

FINAL REPORTS 2002 Report:

Peninsula Health Care District

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Summary:

The Grand Jury finds that the Peninsula Health Care District (PHCD) Board of Directors, in its pursuit to build a new hospital, is not able to negotiate terms of a new agreement in the best interest of the District's residents.

Peninsula Medical Center must be rebuilt to meet the seismic standards mandated by the State of California. PHCD and Mills-Peninsula Health Services are currently negotiating terms of a revised agreement however, two of the five PHCD board members have conflicts of interest and therefore cannot vote nor directly participate in the negotiations.

Issue: Is the Peninsula Health Care District fairly representing the interests of the residents of the District in its negotiations for the terms of building and operating a new hospital?

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Background:

The State of California has determined that the Peninsula Medical Center could sustain significant damage in an earthquake that would render the hospital inoperable. In order to meet California state earthquake safety standards, Peninsula Medical Center must be rebuilt or close in 2013.

Mills-Peninsula Health Services (MPHS) operates Mills Health Center and Peninsula Medical Center. MPHS leases from the Peninsula Health Care District (PHCD) the land on which Peninsula Medical Center is situated. MPHS is a private, not-for-profit corporation that is a member of the Sutter Health (Sutter) network. At the end of 2001, Sutter had cash reserves of \$258 million, and is currently in a position to issue bonds to fund a new hospital in Burlingame.

MPHS has an independent, self-appointed, 21 member Board of Directors that manages the business affairs of Mills Health Center and Peninsula Medical Center. As reported by Modern Healthcare magazine, MPHS was named one of the top 100 hospitals in the United States for the years 1998 and 1999.

PHCD, organized in the 1940's, has a five-member publicly elected Board of Directors. PHCD's mission includes acting as the lessor of Peninsula Medical Center, responding to local health needs, and allocating resources for programs that enhance the health of the District's residents. Annually, PHCD contributes to the community by awarding grants to a variety of agencies and programs.

Examples of agencies and programs funded in fiscal year 2001-02 include: Mills-

Peninsula Senior Focus programs (\$290,000); Samaritan House (\$150,000); Youth and Family Assistance (\$60,000), and; the College of San Mateo Nursing Program (\$150,000).

In fiscal year 2001, PHCD collected \$2.8 million in property tax revenue. At fiscal year end 2001, PHCD had \$12 million in cash reserves, and its property assets were estimated by PHCD to be approximately \$26 million.

PHCD owns Peninsula Medical Center buildings and underlying property which encompasses approximately 26 acres. In 1985, MPHS and PHCD entered into a 30-year lease, which is subject to renewal options. Concurrent with the lease transaction, Peninsula (Burlingame) and Mills (San Mateo) Hospitals merged to form Mills-Peninsula Hospitals in 1985, and subsequently divided their services in order to be more effective in delivering health care. As a result, Mills Health Center was re-designed to primarily serve in-patient rehabilitation and out-patient services including minor surgery, walk-in emergency room service, rehabilitation and diagnostics. Peninsula Medical Center was designated as the primary site for acute-care, emergency services, and to house MPHS management offices.

Because a new hospital is required to be constructed, MPHS is renegotiating all terms and conditions of the 1985 lease with PHCD. Under the current agreement, PHCD does not have the authority to make operational or policy decisions.

Architectural plans for a new hospital have been developed and are currently under review by MPHS and PHCD. The cost to rebuild the hospital is estimated to be over \$350 million. Construction should be completed by 2010.

In August 2000, a letter of intent for a revised agreement was signed by PHCD and MPHS outlining the following terms to be negotiated:

Lease arrangement

PHCD's degree of oversight over the new hospital

Return of properties to PHCD that had been acquired by MPHS in the 1985 lease agreement

In June 1997, PHCD Board of Directors filed suit against MPHS for alleged conflict of interest in the original lease. Disposition of that suit in favor of MPHS is probably assured by the recent decision of the California Court of Appeals in Marin Health District vs. Sutter Health, et al, 2002 Cal. App. Lexis 4981, which under a very similar set of facts affirmed the trial court's determination that the suit was barred by the statute of limitations.

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Findings:

The Grand Jury finds there is widespread public acceptance that Peninsula Medical Center is a needed facility and that it is in the community's best interest to rebuild it. The capital funding required to build a new facility and the oversight required to manage its day-to-day operations are extensive, and beyond the scope of service PHCD is currently able to provide. To date, the arrangement among Sutter, MPHS, and PHCD has had a positive affect on community health care, and the current lease arrangement has served the residents of the District and the larger community well.

The terms being discussed are varied and complex, and require a comprehensive, qualified team to negotiate the new agreement. The current

PHCD Board of Directors does not have the expertise nor experience to negotiate all of the terms. Some of the items being negotiated include:

Option for MPHS to lease or purchase PHCD land

Size and scope of operations of the new hospital

Seven properties surrounding Peninsula Medical Center conveyed by the PHCD to MPHS

Governance structure of the new hospital

Future determination of core services offered by Peninsula Medical Center

Dismissal of the PHCD lawsuit pending against MPHS

Prior to the November 2002 election, only two directors of the PHCD were able to participate in negotiations with MPHS, as the remaining three directors were deemed by the Fair Political Practices Commission (FPPC) to have a conflict of interest. As a result of the election, there will be three non-conflicted members of PHCD Board of Directors, and two directors will continue to be conflicted. Although one of the conflicted directors is in the process of appealing the FPPC ruling, a successful appeal will still leave one conflicted board member.

While PHCD and MPHS would like to proceed quickly with negotiations to finalize an agreement, the Grand Jury believes that a deliberate approach is prudent to ensure that PHCD is equipped to thoroughly consider and negotiate all terms of the agreement.

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Conclusions:

PHCD serves an important role in its support of health programs in the community. To continue to serve the residents of the District, Peninsula Medical Center must be rebuilt to meet the seismic requirements set forth by the State of California.

In order to accomplish the construction of Peninsula Hospital and to maintain MPHS as a business partner, the existing lawsuit between the PHCD and MPHS must be resolved, and the 1985 lease amended according to the letter of intent signed in 2000.

It is not feasible for PHCD to manage the operations of Peninsula Medical Center. MPHS is a viable business partner, and Sutter provides effective financial support and continued management support for MPHS and its two healthcare campuses.

Because MPHS is managed by Sutter, services that are offered by MPHS could potentially be consolidated and moved to other Sutter-affiliated hospitals. If this was to be the case, and should Sutter close any of its hospitals outside San Mateo County, PHCD residents could be adversely affected by the scope of services offered by MPHS.

While a majority of the Board of Directors will be able to participate in negotiations with MPHS, the community would be better served, on the most important issue to face PHCD, if all five directors could have input on negotiations for a new agreement. This could be accomplished if PHCD hired consultants, experienced in healthcare issues, to negotiate terms of a new agreement on behalf of the entire PHCD Board of Directors.

Recommendations:

1. PHCD should enter into an agreement with MPHS with fair and reasonable terms that would best serve the residents of the District.

2. To ensure that the PHCD Board of Directors is better able to serve the District's residents, the two conflicted PHCD directors should immediately resign and PHCD should defer the appointment of their replacements to the Board of Supervisors as provided by law.

3. PHCD should negotiate with MPHS for the following:

Significant representation on the Mills Peninsula Health Services Board of Directors in order to ensure appropriate input on health services proposed to be added or discontinued by MPHS
Right to conduct annual independent operational and financial audits of MPHS

4. PHCD should request the San Mateo County Board of Supervisors to sponsor multiple community forums, to be aired on cable television, for the purpose of educating and orienting the public to the issues facing PHCD and MPHS as the negotiations proceed.

5. PHCD should ensure that a qualified negotiating team, experienced in healthcare industry issues, conduct negotiations on its behalf.

6. While the timeframe for securing the financing and commencing construction is critical, PHCD needs to take into consideration that a fair and equitable agreement may take time and should proceed with deliberate speed and care to this end.

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Response

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