospital Los Angeles ("CHLA"). To facilitate the Center's growth, in the early 1980s, Los Angeles County voters were asked to approve funding to establish a new County-owned and operated cancer hospital to be staffed by Cancer Center faculty. When this proposal was defeated, USC sought alternative funding. The Center received a substantial NCI construction grant ($11.9 million) and funds from philanthropist Kenneth Norris, Jr., and in early 1983, the Cancer Center and Hospital occupied the current buildings at 1441 Eastlake Avenue.

Because of the successful performance of Norris Hospital, USC decided in the mid-1980s, to sponsor development of additional hospital capacity. In 1985, USC leased ground to National Medical Enterprises (NME), which constructed USC University Hospital on that site. USC University Hospital operations are governed by a Development and Operating Agreement, executed in 1985, between USC and NME (now Tenet).

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[1] "Tertiary care" refers to high-acuity, highly specialized services, often for patients who already have received treatment in primary care or community hospital settings but require sophisticated follow-up care.

In 2001, USC University Hospital operated 246 of its 285 licensed beds, and reported an average daily census of 181 inpatients. Between 1995 and 2001, patient care volume increased and financial performance for USC University Hospital improved dramatically. USC University Hospital reported operating revenue of $283 million and net income of $78 million for its fiscal year ended May 31, 2002.[2]

According to USC and Tenet representatives, Norris Hospital's financial performance was weak during the mid-1990s, leading USC to enter into a management agreement with Tenet for operation of Norris Hospital.[3] The management agreement states that the agreement's purpose has been to further Norris' "charitable purposes by providing quality health care services to patients in an efficient and economical manner.[4]" Under the agreement, the Board of Norris Hospital has retained all authority and control over "the business, policies, operation and assets of the Hospital, including the authority over capital budgets and/or non-budgeted capital expenditures.[5]"

Tenet's role also has been to assist in implementing Board policies and directives consistent with JCAHO standards, financial resources available to the Hospital, the competitive marketplace, and applicable laws and regulations. Under the agreement, Tenet has been providing executive managers, access to the USC University Hospital Chief Executive Officer, the hospital's Chief Operating Officer, assistance with budget development (in accordance with Tenet's standard policies and procedures), and access to Tenet's group purchasing arrangements.

The management agreement also includes a Right of Exclusive Negotiation under which USC was required to notify Tenet of any determination to sell Norris Hospital, and Tenet and USC would be able to enter into exclusive negotiations for selling Norris over prescribed time periods. USC decided to sell Norris Hospital and entered into exclusive negotiations during 2001.

Under Tenet's management, Norris hospital financial and operating performance improved, and several interviewees suggest quality also has been enhanced. Interviewees attributed Tenet's successful management to three primary factors:

- Tenet provided improved access to managed care contracts and to relationships with other Los Angeles-area medical staffs and hospitals (including a few Tenet hospitals in the region) which helped to increase hospital census and volume.

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[2] USCUH Individual Disclosure Report, year ended May 31, 2002.

[3] OSHPD reports confirm that Norris Hospital generated a net loss for 1997, and reported positive net income during the prior two years. In 1996, Norris expanded its physical facilities to include the Topping Tower. Capital-related expense associated with this tower substantially explains the decline in financial performance between 1996 and 1997.

[4] Management Agreement, 2001

[5] *Ibid.*

- Tenet managers lowered Norris' staffing ratios (e.g., the number of productive, full time equivalent employees per adjusted occupied bed[6]). Most of the staffing reductions were in administrative and support functions – several of which have been provided by Tenet through the management agreement. Productive hours per adjusted occupied bed for direct patient care staff remained constant from 1995 through 2001.

  Tenet also adjusted the budget to ensure that the hospital was not subsidizing research activities.

- Tenet and USC jointly recruited high-profile academic physicians to Norris and developed or enhanced patient programs at the hospital.

Program development, contracting, and faculty recruitment activities proved successful. Patient days at Norris increased from 12,801 in 1997 to 16,214 in 2001 – a 27 percent increase in the average daily census of inpatients from 35 to 44. As a result, Norris' net income increased from 1997 losses exceeding $3 million to positive net income for fiscal year 2002 of over $7.5 million. Norris Hospital's annual operating revenue now exceeds $80 million.

In July 2001, consultants from The Camden Group presented a report to the Norris Hospital Board recommending capital expenditures of $30 to $50 million over the next three years to keep Norris Hospital viable. This conclusion was based on Camden's findings that Norris needed to operate 90 or more inpatient beds and upgrade its facilities to remain an effective and competitive health care services provider. Several options were considered to finance these needs such as fund raising, financing the capital from USC debt, and pursuing a transaction with Tenet.

In December 2001, the Norris Board passed a resolution to allow the Executive Vice President of USC to negotiate terms for a transaction to sell Norris Hospital to Tenet. Lewin's understanding of the proposed transaction that resulted from this negotiation process is described later in this report.

B. Role of Norris within the USC Health Sciences Center

USC Health Sciences Center. USC was founded in 1880. The School of Medicine was organized in 1885 and was named the Keck School of Medicine in 1999 in recognition of a major gift. The Keck School of Medicine, the School of Pharmacy, and the departments of Nursing, Occupational Therapy, and Physical Therapy all are located on the University Health Sciences Campus.

Clinical services on the Health Sciences Campus include: Norris Hospital, USC University Hospital, the outpatient Healthcare Consultation Center, and the Doheny Eye Institute. These facilities, in addition to LAC+USC (located on the Health Science Campus) and CHLA (not located on this campus), are the primary clinical teaching resources for the Keck School of Medicine. Keck faculty staff LAC+USC through a multi-year professional services agreement

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[6] Calculated by OSHPD as (inpatient days / 365) * (Total Charges / Inpatient Charges)

with Los Angeles County that governs the teaching and research relationship and provision of faculty and resident physician resources to LAC+USC.

Norris Cancer Center. The Cancer Center is an organized research unit (division) of the Keck School of Medicine. The Center Director is appointed by the Dean of the Medical School, functions like a department chair, and is a voting member of the Executive Committee of the School of Medicine. The Director of the Cancer Center also serves as Vice President of Norris Hospital and works with the Norris Hospital Medical Director and associate directors.

The Executive Committee of the Cancer Center is comprised of the Center director, five associate directors, the Norris Hospital Medical Director, and the chair of the Cancer Survivorship Advisory Council. The committee reports directly to the Cancer Center Director. There also are seven other internal committees (Advisory, Cancer Education Scholarships, Cancer Survivorship Advisory Council, Clinical Investigations, Post-doctoral Supplemental Awards, Quality Assurance, and Scientific Review) and an External Advisory Committee in addition to the Executive Committee.

Clinical services at Norris Hospital are provided by approximately 195 “members” and “associate members” of the Cancer Center—faculty members with research grants. Norris also includes 378 physicians and 23 faculty fellows on its medical staff from the following Keck School of Medicine departments: anesthesiology, medicine, pathology, radiation oncology, radiology and surgery.

All Norris Hospital physicians are faculty members of the Keck School of Medicine. Cancer Center members provide, and in some instances supervise, patient care and conduct clinical research at Norris Hospital, USC University Hospital, LAC+USC, and CHLA. No community-based non-faculty physicians practice at Norris Hospital.

All clinical programs at Norris focus on care of cancer patients. The principal clinical programs at Norris are gastroenterology, surgical oncology, gynecology, hematology, medical oncology, radiation oncology, urology, pain management and bone marrow transplantation.

Norris Cancer Center Grant Funding. The Norris Cancer Center has attracted an average of about $100 million in research awards during each of the last three fiscal years. Research grant funding has been received from the NCI, other institutes of the NIH, the American Cancer Society, the National Science Foundation, and other peer-reviewed and non-peer-reviewed sources.

The Cancer Center has nine research programs with five discipline-based programs: Molecular Genetics, Regulatory Biology, Developmental Therapeutics and Clinical Trials, Cancer Epidemiology and Cancer Control Research; and four disease-based translational cancer research programs[7]: Genitourinary, Gastrointestinal, Breast, and Hemologic Malignancy/ Retroviral Disease.

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[7] Translational cancer research uses knowledge of human biology to develop and test the feasibility of cancer-relevant interventions in humans AND/OR determines the biological basis for observations made in individuals with cancer or in populations at risk for cancer.

In 2001-2002, the Norris Cancer Center received $107 million for 348 grants in these areas. Cancer epidemiology received 21 percent of the total grant funding, followed by Developmental Therapeutics and Hemotologic Malignancy. These last two categories also experienced growth in dedicated grant funding of 38 and 44 percent, respectively, over the 1999-2000 to 2001-2002 period.

For the year ended December 31, 2001, there were 1,636 adults and 485 children enrolled in Norris-associated cancer treatment protocols. Of the adults, 50 percent were in trials at Norris Hospital, 43 percent at LAC/USC, and another seven percent at affiliated hospitals. Of the adult trials, 41 percent were for therapeutic trials. Research trials for children generally were conducted at CHLA.

The Cancer Center also received an average of $15 million in annual fund raising between 1995 and 1999. The major funds raised were designated and allocated principally to cancer research.

C. NCI Designation

The Norris Cancer Center is one of thirty-nine Comprehensive Cancer Centers in the United States as designated by the NCI. To be designated as "comprehensive," a cancer center must meet broad requirements (as evaluated by a peer review process) and must demonstrate to the NCI that the center serves its community in the areas of outreach, education and cancer information. None of the thirty-nine Comprehensive Cancer Centers are for-profit entitites.

Comprehensive Cancer Centers conduct basic, clinical, prevention, control, behavioral, and population-based research integrated across program areas. Comprehensive Cancer Centers also participate in NCI cooperative groups by providing leadership and recruiting patients for clinical trials, and providing outreach, education and information on cancer to the communities they serve.[8]

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[8] To receive this NCI designation, a Comprehensive Cancer Center must have six basic characteristics:

- The institution must have a **cancer focus.**
- **Institutional Commitment.** The Center must be part of an institution where the cancer center is a formal, stable and continuous (even with a change in director) organizational component with the organizational status of other similarly important organizational units in the institution.
- **Organization Capabilities** of the Center should promote collaborations and interactions among its programs and enable the Center to take advantage of institutional capabilities in cancer research.
- **Facilities** should be dedicated and sufficient to meet the Center's conduct of research and administrative activities. There should also be a central physical location to establish an identity for the center.
- **Center Director** should be a highly qualified scientist and administrator with leadership experience and authority for managing a complex organization. The director should have authority to control and conduct periodic review of appointments of individuals as members of the cancer center; control of faculty appointments to the cancer center; full or shared control of specific research and resource space and equipment dedicated to the cancer center; to assure adequate access to both inpatient and outpatient facilities to support clinical research.

Ethnic and gender diversity is a goal for NCI clinical trials, and Cancer Centers are required to report these statistics. According to the most recently filed application to the NCI for core grant funding, the Norris Cancer Center has been encouraged by NCI in recent years to assure the participation of minority patients in clinical trials. The Cancer Center implemented certain organizational changes in response to these concerns.

Importantly, the National Cancer Institute relies on a peer review process to determine whether entities initially (or continue to) qualify for the Comprehensive Cancer Center or Cancer Center designations. The NCI review committees, comprised of external peer reviewers that visit potential or existing Comprehensive Cancer Centers for this process, assess whether they fulfill "the broad scientific and interactive requirements for comprehensiveness," and make efforts "to serve their communities in each of the areas of outreach, education, and cancer information.[9]"

The NCI has been apprised of the proposed transaction with Tenet. An External Advisory Committee visited Norris in April 2002 and was informed in detail about the potential change in control. This committee noted in its report that "the positive experience over the years of dealing with Tenet…provides a degree of comfort that this new arrangement will also go well, and due diligence on details of the agreement will help assure that end."

Potential risks to the Comprehensive Cancer Center designation were a key focus of the negotiations between USC and Tenet. Provisions to protect this designation were included in a separate Cancer Center Support Agreement. Some provisions were suggested by the leadership of the NCI after it was informed of the proposed transaction, and these suggestions were incorporated into the agreement.

Several of the 39 Comprehensive Cancer Centers now operating in the United States do not own or directly operate clinical facilities. For example, the Fred Hutchinson Cancer Research Center (along with the University of Washington and Children's Hospital and Regional Medical Center) recently consolidated their adult and pediatric medical oncology/hematology clinical programs into a separate, jointly governed Seattle Cancer Care Alliance (SCCA). Each of the three SCCA Members has equal ownership in the SCCA. FHCRC thus converted its 100 percent ownership of its hospital capacity to one-third ownership in a consolidated Alliance program. The agreements specify a number of provisions and requirements designed to protect the NCI Comprehensive Cancer Center designation.

For Fred Hutchinson and other Comprehensive Cancer Centers, maintaining influence and input over the clinical operations has been important to preserving the Comprehensive Cancer Center designation.

- **Interdisciplinary Coordination and Collaboration.** There should be a variety of disciplines and a high degree of coordination, interaction and collaboration among cancer center members that enhances the quality and productivity of the cancer research at the center.

[9] National Cancer Institute.

D. Overview of Norris Hospital's Programs

Norris Hospital provides comprehensive inpatient and outpatient care for cancer patients and integrates research into clinical practice through clinical trials. Norris Hospital also offers community benefit and cancer education programs for consumers, and continuing education conferences for physicians and other health professionals.

Inpatient Services[10]. During fiscal year 2002, Norris reported 2,886 total discharges, a slight increase over fiscal year 2001. Occupancy rates in the hospital were about 78 percent of the hospital's 60 licensed beds. Gross inpatient revenues represented 56 percent of total gross patient revenue.

Outpatient Services. Norris Hospital provided 66,275 outpatient visits in fiscal year 2002, an increase of 5 percent over 2001. Outpatient services are organized into four main programs: clinic, day hospital, radiation oncology, and breast cancer. (**Exhibit 1**).

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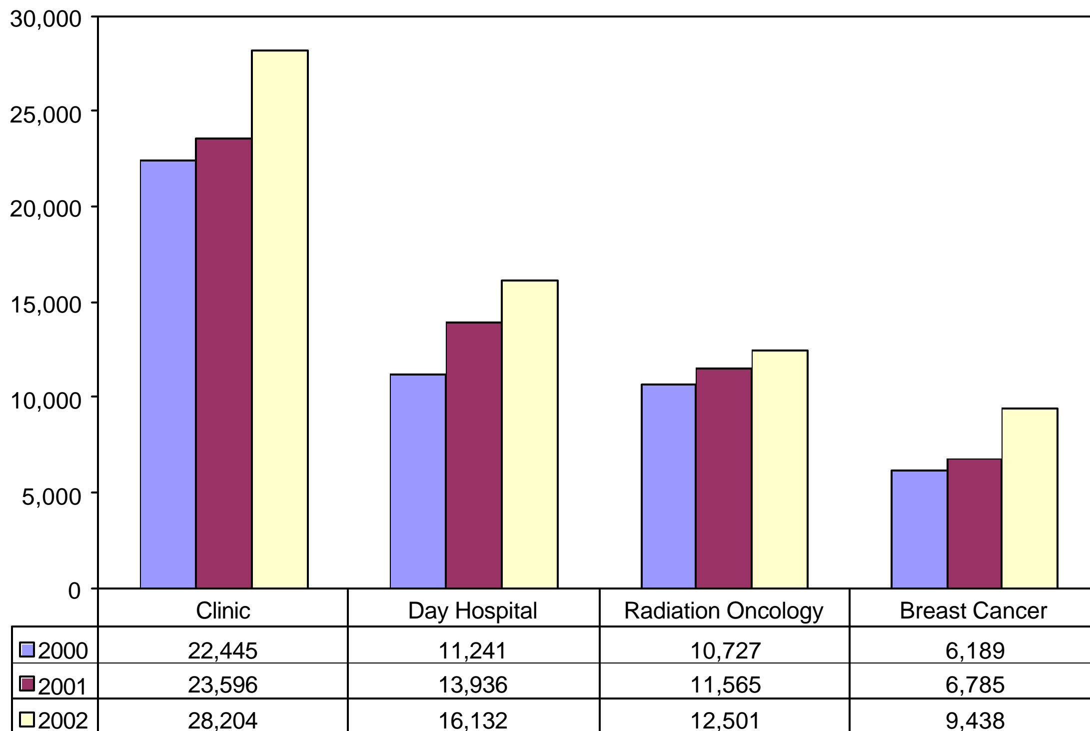
[10] Inpatient services require a hospital stay in excess of 24 hours.

Exhibit 1
Outpatient Visits for FY 2000 to FY 2002



	Clinic	Day Hospital	Radiation Oncology	Breast Cancer
2000	22,445	11,241	10,727	6,189
2001	23,596	13,936	11,565	6,785
2002	28,204	16,132	12,501	9,438

Source: Norris Hospital records.

- Clinic services, which represented 43 percent of total outpatient visits in FY 2002, are similar to physician office visits. The hospital bills for facility/technical fees for services it provides. The faculty practice plan bills patients for professional (physician) service fees.

- The day hospital outpatient center functions as an infusion center to administer intravenous chemotherapy drugs, blood transfusions and other adjuvant therapy requiring specialty oncologic nursing and observation. These services experienced a 44 percent increase in visits over the FY 2000 to FY 2002 period.

- The radiation oncology programs provide services such as external beam radiotherapy, stereotactic radiosurgery (using a gamma knife and cyber knife), high dose brachytherapy, hyperthermia and mammosite for cancer patients.

- The Breast Center provides coordinated services for the diagnosis and treatment of breast cancer using mammography, ultrasound studies, and biopsies. This clinic also provides genetic counseling for women with the potential high risk of acquiring breast and/or ovarian cancer. This category of outpatient visits was the fastest growing category of outpatient services with a 52 percent increase in visits over the 2000 to 2002 period.

E. Medicare Prospective Payment System Exemption

In 1983, the Medicare Inpatient Prospective Payment System (PPS) was implemented. Under PPS, the payment level for each Medicare discharge is set prospectively. The payment per discharge is based on each hospital's base payment rate and the relative weight associated with the Diagnostic Related Group (DRG) to which the patient's hospital stay is assigned (or grouped).

DRGs are used to categorize patients into about 527 clinically coherent groups based on the patient's age, gender, principal diagnosis, and surgical procedures performed during the hospitalization. The DRG relative payment weights are designed to reflect variation in the resources used to treat different types of inpatient cases[11]. The Center for Medicare & Medicaid Services (CMS) recalibrates the DRG relative payment weights annually. The PPS system also incorporates payments for high-cost outlier cases,[12] for hospitals with graduate medical education programs, and for hospitals that serve disproportionate numbers of low-income patients.

As a cancer hospital exempt from the Medicare PPS, inpatient Medicare discharges at Norris Hospital instead are reimbursed under a "TEFRA[13] methodology" that relies on the actual cost per Medicare case established in a base year period from the 1980s. This actual cost per case, after inflation factors that have been applied since the 1980s, serves as the maximum payment amount that Norris can receive under the TEFRA methodology.

On August 1, 2000, Medicare began to reimburse hospital outpatient services using Ambulatory Payment Classifications (APCs) in a new Outpatient Prospective Payment System (OPPS). Like the inpatient PPS, the OPPS replaced a cost-based system. Under the OPPS system, the payment for each outpatient service is a function of a base payment rate (conversion factor) for outpatient services and a relative weight that varies for about 600 different services.

Norris Hospital and certain other hospitals devoted to cancer care have been exempted from PPS. This "Medicare PPS Exemption" has been valuable to Norris Hospital (and to other cancer hospitals) – providing Norris with reimbursements based on its actual costs. As a cancer hospital also exempt from the OPPS, Norris Hospital is reimbursed on the basis of its actual allowable cost incurred in treating Medicare patients in outpatient settings. The intent of both the inpatient and the outpatient Medicare exemptions has been to recognize the unique cost structure and services provided by cancer hospitals and to support their financial performance and ongoing availability. According to Norris managers, the exemption yields annual inpatient and outpatient Medicare revenue "several million dollars" higher than would the PPS and OPPS[14].

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[11] Centers for Medicare and Medicaid Services, "Federal Register" pp. 49985, August 1, 2002.

[12] Note: Concerns have been raised regarding Tenet Healthcare's high level of outlier reimbursement under the Medicare PPS.

[13] TEFRA refers to the Tax Equity and Fiscal Responsibility Act of 1982, which made various Medicare reforms.

[14] Lewin requested but did not receive analyses regarding the amount of additional revenue generated by the PPS exemption. This information was deemed proprietary by the applicants.

The proposed Asset Purchase Agreement contemplates the continuation of the Medicare PPS exemption during the Transition Period before Norris Hospital is consolidated with USC University Hospital.

F. Medi-Cal Services

Norris Hospital entered into a contract with the State of California DHS to provide inpatient services to Medi-Cal beneficiaries effective May 1, 2001. Prior to that date, Norris Hospital did not provide services to Medi-Cal beneficiaries. Keck faculty provided health care services to Medi-Cal cancer patients primarily at LAC+USC and CHLA. According to Norris Hospital representatives, the primary purpose of obtaining a Medi-Cal contract was to enable Norris Hospital to provide bone marrow transplant services and to recoup Medi-Cal reimbursement for these services.

According to data filed in Norris Hospital's fiscal year 2002 Medi-Cal cost report, the hospital provided reimbursable services for 10 Medi-Cal discharges with 101 patient days.

III. PROPOSED SALE TO TENET HEALTH CARE

This chapter summarizes the agreements that would govern the transaction between Norris and Tenet; discusses provisions related to the maintenance of the NCI Comprehensive Cancer Center designation; presents plans for inpatient and outpatient cancer services; and outlines plans for the foundation to be created with the proceeds from the sale of Norris Hospital assets. This section also discusses the rationale for the transaction as described by USC and Tenet.

A. Overview of the Agreements

The purchase of the assets of University of Southern California – Kenneth Norris, Jr. Cancer Hospital by Tenet would be governed by an Asset Purchase Agreement (APA), which specifies the assets that would be transferred, the purchase price, and the obligations and responsibilities of both the buyer (Tenet) and the seller (Norris). Supplementing the APA are other documents that would govern specific areas of the transaction:

- Cancer Center Support Agreement: Designed to preserve the Norris Comprehensive Cancer Center designation through placing various operational, quality and research requirements on Tenet.

- Norris Agreement: Establishes a "not to compete" agreement that would prevent USC from competing with Tenet in matters of cancer care for seven years after the purchase.

- Lease Agreement: Outlines both parties' rights and responsibilities in the leasing of the Norris buildings, and the damages and remedies available in case of default.

- License Agreement: Grants Tenet authority to use licensed trademarks, catalogs sanctioned uses, and establishes a quality control system for the use of the licensed trademarks.

- Indemnification Escrow Agreement: Would establish the role of an escrow agent (who would retain a portion of the sales proceeds for a specified time period) and the protocol to be followed when resolving claims.

The APA was signed by USC and a Tenet subsidiary on September 30, 2002 and final closing originally was scheduled for February 13, 2003.

Assets Transferred by Norris Hospital to Tenet. The primary assets to be transferred to Tenet include items related to the operations of the Norris "hospital business" such as equipment, inventories, contracts, leases, transferable certificates of need, accreditations, registrations, licenses, permits, other governmental consents or approvals, unexpired warranties and covenants not to compete received from third parties, rights to computer hardware used at the hospital, and additional assets identified in a schedule to be prepared before closing.[15]

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[15] This schedule is not yet available.

Assets Retained by Norris Hospital. The primary assets to be retained by Norris Hospital (and its sole corporate member, USC) are real property, buildings (the Leased Premises), current assets (including cash, securities, working capital and accounts receivable but excluding inventory and prepaid expense), names, corporate records and other assets that will be identified in a schedule prior to closing.[16]

Norris Hospital Services. As described in the APA, Tenet would operate Norris Hospital as a separately licensed general acute care facility in space owned by USC and leased by Tenet until the end of a Transition Period which would last until construction of a new tower at USC University Hospital is completed (estimated to be four years from the date of closing).

During the Transition Period, Tenet would own the Norris Hospital business, would operate the Norris Hospital and offer the same programs and services now present, and would not terminate or materially reduce the services and programs provided.

At the expiration of the Transition Period, Tenet would transfer acute care service and inpatients that now are present in the Norris Hospital's 3rd and 4th floors to the new tower. According to Tenet representatives, the incremental capital cost to include Norris beds and inpatient services in the new tower is approximately $27 million. After the Transition Period, Tenet would reconfigure the current Norris Hospital buildings (Leased Premises) to develop outpatient cancer clinics comparable to those of a specified Peer Group, expand the Lee Breast Clinic, and open a urologic institute.

When Norris Hospital and USC University Hospital are consolidated, Tenet would cease operating Norris Hospital as a separately licensed facility and would integrate Norris Hospital programs into the license for USCUH.

After the Transition Period, any termination or material reduction in "core programs or services"[17] would require four months' prior written notice to USC, consultation with the Norris Cancer Center Director and faculty specializing in cancer care, and approval of the USC University Hospital Governing Board.

If Tenet breaches this element of the agreement and fails to provide the "core programs or services," USC's remedy would be to vacate the Leased Premises (the current Norris Hospital buildings) and transfer to USC all equipment and furnishings on the site so the space could be operated by another provider as outpatient clinics.

Purchase Price. The purchase price and prepaid rent for the transferred assets is the sum of three components: the price of $35 million, of which $20 million is to be paid at closing and $15 million upon the earlier of the completion of the new tower or five years after closing; an adjustment based on whether the sum of the inventory on hand and the prepaid expenses exceeds plus or minus five percent of their values on June 30, 2002; and half of filing costs to a maximum of $250,000.

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[16] *Ibid.*

[17] A draft schedule of "core programs and services" has been provided, but as of the publication date for this report has not been approved by USC.

Proceeds Allocated to USC. According to the terms of the transaction and a valuation of Norris Hospital relied upon by the Norris Board and USC, $5 million of the purchase price would be paid to USC and deposited in its general capital funds. This payment reimburses USC for: the termination of an arrangement with Norris through which USC made available to Norris the space to operate the Norris Hospital, a licensing agreement to allow Tenet to use the University's name, and a covenant through which USC agrees to not compete with Tenet for seven years.

According to a January 24, 2003 communication from USC, the University "intends to (1) deposit the $5 million in its general capital funds held for investment and (2) designate the funds for exclusive use in activities which (i) further cancer research activities and (ii) are consistent with the charitable activities and purposes of Norris [Hospital]."[18]

Governance. During the Transition Period, Norris Hospital would have a separate Governing Board – comprised of the same 15 members as the governing Board for USC University Hospital: 5 USC-appointed members (the five include the CEO of USC Care, the Dean of the Keck School of Medicine, the Cancer Center Director, the current USC University Hospital Chief of Staff and the immediate past USC University Hospital Chief of Staff), and 8 Tenet-appointed members. When acting as the Governing Board of Norris, this body would have authority over the medical aspects of Norris Hospital's operations, including final decisions concerning medical appointments and reappointments, and physician contracts. The Governing Board also would be responsible for maintaining Norris Hospital's licensure and accreditation from JCAHO, appointing the CEO (and successors), approving the hospital CEO, and reviewing and commenting on operating and capital budgets. After the Transition Period, the Governing Board of USC University Hospital[19] would oversee all operations of the inpatient and outpatient Norris Hospital businesses.

Capital Expenditures. During the five years after the closing, Tenet would commit to spending a minimum of $10 million in capital on the Leased Premises. Capital expenditures would be used to purchase equipment, make improvements or renovations, reconfigure the Leased Premises after the transfer of the inpatient services to the new tower to accommodate outpatient cancer services, and expand the Lee Breast Center and open a urological institute.

Fund Raising. USC or Norris would continue to control charitable fund raising activities related to the Norris Cancer Center.

Medical Staff. During the Transition Period, and after as part of the USC University Hospital, only physician faculty members of the Keck School of Medicine would be permitted to be members of the Norris medical staff (subject to very limited exceptions). Residents and interns would continue to train under the supervision of Norris-credentialed Keck faculty at the hospital during the Transition Period; after the Transition Period, resident and intern training would take place at the merged University Hospital in its cancer programs.

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[18] Letter from Stanley P. Gold, Chairman, University of Southern California to Bill Lockyer, January 24, 2003.

[19] According to Tenet representatives, the USCUH Board members receive nominal compensation ($200 per meeting).

Employee Matters. Tenet would extend employment to every employee of Norris who is in good standing, excluding those whose employment status has been restricted for correction, disciplinary or other reasons, and any other employee who is otherwise identified in a nondiscriminatory manner. All of the employees offered continuation of their employment would be subjected to Tenet's customary background checks, and would subsequently be hired at will with no employment contracts being generated. Only those employees under contracts that are assumed by Tenet would remain under contract. All hired employees would retain their seniority and be offered the same health care and other benefits as are provided at USC University Hospital.

Charity and Indigent Care. The level of Charity and Indigent Care would be determined for the fiscal year ending June 30, 2002 and that amount would be used as a minimum benchmark for Tenet's provision of Charity and Indigent Care at Norris during and after the Transition Period.

Payer Agreements. Tenet would have the option to accept Norris' Provider Agreement with Medicare, Medi-Cal, and TRICARE/CHAMPUS, or it can reject any or all of them (by notifying the hospital in writing before the expiration of the Due Diligence Period). If any agreements are rejected, Norris would be obligated to help Tenet secure new agreements. Additionally, the agreements require certification or confirmation that the Norris Hospital will continue to qualify for and maintain its exemption from the Medicare Prospective Payment System during the Transition Period. Once Norris Hospital and USC University Hospital are consolidated, the Medicare exemption would be lost[20].

Quality Standards. Both during and after the transition period, the level of care at Norris Hospital would be compared to a Peer Group of institutions. Initially, the Peer Group would be composed of the Dana-Farber Cancer Institute, Fox Chase Cancer Center, Fred Hutchison Cancer Research Center, University of Michigan Comprehensive Cancer Center, Johns Hopkins Oncology Center and the City of Hope National Medical Center. After the Transition Period, the Peer Group could change based on recommendations from the External Advisory Committee of the Cancer Center or the Norris Board of Directors to the Governing Board of the University Hospital.

Some statistics that currently are being used by Norris Hospital to measure and compare quality include: mortality, morbidity, length of stay, patient care complications, and readmissions. Specific quality measures are not included in the agreements.

Agreement Not to Compete. For seven years after the Closing Date, USC would agree not to compete with Tenet in Southern California by owning, managing, or operating another NCI designated Comprehensive Cancer Center or any provider of clinical cancer services. The agreements do not limit Keck faculty from affiliating with other hospitals or cancer programs and include an exception for current relationships and affiliations of the hospital.

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[20] Tenet representatives indicated that Tenet and USCUH are not likely to reapply for the PPS exemption for Norris Hospital's programs.

Licensing / Use of Name. Tenet will receive the right and authority to use the licensed trademarks of Norris Hospital in connection with providing clinical cancer services at Norris Hospital. These rights would automatically be terminated if the Lease Agreement is terminated, the NCI designation is lost due to insufficient outpatient services, or the hospital's NCI designation is affected by the licensee's affiliation with another NCI designated Comprehensive Cancer Center in the region outlined in the agreement.

B. Maintaining NCI Designation

The continuation of the NCI Comprehensive Cancer Center designation for Norris Cancer Center has been a significant concern for USC and for USC faculty. To ensure this designation is not lost due to the acquisition of the Norris hospital business, Norris sought written documentation from the NCI stating that the transaction would not cause loss of this designation.

In March 2002, Tenet and Norris met with the NCI to discuss plans for the transaction. The NCI responded in writing that the transaction "seemed reasonable and feasible. This should not compromise the NCI cancer center's ability to conduct clinical research if the fundamental principles outlined in the terms of your Agreement are upheld in good faith."[21] The letter emphasized that the designation would be subject to the peer review process at the time of the next application for the NCI core grant.

The letter also suggested that the agreements between USC and Tenet should emphasize the following five points:

- Commitment to a single cancer center in the institution;
- Closed medical staff of USC faculty for Norris Hospital programs;
- The Cancer Center Director should have sole authority to nominate the Oncology Director for Norris Hospital programs;
- The performance of the Oncology Director should be evaluated based on effectiveness of facilitating clinical research; and
- The External Advisory Committee comprised of peer reviewers should meet regularly to evaluate the effectiveness of the clinical programs to facilitating clinical research.

These points were incorporated into the Cancer Support Agreement.

Interviewees from other cancer centers we contacted for this study emphasized that continuing the Comprehensive Cancer Center designation would be facilitated if agreements between the parties included the following elements.

[21] Letter from the NCI dated March 21, 2002.

- Explicit mechanisms that "demonstrate institutional support for the cancer center" are important to maintaining the NCI designation. One suggestion was to commit a portion of hospital profits to supporting research.

- Clinical programs associated with cancer centers always include certain services that are not profitable, but needed for comprehensive and sensitive patient care. These services should be protected to assure continuation of the Comprehensive Cancer Center designation.

- One cancer center that recently reorganized clinical services emphasized the importance of retaining clinical services budget authority or budget review with the cancer center director.

C. Plan for Norris Hospital Operations

Inpatient services. Construction of a new, 10-story inpatient tower at University Hospital already is underway. The contemplated transaction provides the opportunity to build out floors in the New Tower that were planned to be shelled space until needed.

Upon the completion of the new tower, which will be constructed at Tenet's cost, Norris Hospital inpatient services will be relocated to the new tower and will include at least the following: 28 medical/surgical beds, 20 ICU beds, 12 operating rooms, an acute access center, dedicated "concierge services" and valet parking.

Initially, two floors of the new tower will be dedicated to cancer care. These floors would be able to accommodate the transfer of inpatient services from the old Norris facility, at the end of the Transition Period, scheduled for early 2005. The new tower would be known as the Norris Tower, would have a separate entrance and dedicated services, and have two floors initially dedicated to cancer care sufficient to accommodate the inpatients at Norris Hospital at the end of the Transition Period.

Outpatient services. After the transfer of inpatient beds to the new tower, the current Norris Hospital space would be reconfigured and re-equipped to accommodate expanded outpatient clinic services. In response to our request for additional details regarding these plans, Norris Hospital provided the description on the next page.

Upon the completion of the new Norris Inpatient Tower adjacent to the existing USC University Hospital, the USC Norris Cancer Hospital inpatient services will be relocated to this new tower. The completion of the tower and relocation of patients to the new tower is projected to occur in early 2005. The tower offers an additional number of beds that exceed the current and future space capacity at existing USC Norris Cancer Hospital building.

Current inpatient services are located on the 3rd and 4th floors of the hospital building. When the floors are vacated, this space will allow for expanded outpatient services offered to established and new Norris patients. It is programmed that the Breast Center, currently located on the first floor, would be relocated and occupy one of the inpatient floors. The Breast Center would grow from 2,000 square feet to almost 12,000 square feet. The additional space would allow this vital service to expand to address all women's cancer needs including ovarian, gynecological and related services. The name would change from Breast Center to something that would more accurately depict its expanded service capability.

Urology services now located at USC Norris Cancer Hospital and University Hospital would be consolidated onto the remaining vacated inpatient floor. These services have been a cornerstone to the reputation and capability of the Norris Hospital. The move of these services from the existing clinic space shared with other medical specialties to dedicated space will allow for expanded services in both in terms of type and volume. In addition, by having dedicated space used only for urology cancer care, the space can be modified and constructed to create an environment more suited to the particular needs of these patients.

After the relocation of the current Breast Center to one of the current inpatient floors, the space on the first floor will be renovated to house the Colorectal Cancer treatment center. This is an expanding area of cancer care for Norris. Norris has been able to recruit some of the most knowledgeable and talented medical oncologists and surgeons in this specialty. The dedicated space will allow for greater collaboration between these two specialties to translate state of the art cancer research into the clinical setting, combining the latest in surgical technique and medical care.

D. Plans for the Sale Proceeds

The following table estimates the amount of proceeds that would be available from the sale of Norris Hospital for the endowment. Approximately $11.5 million would be available within one year of closing (the "initial cash at closing" and "payment to USC" amounts), and up to another $20 million would be available at the end of the Transition Period.

Exhibit 2
The Applicants' Estimate of Sale Proceeds ($ Millions)

Initial sale proceeds		$ 20.0	Paid At Closing
Plus:			
	Current assets	40.0	USC Assets Not Purchased
	Funded depreciation	1.2	USC Assets Not Purchased
	Subtotal	61.2	Total Cash Before Deductions
Less:			
	Current liabilities	(15.4)	USC Liabilities Not Assumed
	Inventories	(1.9)	Included in Purchase Price
	Cost to collect receivables	(2.0)	Payments to Tenet to Collect AR
	Cost to defease bonds	(18.4)	Cost to Pay-Off Debt
	Indemnification escrow	(4.0)	As Required by Asset Purchase Agreement
	Payment to USC	(5.0)	Buyout of Contract
	Contingency	(1.0)	For Unforeseen Items
	Insurance costs	(0.4)	Tail Liability Policy
	Other fees and expenses	(1.5)	Legal, Consulting, and AG Fees
		(49.7)	
Initial Net Proceeds		11.5	Net Cash at Closing
Deferred Cash Payment		15.0	Payment at End of Transition Period
Total Net Cash		26.5	Sum of Net Cash Payments
Possible Additional Funds:			
	Indemnification escrow	4.0	May Not be Needed
	Contingency	1.0	May Not be Needed
Estimated Net Proceeds Balance		$ 26.5 - $31.5	

The proceeds from the sale of the Norris Assets would be used to pay off and retire outstanding bonds issued to construct the hospital and to establish a support fund with investment and spending rules to be established by USC. The applicants intend that the fund would focus on cancer research and programs relating to cancers disproportionately affecting the population of Los Angeles County. This primary focus on research is reflected in a proposed amendment to the Norris articles of incorporation intended to recognize that Norris no longer would operate a hospital after closing.

The community needs assessments prepared by Norris Hospital in 1996 and 1999 identified four areas of concern: health education, informational resources, and training; access to cancer services for the underserved; psychosocial and support services for cancer patients and families; and cancer research. USC proposes that the fund be used to focus on research, community

education, and research related to treatment of cervical and prostate cancers that disproportionately affect minority and underserved populations in the Norris service area.

According to the application filed with the Attorney General's Office, one element of the community education and treatment program would involve increased cancer screening that is planned to be accommodated in the new, expanded outpatient center. Funds would be dedicated to increased screening efforts for cervical cancer and prostate cancer in Latinos and African Americans. Net funds from the sale also would be used to support research and development for a vaccine for cervical cancer. Similarly, research efforts related to prevention of prostate cancer would be targeted to African-American men.

Although not mentioned in the plans for the support fund, hospital staff also mentioned increasing funding for other efforts such as hepatoma screening for Asian Americans.

The agreements also indicate that the Governing Board of Norris Comprehensive Cancer Center will govern decision making regarding the fund.

E. USC's Rationale for the Sale

The application filed by Norris Hospital and Tenet for the proposed transaction and our on-site interviews identified several factors that comprise USC's rationale for the sale of the Norris Hospital operations to Tenet. This section summarizes these points.

Ability to advance USC's and Norris Hospital's missions. USC has strategic plans for the medical school that call for growth in research funding of over 15 percent annually as a primary approach to achieving a "top 10" medical school ranking. USC is developing new buildings to double current space devoted to medical research, and also is developing a biomedical research park. Any resources diverted from this purpose either to meet Norris Hospital's capital needs (through subsidies or fund raising) or to offset any future Norris operating losses potentially would impede USC's ability to meet these goals. The proceeds from the Norris Hospital transaction also would facilitate achieving the medical school's goals.

USC also believes that the transaction with Tenet provides growth opportunities for Norris Hospital clinical programs. These, in turn, facilitate research growth. Greater numbers of faculty could be attracted to the health sciences center, which would benefit private patients served by Norris and USC University Hospital and also low-income consumers who rely on Los Angeles County/USC Medical Center.

USC policy to reduce risk associated with operating hospital facilities. USC leadership has indicated publicly that directly operating Norris Hospital—or any other hospital—presents unacceptable financial risks to the university. USC seeks to transfer this risk to Tenet to protect the university from the types of losses experienced at other institutions having teaching hospitals, such as the University of California, University of Pennsylvania, and Stanford. According to USC, the university is not expert in managing hospitals, particularly in the challenging Los Angeles County market, and strongly prefers a relationship with professional hospital managers.

Successful USC and Tenet relationship. Both USC and Tenet indicated that the relationship they have maintained that led to development and operation of University Hospital has been successful. The relationship between USC and Tenet has been in place since 1985. Because Tenet is well known to USC leadership, has demonstrated its ability to manage Norris, has demonstrated its willingness to adjust plans for the new tower at USC University Hospital, and has been responsive to medical school and faculty needs, USC determined that Tenet was the optimal partner for assuming responsibility for Norris.

USC also observed that there could be efficiencies associated with merging the operations of the two hospitals, that it would have been difficult to find another entity willing to purchase the hospital with Tenet as a competitor "right next door" at USC University Hospital, and that having competing firms operating on the USC Health Sciences campus could be problematic.

Additionally, according to the Management Agreement, Tenet had the right of first opportunity to purchase the hospital – a clause that contributed to USC leadership's initiating discussions with Tenet to acquire Norris.

Capital cost avoidance. Consultants retained by USC to assess Norris Hospital's future concluded that substantial capital resources would be needed to assure the hospital's ongoing viability. The Camden Group reported that $60 million in capital investment was needed over five years (or $30 to $50 million over three years) to keep Norris Hospital viable and provide the hospital with sufficient scale to achieve efficient operations. Not only would these capital requirements potentially divert resources from research, but they could complicate ongoing fund raising efforts for Norris Comprehensive Cancer Center research programs.

Ability to take advantage of the new USC University Hospital tower. USC leadership also recognized the opportunity—and threat—associated with USC University Hospital expansion. Regarding the opportunity, the current plan for Norris clinical services after the Transition Period allows substantial expansion of outpatient programs in the current Norris Hospital building and provides access to additional beds in the new tower. USC University Hospital currently provides inpatient cancer care focused on neurosurgery, orthopedics, and other surgically-focused programs. USC University expansion through the new tower, coupled with limited capital investment in Norris, could lead to shifts in cancer care from Norris to USC University Hospital through time.

F. Tenet's Rationale for the Acquisition

Tenet representatives provided the following rationale for the acquisition of the Norris Hospital business.

Ability to move programs and capital between Norris and USC University Hospital. Tenet initially became interested in purchasing the Norris Hospital operations because of the desire to have increased flexibility to move and restructure programs across the USC Health Sciences Campus. Specifically, there was extra equipment at USC University Hospital that could be used

by Norris, but different ownership structures made sharing equipment between the two hospitals difficult.[22]

Solidifies relationship with USC. Tenet also views the transaction as an opportunity to continue to enhance its relationship with USC. One Tenet representative described the acquisition as "political and ethical." USC wanted to sell Norris Hospital, and Tenet believed the USC University Hospital new tower project could negatively affect the capacity-constrained Norris Hospital if USC University Hospital expanded its cancer services in new North Tower beds and if the hospitals were competitors instead of under one ownership structure.

Opportunity for economies of scale and cancer program expansion. Tenet also recognizes the potential for achieving economies of scale and rapid occupancy of the new tower. The transaction would lead to integrated policies and procedures, medical records, physician credentialing, and support functions. Relieving space constraints at Norris also would provide opportunities for clinical program growth through enhancing referral relationships between Norris/USC University Hospital and other Los Angeles-area Tenet facilities and medical staffs. Norris would have a larger patient base from which to identify patients appropriate for clinical trials.

[22] Source: Interview with Tenet representative.

IV. PUBLIC CONCERNS REGARDING THE SALE

This chapter highlights concerns and issues regarding the transaction raised during our interviews, at the Attorney General's public hearing, and in other communications to the Attorney General's office from parties interested in the transaction.

A. Unique "Culture of Caring" at Norris Hospital

Norris medical staff, Board members, and employees emphasized that Norris Hospital has developed and maintained a unique "culture for caring" for cancer patients. With numerous long-standing employees and medical staff members, Norris was described as a "family."

Some expressed concerns that these characteristics could be lost particularly after the Transition Period because the inpatient beds at Norris would be merged with a larger hospital, inpatient and outpatient care would be performed in separate settings (creating possible "continuity of care" concerns), and because the agreements are silent regarding whether staff would be dedicated to "Norris Hospital patients" and whether certain staffing ratios would be maintained.

While many acknowledge that the plans to have Norris nursing and other staff remain dedicated to cancer care in the new tower, that current Norris Hospital buildings will remain dedicated to outpatient cancer services, and that the new tower would be configured with a separate, dedicated entrance and with dedicated Norris floors, opinions vary regarding the ability of the merged Norris/USC University Hospital operations to maintain "the Norris culture of caring."

B. Conflict between Missions of Academic Health Centers and For-Profit Hospitals

Some interviewees expressed concern that Tenet's return on investment requirements would conflict with the mission requirements of Norris as an academic health center. Norris has "provided the maximum" patient care, including access to clinical research resources, and has made clinical and administrative decisions based on patient needs, to expand knowledge and support research, and train new clinicians and researchers. Some are concerned that Tenet's focus on the "bottom line" could lead to "providing the minimum" for patients and researchers.

C. Tenet's Corporate Practices

Tenet's Record of Compliance with Conditions on Hospital Acquisitions. Advocates argue that this transaction is not in the public interest in part because Tenet has not demonstrated its willingness to accept conditions established by the Attorney General under which hospital acquisitions have been approved. For example, the Attorney General needed to secure an injunction against Tenet due to compliance problems with conditions relating to its planning processes set forth in the approval of the Daniel Freeman Hospitals transaction.

Tenet's Labor Practices. During the public hearing and our interviews, labor representatives expressed concerns regarding Tenet's labor practices. Labor unions in particular are concerned

about "anti-labor policies," reductions in staff, and the inability of employees to have meaningful input in hospital policy or operations without reprisal.[23]

Tenet's Pricing Policies. In the past few months, a number of questions have been raised about Tenet Healthcare's pricing policies. These questions have led to government scrutiny of the company, investigations, lawsuits, and general public concern related these practices. There are specific public concerns that rapid increases in Tenet's gross charges could be applied to Norris Hospital's patient care services, making them less affordable and thus affecting patients' access to care.

D. Norris Hospital Governance

Some physicians we interviewed expressed concern about the proposed new governance structure for Norris. Under the terms of the transaction, the current Norris board would be replaced by the USC University Hospital Board that would have authority over medical and administrative aspects of Norris' operations. Governance and management authority of USC University Hosptial itself also is shared with Tenet Healthcare, Inc. Physicians worry that this potentially would provide less voice for Norris Hospital interests. They expressed their belief that medical staff at Norris Hospital have become accustomed to a greater level of input into hospital decision making than physicians who practice primarily at USC University Hospital.

E. Use of the Sale Proceeds

Other interviewees have recognized, and USC officials have acknowledged, that the trust created through the sale of Norris to Tenet primarily would endow and fund research programs rather than direct inpatient and outpatient clinical services. Some argue that this use of the sale proceeds is not consistent with the current charitable purposes of Norris – and that research, even though it eventually may benefit patient care, is not equivalent to direct inpatient and outpatient clinical care that historically has been provided by the hospital.

There also is some concern that the proposed use of endowment funds for cervical and prostate cancers in Latinos and African Americans may be too narrow and that there are many other diseases that Norris could examine given the ethnic and socioeconomic diversity of LA County.

F. Downsizing of LAC+USC

Over the years, there has been discussion about the potential downsizing of LAC+USC Medical Center. This downsizing could have implications for Norris Hospital and USC University Hospital related to patient care, teaching, and research programs. LAC+USC is scheduled to reduce hospital capacity by 100 beds over the next two years in preparation to move into a new medical center building[24]. Because many of these beds are currently not occupied, our inquiries suggest that planned downsizing of LAC+USC should not have material effects on patient care volume at USC University Hospital or Norris Hospital.

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[23] Several of these points are raised in a report released by SEIU in December 2002 entitled, "Tenet Hospitals: Corporate Conduct Puts Patients at Risk."

[24] Source: Lewin Group interviews.

G. Does the Transaction Benefit the Institutions or the Public?

Concern exists in the community that the rationale for this transaction articulated by USC and Tenet focuses on improving the stature of USC's medical school, the ability to assure that the new tower at USC University Hospital is well occupied upon completion, and other matters. Interviewees questioned whether this transaction would advance access to care for vulnerable patient populations, such as Los Angeles-area uninsured and Medi-Cal clients. They recognized that advancing knowledge through research would provide longer-term benefits, but suggested that these benefits are less direct and measurable for Los Angeles citizens.

V. NORRIS HOSPITAL'S ROLE IN PROVIDING CANCER CARE

Cancer accounts for the largest number of person-years of life lost[25] (PYLL) in the United States—approximately 8 million years in 1998.[26] Recent trends, however, are positive in terms of two key measures of progress in combating cancer: incidence and mortality.

- Incidence of cancer in the United States peaked in 1992 at 511 new cases per 100,000 persons and began to decline. In 1999 there were 476 new cases per 100,000 people.[27]
- Mortality from cancer has decreased in recent years at a rate of approximately 1 percent per year between 1993 and 1999 and approximately 6 percent overall between 1990 and 1999.[28]

Despite some progress, the Department of Health and Human Services' Healthy People 2010 project reports that the absolute number of cases of cancer has been increasing every year due to a growing and aging population. Approximately 1.3 million new cases of cancer and more than 555,000 cancer deaths are expected in 2002.[29] It is projected that by the year 2050 the number of new cancer cases will have doubled to 2.3 million and the number of cancer patients aged 85 or older will increase four times.[30]

California will report an estimated 119,900 new cancer cases and an estimated 51,800 cancer deaths for 2002,[31] representing approximately 10 percent of the nation's total. Cancer incidence and mortality in California, however, have been below national averages both for men and women.[32]

A. Norris Cases by Diagnosis Related Group

Norris Hospital reported 2,346 discharges in 1999 (for 238 different diagnosis related groups or DRGs). Twenty DRGs comprised about 54 percent of all Norris Hospital discharges in that year (**Exhibit 3**). The highest-volume DRGs included chemotherapy treatment (10 percent of all discharges), major male pelvic procedures (8 percent of total) and kidney and major bladder procedures for neoplasms (tumors) (6 percent of total).

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[25] Person Years of Life Lost = Difference between normal life expectancy and age at death for persons diagnosed with cancer.

[26] National Cancer Institute, 2002. Statistics are age-adjusted.

[27] *Ibid*

[28] National Cancer Institute News.

[29] American Cancer Society.

[30] Edwards, BK, *et. al.* (May 2002) "Annual Report to the Nation on the Status of Cancer, 1973-1999, Featuring Implications of Age and Aging on U.S. Cancer Burden." *Cancer* 94(10):2766-2792.

[31] American Cancer Society.

[32] *Ibid.*

Exhibit 3
Top 20 DRGs for Norris Hospital, 1999

DRG	Description of DRG	Discharges	% of Total
410	Chemotherapy	233	9.9%
335	Major male pelvic procedures w/o CC	184	7.8%
303	Kidney, ureter & major bladder procedures for neoplasm	132	5.6%
148	Major small and large bowel procedures w/ CC	90	3.8%
296	Nutritional & miscellaneous metabolic disorders	85	3.6%
334	Major male pelvic procedures w/ CC	74	3.2%
182	Esophagitis, gastroenterology & miscellaneous digestive disorders, age > 17, w/ CC	52	2.2%
258	Total Mastectomy for malignancy w/o CC	49	2.1%
304	Kidney, ureter & major bladder procedures for non-neoplasm w/ CC	49	2.1%
149	Major small & large bowel procedures w/o CC	45	1.9%
180	G.I. obstruction w/ CC	32	1.4%
239	Pathological fractures & musculoskeletal & connective tissue malignancy	31	1.3%
144	Other circulatory system diagnoses w/ CC	27	1.2%
320	Kidney & urinary tract infections, age > 17, w/ CC	27	1.2%
191	Pancreas, liver & shunt procedures w/ CC	26	1.1%
75	Major chest procedures	25	1.1%
188	Other digestive system diagnoses, age > 17, w/ CC	24	1.0%
257	Total Mastectomy for malignancy w/ CC	24	1.0%
398	Reticuloendothelial & immunity disorders w/ CC	24	1.0%
158	Anal & stomal procedures w/o CC	23	1.0%
Total Discharges			2,346
% of Total Discharges			53.5%

Source: OSHPD, 1999.
Note: CC = "complications"

Because Norris Hospital provides specialized, tertiary cancer care services, our analysis focuses on these top 20 DRGs. **Exhibit 4** shows the other hospitals in Los Angeles County with 1,000 or more discharges reported for these specific inpatient services.

Exhibit 4
Discharges from Los Angeles County Hospitals for Top 20 Norris DRGs, 1999

	Hospital	Los Angeles	Other Areas	Total	Other Area %
1	UCLA MEDICAL CENTER	2,395	1,092	3,487	31%
2	CEDARS-SINAI MEDICAL CENTER	3,048	279	3,327	8%
3	LAC/USC MEDICAL CENTER	2,832	188	3,020	6%
4	PROVIDENCE SAINT JOSEPH MEDICAL CENTER	2,481	49	2,530	2%
5	HUNTINGTON MEMORIAL HOSPITAL	2,222	52	2,274	2%
6	ST. FRANCIS MEDICAL CENTER	2,092	13	2,105	1%
7	LONG BEACH MEMORIAL MEDICAL CENTER	1,725	358	2,083	17%
8	TORRANCE MEMORIAL MEDICAL CENTER	1,622	51	1,673	3%
9	METHODIST HOSPITAL OF SOUTHERN CAL	1,515	15	1,530	1%
10	KAISER FDN HOSP - SUNSET	1,216	169	1,385	12%
11	BEVERLY HOSPITAL	1,340	20	1,360	1%
12	CITY OF HOPE NATIONAL MEDICAL CENTER	868	473	1,341	35%
13	HOLLYWOOD COMMUNITY HOSP OF HOLLYWOOD	1,314	-	1,314	0%
14	CITRUS VALLEY MEDICAL CENTER-QV CAMPUS	1,246	59	1,305	5%
15	**USC KENNETH NORRIS JR. CANCER HOSPITAL**	**790**	**466**	**1,256**	**37%**
16	LAC/HARBOR+UCLA MEDICAL CTR	1,187	62	1,249	5%
17	ST. VINCENT MEDICAL CENTER	1,124	102	1,226	8%
18	KAISER FDN HOSP - BELLFLOWER	1,104	106	1,210	9%
19	LITTLE COMPANY OF MARY HOSPITAL	1,150	47	1,197	4%
20	POMONA VALLEY HOSPITAL MEDICAL CENTER	744	366	1,110	33%
21	WHITE MEMORIAL MEDICAL CENTER	1,096	6	1,102	1%
22	ST. MARY MEDICAL CENTER	1,023	78	1,101	7%
23	DANIEL FREEMAN MARINA HOSPITAL	1,083	9	1,092	1%
24	PRESBYTERIAN INTERCOMMUNITY HOSPITAL	979	106	1,085	10%
25	CALIFORNIA HOSPITAL MEDICAL CENTER	1,067	9	1,076	1%
26	KAISER FDN HOSP - WEST LA	1,018	16	1,034	2%
27	DOWNEY COMMUNITY HOSPITAL	979	44	1,023	4%
28	GOOD SAMARITAN HOSPITAL	962	52	1,014	5%
29	PACIFIC ALLIANCE MEDICAL CENTER	1,002	1	1,003	0%
	Subtotal	41,224	4,288	45,512	9%
	Other Hospitals	25,328	1,391	26,719	5%
	Total	66,552	5,679	72,231	8%

Source: OSHPD, 1999.

Of these 29 hospitals, UCLA Medical Center has the highest number of discharges for the 20 DRGs; Norris Hospital ranked 15th.

Analyzing Norris Hospital's inpatient services at the DRG level provides additional insights into its distinctive role in providing cancer care. **Exhibit 5** demonstrates that while Norris Hospital was the 15th largest provider of the top 20 DRGs in 1999, the hospital was in the top 5 in terms of inpatient volume for six specific DRGs.

Exhibit 5
Norris Hospital Ranking of Discharges by DRG, 1999
(1 indicates that Norris Hospital discharged more DRG 335 patients than any other hospital in Los Angeles)

DRG	DRG Descriptions	Norris Cases	LA Hospital Cases	Norris Rank
335	MAJOR MALE PELVIC PROCEDURES W/O CC	184	1,446	1
303	KIDNEY,URETER & MAJOR BLADDER PROCEDURES FOR NEOPLASM	132	1,219	2
334	MAJOR MALE PELVIC PROCEDURES W CC	74	1,042	2
258	TOTAL MASTECTOMY FOR MALIGNANCY W/O CC	49	1,157	3
410	CHEMOTHERAPY W/O ACUTE LEUKEMIA AS SECONDARY DIAGNOSIS	233	5,952	5
304	KIDNEY,URETER & MAJOR BLADDER PROC FOR NON-NEOPL W CC	49	1,038	5
191	PANCREAS, LIVER & SHUNT PROCEDURES W CC	26	877	8
158	ANAL & STOMAL PROCEDURES W/O CC	23	870	9
149	MAJOR SMALL & LARGE BOWEL PROCEDURES W/O CC	45	1,566	10
257	TOTAL MASTECTOMY FOR MALIGNANCY W CC	24	949	11
398	RETICULOENDOTHELIAL & IMMUNITY DISORDERS W CC	24	1,556	17
148	MAJOR SMALL & LARGE BOWEL PROCEDURES W CC	90	5,774	23
239	PATHOLOGICAL FRACTURES & MUSCULOSKELETAL & CONN TISS MALIGNANCY	31	2,502	28
075	MAJOR CHEST PROCEDURES	25	2,513	36
180	G.I. OBSTRUCTION W CC	32	3,455	45
296	NUTRITIONAL & MISC METABOLIC DISORDERS AGE >17 W CC	85	9,477	49
144	OTHER CIRCULATORY SYSTEM DIAGNOSES W CC	27	5,178	59
188	OTHER DIGESTIVE SYSTEM DIAGNOSES AGE >17 W CC	24	4,925	65
182	ESOPHAGITIS, GASTROENT & MISC DIGEST DISORDERS AGE >17 W CC	52	10,878	67
320	KIDNEY & URINARY TRACT INFECTIONS AGE >17 W CC	27	9,587	75
		1,256	71,961	

Source: OSHPD, 1999.

B. Geographic Origin of Norris Hospital Inpatient Cases

Exhibit 6 presents Norris Hospital discharges for LA County and non-LA County residents. Overall, about 66 percent (1,544 cases) of Norris Hospital's 1999 discharges were for residents of LA County, 34 percent (802 cases) for patients who traveled to Norris from outside the county for care.

Exhibit 6
Top 20 DRGs for Norris Hospital - LA County vs. Non-LA County

DRG	Description of DRG	Total Discharges for DRG (LA and Non-LA County)	% of Total Discharges for DRG - LA County	% of Total Discharges for DRG - Non-LA County
304	Kidney, ureter & major bladder procedures for non-neoplasm w/ CC	49	44.9%	55.1%
191	Pancreas, liver & shunt procedures w/ CC	26	46.2%	53.8%
303	Kidney, ureter & major bladder procedures for neoplasm	132	46.2%	53.8%
144	Other circulatory system diagnoses w/ CC	27	55.6%	44.4%
335	Major male pelvic procedures w/o CC	184	59.2%	40.8%
149	Major small & large bowel procedures w/o CC	45	60.0%	40.0%
148	Major small and large bowel procedures w/ CC	90	60.0%	40.0%
75	Major chest procedures	25	60.0%	40.0%
334	Major male pelvic procedures w/ CC	74	60.8%	39.2%
410	Chemotherapy	233	63.9%	36.1%
158	Anal & stomal procedures w/o CC	23	65.2%	34.8%
296	Nutritional & miscellaneous metabolic disorders	85	67.1%	32.9%
258	Total Mastectomy for malignancy w/o CC	49	67.3%	32.7%
257	Total Mastectomy for malignancy w/ CC	24	75.0%	25.0%
188	Other digestive system diagnoses, age > 17, w/ CC	24	75.0%	25.0%
182	Esophagitis, gastroenterology & miscellaneous digestive disorders, age > 17, w/ CC	52	78.8%	21.2%
398	Reticuloendothelial & immunity disorders w/ CC	24	83.3%	16.7%
180	G.I. obstruction w/ CC	32	84.4%	15.6%
320	Kidney & urinary tract infections, age > 17, w/ CC	27	88.9%	11.1%
239	Pathological fractures & musculoskeletal & connective tissue malignancy	31	90.3%	9.7%
Total LA County Discharges for Top 20 DRGs for Norris Hospital				790
Total Non-LA County Discharges for Top 20 DRGs for Norris Hospital				466
Total LA County Discharges for Norris Hospital				1,544
Total Non-LA County Discharges for Norris Hospital				802
Total Discharges for Norris Hospital				2,346

Source: OSHPD, 1999.

For three DRGs, Norris Hospital reported a particularly high volume of patients from outside Los Angeles County (greater than 50 percent, indicating that larger numbers of patients are traveling to Los Angeles to receive care for these cancers): kidney, ureter and major bladder procedures for non-neoplasm; pancreas, liver and shunt procedures; and kidney, ureter and major bladder procedures for neoplasm.

Our analysis also reviewed the distribution of Norris cases by zip code (**Exhibit 7**).

Exhibit 7
Distribution of Discharges by Top 10 Zip Codes for Norris Hospital Patients

Zip Codes	Discharges	% of All Norris Discharges
91011	35	1.49%
90046	27	1.15%
91001	27	1.15%
91316	23	0.98%
91105	22	0.94%
91108	22	0.94%
90266	21	0.90%
90640	21	0.90%
91106	21	0.90%
90027	20	0.85%

Source: OSHPD, 1999.

Exhibit 7 shows Norris' inpatient volumes for Los Angeles County zip codes reporting 20 or more inpatient discharges. Overall, there does not appear to be a high concentration of Norris patients originating from any one Los Angeles community. In no zip code did Norris' market share exceed 16 percent.

C. Norris Hospital's Inpatient Payer Mix

The analysis of Norris Hospitals top 20 DRGs by payer category (**Exhibit 8**) highlights that Norris almost exclusively has treated inpatients with private insurance or Medicare coverage. In 1999, 98 percent of the hospital's inpatients were funded by these two categories of insurance coverage. Other hospitals in Los Angeles generally treat higher proportions of government-funded or uninsured patients.

Exhibit 8
Top 20 Discharges by Payer, Norris and Other L.A. hospitals

	Cases for L.A. Hospitals			Cases for L.A. Residents		
Payer Source	All Hospitals	Norris	All Other Hospitals	All Hospitals	Norris	All Other Hospitals
Medicare	36,157	478	35,679	34,058	331	33,727
Private	19,941	753	19,188	17,375	450	16,925
Medi-Cal	11,377	-	11,377	10,866	-	10,866
Charity	3,010	25	2,985	2,715	9	2,706
Other	1,746	-	1,746	1,538	-	1,538
	72,231	1,256	70,975	66,552	790	65,762
		.				
Medicare	50%	38%	50%	51%	42%	51%
Private	28%	60%	27%	26%	57%	26%
Medi-Cal	16%	0%	16%	16%	0%	17%
Charity	4%	2%	4%	4%	1%	4%
Other	2%	0%	2%	2%	0%	2%
	100%	100%	100%	100%	100%	100%

Source: OSHPD, 1999.

At Norris, all patients are screened for insurance availability before being registered or admitted, and Norris faculty physicians provide the majority of their Medi-Cal or indigent care services at LAC+USC or CCMC.

According to other Norris data, in FY 2001, 57 percent of inpatient days were for patients with private insurance and 41 percent of the days were for Medicare beneficiaries. There were no Medi-Cal cases recorded for 2000 or 2001, but since Norris Hospital obtained a Medi-Cal contract in May 2001, some Medi-Cal cases should show up in 2002 data.

D. Inpatient versus Outpatient Care

Cancer care has changed dramatically over the years. Developments in technology have made it possible to detect cancer earlier, increased available treatment options, and resulted in enhanced survival and quality of life of cancer patients.[33] The current range of options available to cancer patients is diverse and includes surgery, radiation therapy, chemotherapy, biological therapy, and hormone therapy. New technologies and surgical techniques are allowing for more innovative and localized treatment. The pharmaceutical industry also is making advances in the treatment of cancer patients: since 1996, more than 80 new drugs have been approved for cancer care.[34]

Medical care is not the only area of recent advancement. The treatment of cancer is no longer viewed as simply a medical process. Ancillary and social services focusing on education, prevention, family services, and counseling have all gained prominence as care has shifted from focusing solely on the treatment of the patient to prevention, treatment, and support.

Today, the focus is on treating cancer patients in outpatient settings due to advances in technology, payer influences, and patient preferences.[35] Approximately 85 percent of cancer care now is delivered in outpatient settings; Norris Hospital clinicians indicated during interviews that this shift in care settings has stabilized. The relative balance between inpatient and outpatient care provided by Norris Hospital thus is not likely to change dramatically over the next few years.

[33] 2001 Cancer Progress Report, National Cancer Institute

[34] *Ibid*

[35] Association of Community Cancer Centers and Chris Serb, *Hospitals & Health Networks*, May 2002

VI. TENET'S PRICING POLICIES

In the past few months, a number of questions have been raised about Tenet Healthcare's pricing policies. These questions have led to:

- Greater scrutiny of the company and its pricing policies by government agencies and others;
- A substantial decline in the company's stock price, reflecting reduced investor confidence.

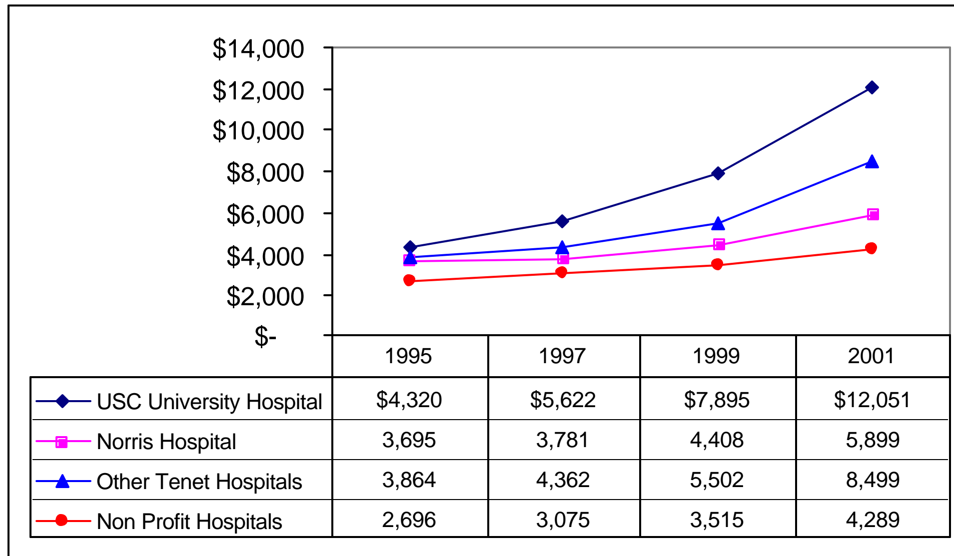
Some of pricing-policy related health care issues associated with Tenet include:

- Increases in "gross charges" at Tenet facilities that have been much higher than industry averages;
- In part due to the higher than average gross charges, Tenet's collecting "outlier payments" from the Medicare program at amounts substantially higher than payments to comparable facilities;
- Concerns that the high gross-charge levels also have increased payments from insurers having stop-loss provisions in their contracts with Tenet hospitals; and
- Concerns that the high prices, when charged to uninsured or underinsured patients, also have led to increased payments from programs that reimburse hospitals serving low-income or indigent consumers.

Exhibit 9 portrays gross charges per adjusted patient day at Tenet facilities (including USC University Hospital) and at non-profit hospitals in California from 1995 to 2001. The "adjusted patient day" statistic is designed to measure both inpatient and outpatient hospital services.

Results of this assessment confirm that gross charges at Tenet facilities (including USC University Hospital) have increased at substantially higher rates than charges at non-Tenet facilities (including Norris Hospital).

Exhibit 9
Gross Charges per Adjusted Patient Day,
Tenet, USC University Hospital, and California Non-Profit Hospitals, 1995-2001



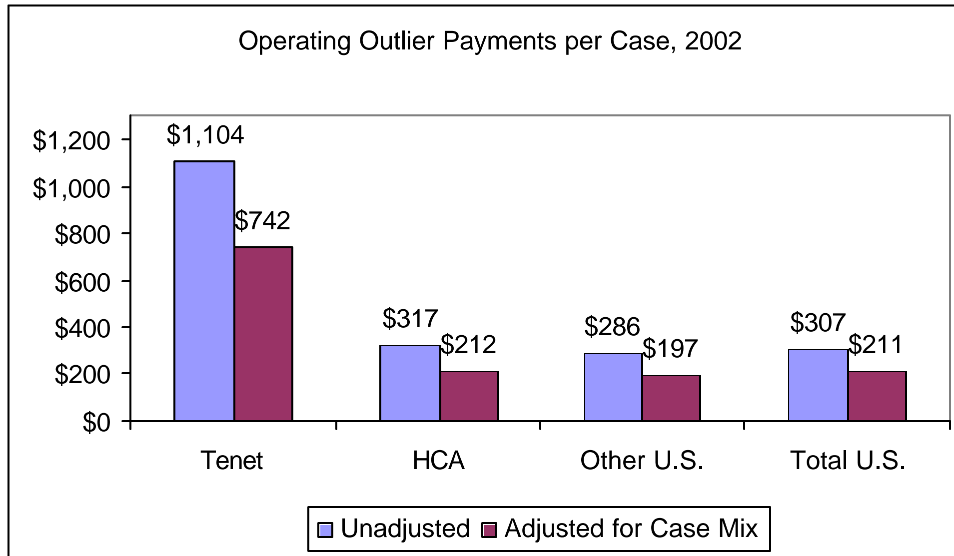
	1995	1997	1999	2001
USC University Hospital	$4,320	$5,622	$7,895	$12,051
Norris Hospital	3,695	3,781	4,408	5,899
Other Tenet Hospitals	3,864	4,362	5,502	8,499
Non Profit Hospitals	2,696	3,075	3,515	4,289

Source: Lewin Group analysis of OSHPD Disclosure Report statistics.

The data in **Exhibit 9** show that gross charges per adjusted day at USC University Hospital increased 179 percent between 1995 and 2001 (18.6 percent annually), at other Tenet Hospitals 120 percent (14 percent annually), and at non-profit hospitals in California 59 percent (8.0 percent annually). Gross charges per adjusted day at Norris Hospital rose at an average annual rate of 8.8 percent during this period.

Regarding Medicare outlier payments, **Exhibit 10** shows that in federal fiscal year 2002 Tenet hospitals are estimated to have collected substantially higher outlier payments per Medicare admission than other hospitals in the United States (including hospitals operated by another large for-profit firm, Hospital Corporation of America or HCA).

Exhibit 10
Medicare Outlier Payments per Case, 2002
(Unadjusted and Adjusted for Case Mix Acuity)



Source: Lewin Group analysis of Medicare Provider Impact File, 2002.

The Lewin Group also conducted an analysis of the OSHPD disclosure reports for Norris Hospital and USC University Hospital and found that gross revenue per unit of service (for USC University Hospital's 2002 fiscal year) was higher than at Norris (for Norris Hospital's 2001 fiscal year) for every category of service, while direct expenses per unit were more comparable between the two hospitals. For example, common ancillary services such as surgery recovery services or clinical laboratory services were 1.8 and 2.2 times higher at USC University Hospital than Norris (**Exhibit 11**).

USC University Hospital has a higher overall case-mix index than Norris Hospital (1.9536 compared to 1.5861), which explains some of this variance; however, computing revenue and expense on a per unit of service basis accounts for differences in case-mix.

Exhibit 11
Gross Revenue and Adjusted Direct Expenses per Unit for Norris and USC University Hospital

	Norris Hospital			USC University Hospital		
	Units of Service	Gross Revenue per Unit	Adjusted Direct Expenses per Unit	Units of Service	Gross Revenue per Unit	Adjusted Direct Expenses per Unit
Daily Hospital Services						
Medical/Surgical Intensive Care	3,708	$ 2,523	$ 840	7,897	$ 6,213	$ 1,149
Medical/Surgical Acute	12,506	$ 1,212	$ 488	24,421	$ 1,901	$ 353
Total Patient Care Services	16,214	$ 1,512	$ 609	72,232	$ 2,889	$ 516
Ambulatory Services						
Clinics	44,311	$ 113	$ 60	44,398	$ 335	$ 90
Ancillary Services						
Surgery and Recovery Services	384,074	$ 45	$ 11	1,565,700	$ 81	$ 10
Medical Supplies Sold to Patients	22,251	$ 574	$ 68	86,118	$ 2,953	$ 324
Clinical Laboratory Services	273,098	$ 60	$ 12	518,840	$ 131	$ 12
Radiology-Diagnostic	102,444	$ 60	$ 22	412,387	$ 80	$ 10
Computed Tomographic Scanner	5,854	$ 1,304	$ 113	8,316	$ 2,043	$ 93
Drugs Sold to Patients	36,976	$ 1,604	$ 282	80,543	$ 3,204	$ 185
Respiratory Therapy	76,851	$ 35	$ 6	173,842	$ 533	$ 25
Physical Therapy	32,482	$ 31	$ 8	88,879	$ 153	$ 31

Source: OSHPD, Individual Disclosure Reports.

While these two sets of statistics are for different fiscal periods (2002 versus 2001), average increases in gross charges at Norris between 2001 and 2002 (of approximately 18 percent) were not high enough to account for the large differences between the two hospitals.

A recent report prepared for Tenet showed that the differential in gross charges per patient day has not necessarily translated into higher collections per patient day. That study found that net inpatient revenue per patient day for Tenet's 39 California-based acute care hospitals was $1,672 compared to the California average of $1,683. The report also shows that in Los Angeles, 17 Tenet hospitals received an average two percent less in net patient revenue per patient day than the county average.[36]

[36] "Net Inpatient Revenue Per Patient Day Comparison: A Review of State Data on Hospitals in California and the 10 Counties in which Tenet has Operations." Prepared by Tenet Healthcare Corporation in association with Henry Zaretsky, February 4, 2003.

VII. PUBLIC BENEFITS PROVIDED BY NORRIS HOSPITAL

Norris Hospital has provided several types of community benefits over the years. These include:

- Inpatient and outpatient charity care provided for cancer patients
- A range of specific educational and patient support programs that Norris has included in its annual community benefit filings with the State of California
- The provision of "administrative and research" subsidies for patients whose insurance eligibility expires at some point during the course of treatment
- Serving as a site for clinical trials and research related to cancer treatment and prevention.

The community also benefits from Norris because the hospital helps to attract faculty of high academic and research standing through providing a site for Keck faculty private practice and clinical research. These faculty physicians practice not only at Norris but also at LAC+USC.

A. Charity Care at Norris Hospital

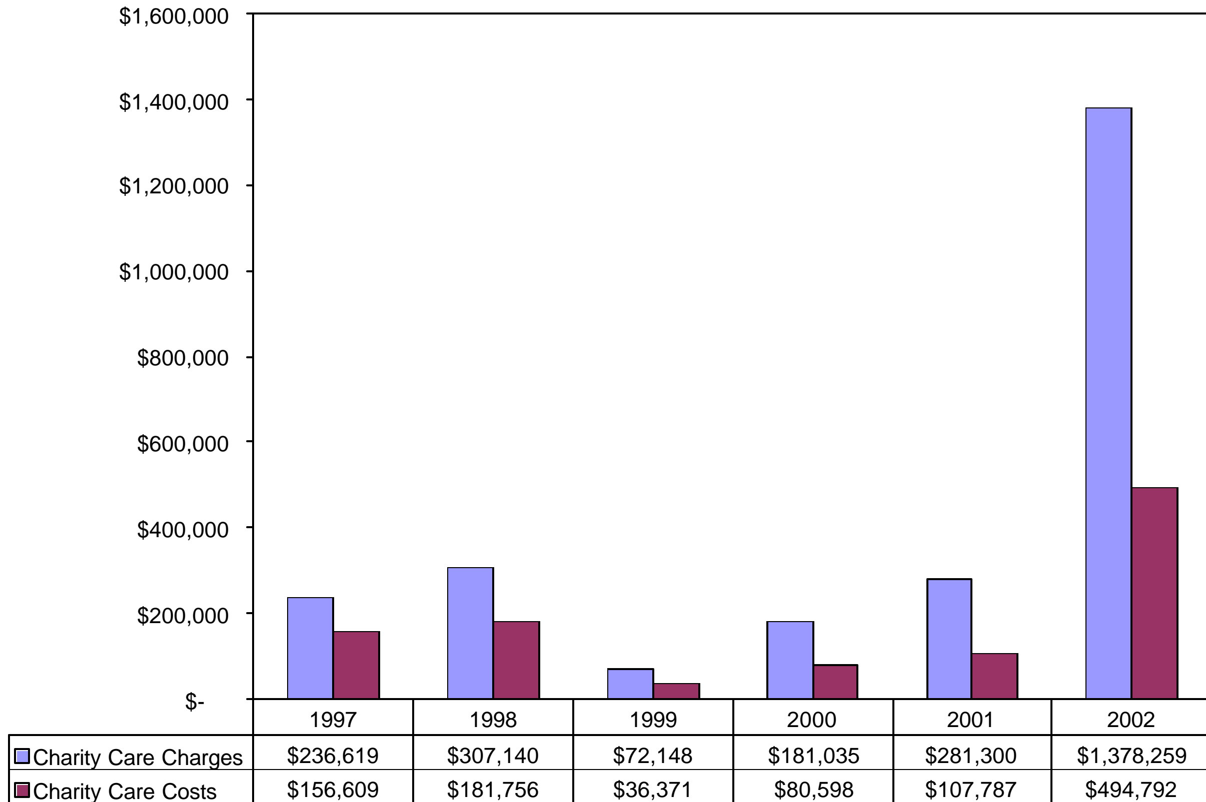
The charity care program of Norris Hospital has been designed to assist patients in their financial liability for care. According to hospital staff, all patients are screened for insurance availability before inpatient admission or outpatient registration. Virtually all reported charity care thus has been associated with patients whose financial circumstances change after they have begun a course of therapy at Norris, and who as a result need assistance to finance their ongoing care.

This assistance is offered to patients and families after all efforts to seek payment have been exhausted. Patients complete an application for charity care, and then approved amounts are classified as charity in the hospital's patient accounting system.

The hospital's audited financial statements report values for charity care based on the amount of gross charges forgiven under this program. These amounts also include a "research allowances component," which is described in more detail below.

The amount of reported charity care charges for Norris Hospital has been somewhat volatile over the years. For example, in 2002 charity care charges were approximately $1.4 million – an amount substantially higher than in prior years (**Exhibit 12**).

Exhibit 12
Norris Hospital Charity Care 1997 – 2002



	1997	1998	1999	2000	2001	2002
Charity Care Charges	$236,619	$307,140	$72,148	$181,035	$281,300	$1,378,259
Charity Care Costs	$156,609	$181,756	$36,371	$80,598	$107,787	$494,792

Source: OSHPD and audited and budget data from Norris Hospital.

In 2001 and 2002, Norris Hospital charity care costs[37] represented 0.17 percent and 0.67 percent of total operating expenses. This increase is mainly attributable to charity cases associated with the start-up of the hospital's new Bone Marrow Transplant (BMT) Program. To be eligible for Medi-Cal reimbursement for these services, a hospital must provide a certain number of these cases as charity care.

Norris Hospital's charity care ratios (as a percent of total operating expenses) compare to a 2001 average of 1.24 percent of operating expenses for non-profit hospitals in Los Angeles County. Norris Hospital's ratios are lower than that of other non-profit hospitals because the hospital primarily serves patients with Medicare and private health insurance coverage. The majority of services for low-income patients provided by Norris Cancer Center faculty is located at nearby LAC+USC Medical Center.

While the applicants have recognized the substantial increase in charity care for fiscal year 2002, the agreements governing the transaction specify commitments to maintaining charity care for Norris Hospital at levels based on FY 2002 reported amounts.

[37] Determined based on the following formula: (Total operating expenses – Other operating revenue) / Total gross patient care charges. This formula also is used by OSHPD for calculating uncompensated care costs.

We believe it is important to measure charity care based on the cost of services rather than charges, particularly since few payers actually pay posted charges. Using ratios of cost to charges (RCC), the level of charity care can be converted into costs. The ratio of costs to charges for Norris Hospital declined from 67 percent in 1995 to 38 percent in 2001. Using budget estimates for 2002, the estimated RCC for 2002 is 36 percent, which would yield charity care costs of approximately $494,800 (compared to charges of $1.4 million) for that year.

B. Research Write-Offs

Norris also forgives portions of clinical charges for a group of patients participating in clinical research protocols. These research protocol patients often require services that are not fully paid for by research grants or third-party insurers.

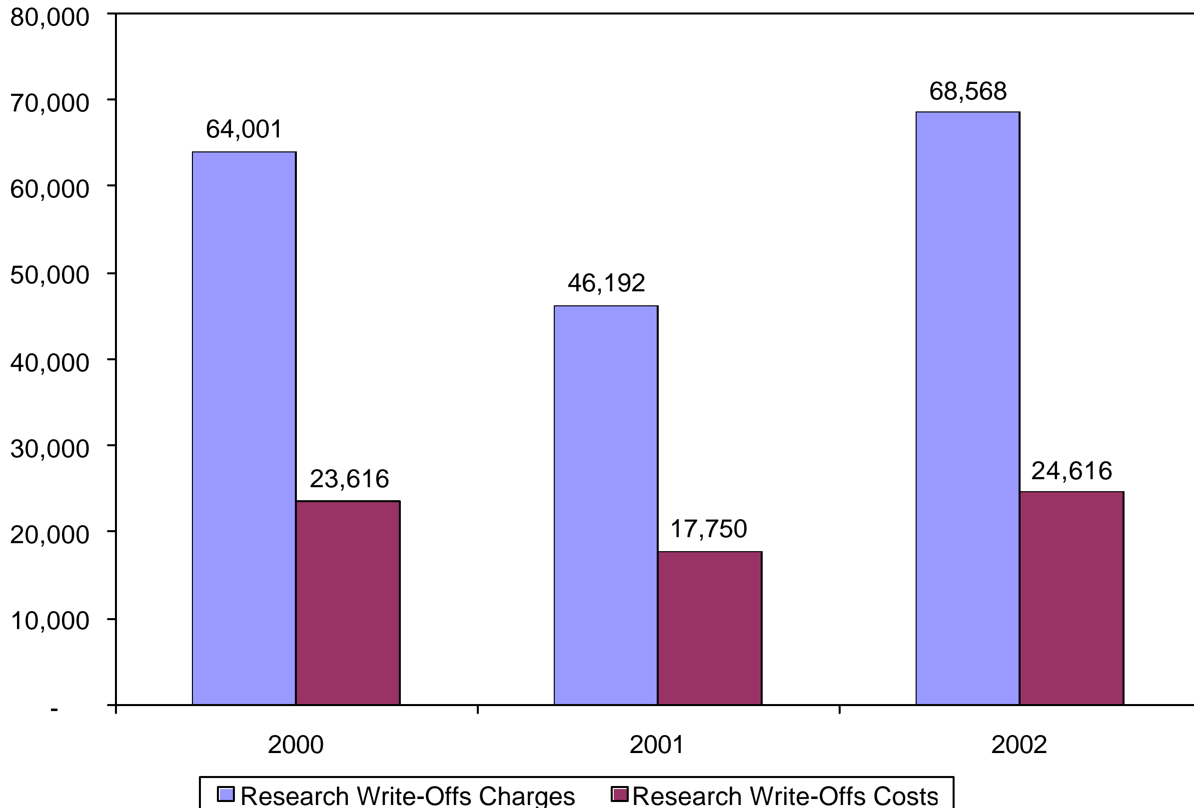
The total funding planned for this research protocol patients (including retroactively denied services and prospective cases) is determined during the annual budget process for the hospital. The majority of these funds are included in the hospital's reported charity care write-offs. Additional research write-offs are included in "administrative allowances."

The Clinical Investigations Committee of the Comprehensive Cancer Center prepares a plan to guide the allocation of funds which is approved by the hospital CFO and the Medical Director. The Director of Patient Financial Services and the CFO are responsible for ensuring compliance with the allocation plan and budget.

In general, discounts of up to 40 percent have been granted (greater discounts require separate administrative approvals). These discounts are applied to the billed charges for care rendered as part of the clinical study. Items such as extra CT scans, blood tests, molecular tests, ambulance transfers for MRI, and supportive drugs might be examples of services associated with clinical study that are not covered by third party insurance.

The Lewin Group requested data allowing analysis of the research write-offs. The total amount of these write-offs (measured as charges) not reported as charity care was $64,001 in fiscal year 2000, $46,192 in fiscal year 2001, and $68,568 in fiscal year 2002. **Exhibit 13** converts these charges into costs.

Exhibit 13
Write-Offs for Research Patients 2000-2002



Source: Norris Hospital records.

C. Charity Care at USC University Hospital

The transaction contemplates the effective merger of USC University Hospital and Norris Hospital after the Transition Period. The merger of the two hospitals creates challenges for ongoing measurement of the unique charity care and other community benefits associated in the future with Norris Hospital's programs.

USC University Hospital reported the following statistics regarding charity care to OSHPD for its fiscal years 2001 and 2002.

Exhibit 14
USC University Hospital Charity Care, 2001 and 2002

	2001	2002
Charity Care Charges	1,189,318	1,848,843
Charity Care Costs	205,015	310,295
Charity % of Operating Expenses	0.12%	0.15%

Source: OSHPD Disclosure Report Filings.

The combined charity care costs of Norris Hospital and USC University Hospital in fiscal year 2002 were approximately $800,000.

D. Community Benefit Programs

Exhibit 15 portrays the cost of community benefit programs as submitted to the State of California in 2001 and 2002. Norris Hospital programs generated approximately $670,000 in cost for 2001 and $244,000 in 2002.

According to Norris Hospital representatives, Norris Hospital's community benefits program costs increased substantially in 2000 and 2001 (from prior year levels of approximately $350,000) because the hospital initiated a new Image Enhancement Center. Start-up costs for this Center were incurred for video and internet-based productions and other education materials.

Exhibit 15
Community Benefit Programs 2001 and 2002

Program	2001	2002
Educational resources for cancer patients	351,125	21,015
Toll-free telephone information and referral lines	100,000	100,000
Referrals to community organizations	36,000	-
Research reports and updates	49,500	-
Support groups	47,200	55,250
Sponsorship of community events	32,980	7,600
Annual breast health and prostate health days	12,040	23,325
Festival of life / health program	10,000	24,220
Other	31,000	12,155
Total	669,845	243,565

Source: Norris Community Benefit Plans submitted to the State of California for 2001 and 2002.

Norris Hospital defines these categories of community benefits as follows.

Educational Resources for Patients. Includes brochures on treatment and research, television programming, and newsletters related to cancer prevention, detection, treatment and research.

Support Groups. Norris hosts support groups for cancer patients, with specialized groups for prostate, breast and colorectal cancers.

Sponsorship of Community Events. Includes participation in events to raise awareness and understanding of cancer. In 2002 sponsorship of a "Day at the Races" and the Revlon Run/Walk was included in this category.

Annual Breast/Prostate Health Days. Free prostate and breast cancer screening days with efforts to target minority and under-served communities.

Festival of Life Program. Annual celebration for cancer survivors.

VIII. PROPOSED CONDITIONS

Based on the foregoing analysis, there are a number of factors associated with Norris Hospital, the Norris Cancer Center, USC University Hospital, and the proposed transaction that should be considered in setting conditions if the transaction is approved by the Attorney General.

A. Factors to be Considered in Setting Conditions

Before proposing conditions for this transaction, The Lewin Group believes it important to acknowledge the following:

- Many of the most important concerns regarding the potential health impacts of this proposed transaction are covered by the agreements between the parties. The Asset Purchase Agreement, Cancer Center Support Agreement, and Norris Agreement include provisions under which charity care historically provided by Norris would be sustained, the NCI Comprehensive Cancer Center designation would be protected, Tenet would provide capital resources for Norris Hospital, and Tenet would be obligated to continue Norris clinical programs.

- Norris historically has not been a major provider of community care. The hospital is relatively small, focuses on tertiary services for privately-funded and Medicare patients, and does not operate emergency room services.

- Tenet has been functioning as Norris Hospital's manager for several years. Tenet's management has contributed to Norris' growth, and during this time the hospital has continued to support the research mission of the Norris Cancer Center, and both USC and Tenet have been pleased with the relationship.

- The development of USC University Hospital has been viewed as highly successful, both by Tenet and by USC. This relationship is important to both organizations and both view the Norris transaction as a continued commitment to expanding the private practice of Keck School of Medicine faculty.

- Both USC and Tenet appear committed to maintaining the Comprehensive Cancer Center designation for the Norris Cancer Center going forward. The Cancer Center agreement, authorities retained by the Cancer Center Director, and NCI's requirements for Comprehensive Cancer Centers serve somewhat as protections to the historical mission of Norris Hospital's clinical programs.

- The Asset Purchase Agreement provides for the preparation of a list of "core programs and services" be prepared. Terminating or materially reducing these "core programs or services" would require four months' prior written notice to USC, consultation with the Norris Cancer Center Director and faculty specializing in cancer care, and approval of the USC University Hospital Governing Board. This list has not yet been completed.

- During the Transition Period, the agreements specify that Tenet will continue to offer the same services and programs currently provided by Norris.

- The parties intend to maintain Norris Hospital's exemption from the Medicare Prospective Payment System. Norris Hospital Medicare inpatient services do not generate the outlier payments that have generated controversy and spawned investigations of Tenet.

- The National Cancer Institute relies on a peer review process to determine whether entities continue to qualify for the Comprehensive Cancer Center or Cancer Center designations. The NCI review committees, comprised of external peer reviewers that visit existing Comprehensive Cancer Centers for this process assess whether they fulfill "the broad scientific and interactive requirements for comprehensiveness," and make efforts "to serve their communities in each of the areas of outreach, education, and cancer information." Maintaining the Comprehensive Cancer Center designation is necessary for the Norris Cancer Center to continue receiving NIH core grant funding and attracting top researchers and clinicians to USC. Norris and Tenet reviewed the proposed transaction with the external peer reviewers and with the NCI's Director during 2002.

- The proposed plan for Norris Hospital's operations provides opportunities to expand clinical services and Norris Cancer Center research. According to the applicants, Norris faculty have been very involved in the design of the new tower and the plan for Norris clinical programs.

- The agreements governing this transaction also specify that only faculty of the Keck School of Medicine be allowed to serve on the medical staff of Norris Hospital going forward.

- Norris Hospital would be operated as a separate corporate entity until the completion of the new tower at USC University Hospital (scheduled for 2005), allowing measurement of the continued provision of charity care and other community benefit services historically provided by Norris. After the new tower is completed, outpatient services would continue to be operated in the current Norris Hospital building, providing an opportunity to continue Norris' historical "culture of caring."

- Competition exists for cancer researchers, clinical faculty, and patients. Cancer care often involves a long course of treatment. If the proposed transaction is deemed problematic for research or patient care, alternative settings (such as UCLA or the City of Hope) exist in the Los Angeles area.

- Alternatives to the proposed transactions may be problematic for Norris Hospital's ability to obtain access to resources needed to remain competitive, including capital funds.

  One alternative option would be to maintain the status quo. Under this option, Norris inpatient and outpatient services would remain in the current facility and Tenet would continue to manage the hospital's operations. Under this alternative, Norris Hospital operations would remain somewhat capacity constrained, and questions about USC's ongoing support for the hospital's capital needs would be present. It also is not clear that

Tenet would be willing to continue the current management agreement, and USC University Hospital may decide to expand its current cancer services[38].

USC also could seek an alternative buyer for Norris Hospital. Regarding this alternative, it would be difficult to find another entity willing to purchase the hospital with Tenet as a competitor "right next door" at USC University Hospital, and having competing firms operating on the USC Health Sciences campus could be problematic.

B. Proposed Conditions

The Lewin Group recommends that the following minimum conditions shall be required if the transaction is approved:

1. Tenet, Norris, and USC shall be required to carry out the terms specified in the Asset Purchase Agreement and in all other agreements governing the proposed transaction. The Office of the California Attorney General shall have the right to enforce all provisions of the agreements.

2. For 5 years after the transition to the new tower, Tenet shall maintain a minimum of 60 beds and two floors dedicated to cancer care and associated with Norris Hospital in the new tower, and the current Norris Hospital building shall be maintained solely for outpatient cancer care and cancer care research.

3. For purposes of the agreements governing this transaction, "core programs and services" shall be defined as follows:

   - Anatomic And Surgical Pathology
   - Bone Marrow Transplantation
   - Breast Cancer
   - Gastro-Intestinal Cancers
   - Dermatology/ Melanoma
   - Genetic Testing And Counseling
   - Gynecologic Oncology
   - Hematology
   - Lung Cancer
   - Medical Oncology
   - Neuro-Oncology
   - Plastic And Reconstructive Surgery
   - Orthopedic Oncology
   - Otolaryngology
   - Radiation Oncology
   - Urologic Oncology

[38] USCUH also provides cancer care. In 2001, USC had 214 cancer care discharges. These cases included hepatobiliary/pancreas malignancies, red blood cell disorders, cancer-associated fractures and malignancies, respiratory neoplasms (tumors), and nervous system neoplasms.

4. During the Transition Period, Tenet shall maintain charity care levels at Norris Hospital valued at a minimum cost (not charges) of $525,000 (the 2002 level of Norris Hospital charity care and research write-offs) inflated at the "All Items Consumer Price Index for All Urban Consumers in the Los Angeles-Riverside-Orange County Consolidated Metropolitan Statistical Area" (CPI-LA, as published by the U.S. Bureau of Labor Statistics). The definition and methodology for calculating "charity care" and the method for calculating cost shall be the same as that used by the Office of Statewide Health Planning and Development.

   After the Transition Period and the consolidation of USC University Hospital and Norris Hospital, Tenet shall maintain charity care levels at USC University Hospital valued at a minimum cost (not charges) of $825,000 (the combined 2002 level of Norris Hospital and USC University Hospital charity care) inflated from 2002 at CPI-LA. The definition of "charity care" also shall be the same as that used by the Office of Statewide Health Planning and Development.

   If this level is not met, Tenet shall pay the difference between actual charity care cost provided and the minimum cost as required to any non-profit or public hospital or clinic that provides cancer care services to the residents of Los Angeles County.

5. In operating both Norris Hospital during the Transition Period and at USC University Hospital thereafter, Tenet shall adopt policies facilitating physician, nurse and other employee and staff input into healthcare quality and staffing level concerns without fear of retaliation.

6. The proceeds of the sale shall be used to establish a non-profit foundation. Foundation expenditures shall fund clinical cancer services provided by non-profit or public hospitals or clinics located in Los Angeles County, based on the following proportions: 50 percent inpatient care and 50 percent outpatient care.

   Foundation board membership shall be independent of governing board membership of Tenet, USC, USC University Hospital, and USC Norris Hospital.

7. For 10 years from the date of closing, Tenet shall provide from resources at USC University Hospital or Norris Hospital a minimum of $600,000 for community benefit programs for cancer care educational resources, support groups, and screening.

8. The Attorney General shall require Tenet to verify at least annually its compliance with any terms and conditions adopted as part of the approval of this transaction.