

Sutter Health In Acquisition Talks With Watsonville Hospital

by Mary Bryant

In a move that may end a century of home rule at Watsonville Community Hospital, hospital administrators are actively seeking a large corporate partner.

"Watsonville Community Hospital has been looking deep into the future as to what alignments would be most appropriate," Cory Allen responded in a written release prepared in response to inquires by The Post. "In October 1994, WCH sent RFIs (Requests for Information) to over a dozen organizations. Sutter Health is one of those responding."

Sutter Health Vice President Steve Heath also confirmed that the Sacramento multi-hospital health network was again in discussions with Watsonville Community Hospital directors regarding the possibility of the South County hospital affiliating with Sutter. However, neither Heath nor Allen would say if talks were close to producing an agreement.

"[Watsonville Hospital] is not prepared to discuss the RFI process any further at this time. The process of information finding is in process," added Allen.

For Sutter Health directors, the on-going talks would mark the second time they have formally approached Watsonville Community Hospital with partnership plans.

"We responded to their [1994] request for information. I don't know who else did, or what the current status of that is," said Sutter's Heath. "There was some discussion between Sutter and Watsonville Community [in 1990], even before Sutter became involved in the current project [of building a small acute care hospital in North Santa Cruz County]."

In 1990, upon the request of Watsonville Hospital administrators, Sutter Health proposed studying the idea of Watsonville Hospital becoming a Sutter Hospital through a management services agreement, a proposal that was eventually declined by members of the hospital's board of directors when current president and chief executive officer John Friel was hired. "The Board of Directors on behalf of the hospital decided not to have the hospital managed, and hired an administrator," said Friel, in a 1993 interview. Friel has continued to recognize during the past years that someday that decision might change.

"We are one of a few free-standing

Sutter Health Says They Are In Discussions With 11 Hospitals in State — Plans for Local Omni HMO Sales Still On Hold

by Mary Bryant

While it has been reported that Sutter Health of Sacramento has secured a license to sell Omni Health in Santa Cruz County, including a mention in The Post, a recent check with the Department of Corporations finds that Omni has not filed its application for license. This is a detail that Sutter's Vice President Steve Heath said will be attended to.

Heath said the application for a license to market Sutter's HMO Omni Health would probably be made sometime this year, before or after the anticipated November opening of Sutter's 30-bed, \$20 million maternity and surgery hospital in Mid-County.

"Omni could be there sooner, could be there later, I don't know what their timing is going to be but the one isn't dependent on the other," said Heath, adding that neither is the full immersion of the Santa Cruz Medical Clinic into the Sutter system. "We feel no sense of urgency to change the current relationship with the medical clinic."

Heath also reported that many of the rumors about the discussion of system mergers between Sutter and others had been taken out of context, even if the bigger picture in an emerging health care market has focused on the multi-billion mergers during the past year.

That is most of the activity in the hospital market has occurred among the "big fish" or existing multi-hospital systems. The Federal Trade Commission recently gave preliminary approval to the merger of Catholic Healthcare

hospitals in Northern California," said Friel in a 1992 interview about what he saw in store in the future for the South County's only acute-care hospital. "I think we are moving in the direction [of an alliance]."

Proud To Be One of the Few

Despite the rush to affiliate by most hospitals in the state, Watsonville Community Hospital has remained independent. Watsonville Hospital volunteer community board

West and Daughters of Charity Health Care Systems, a partnership that may soon make for the largest not-for-profit multi-hospital, physician network in the Western United States, a kind of partnership Heath said Sutter is not interested in.

Among the rumors that Heath denied is the often published report that Sutter is in discussions about alignment with the nation's biggest health care systems. Or, at least, Heath said that Columbia-HCA and Sutter officials weren't talking about joining one of California's larger non-profit health systems with the country's leading for-profit conglomerate.

"Columbia-HCA approached Sutter about our potential interest in doing a joint venture in the Santa Rosa area, where Columbia-HCA already has two hospitals," said Heath referring to the nation's largest for-profit health care chain Columbia-HCA. "That is the only discussion that's taken place between Sutter and Columbia-HCA. ... None of Sutter is on the sale block."

Heath added that Sutter is presently in discussion with 11 hospitals and two or three large medical groups throughout Northern California about acquisition.

"How many of those discussions will lead to a relationship remains to be seen. But I think Sutter will continue to grow ... and continue to work toward the creation of the integrated system that we've been working [on] for a number of years now." □

members have chosen to not affiliate their not-for-profit corporation with any other not-for-profit or for-profit in the region or state.

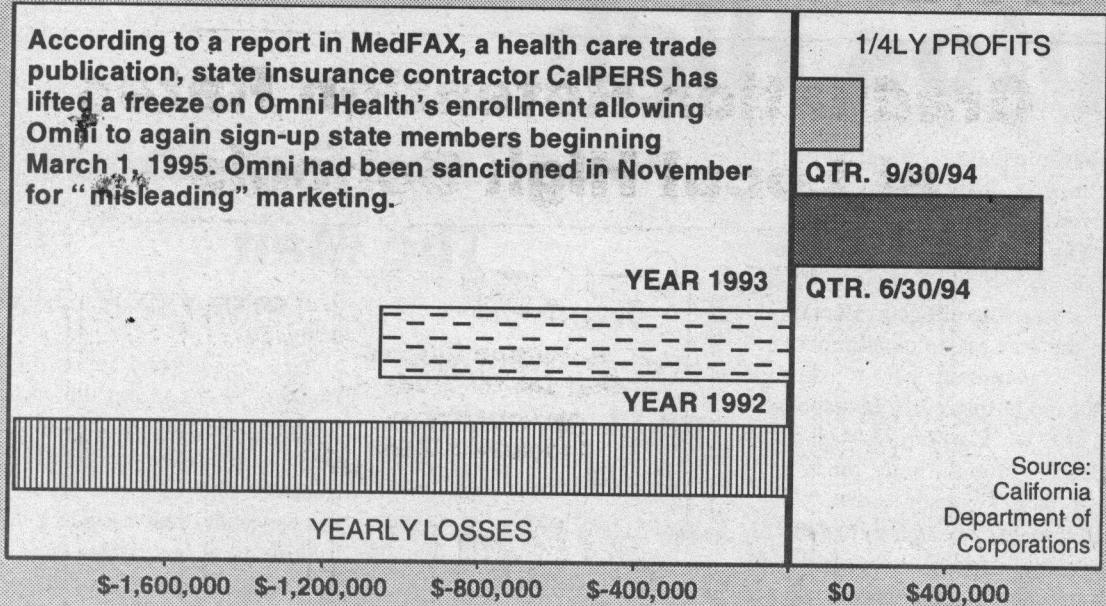
Likely part of Watsonville Hospital's autonomy can be attributed to a relatively secure market, albeit even in better years only a marginally profitable one in which unemployment and demand for unreimbursed care remains higher than state averages.

However, several recent factors may have shaken the state of the status

continued on page 6

Sutter's Omni Health Plan Posted Modest Profits in Mid-1994

According to a report in MedFAX, a health care trade publication, state insurance contractor CalPERS has lifted a freeze on Omni Health's enrollment allowing Omni to again sign-up state members beginning March 1, 1995. Omni had been sanctioned in November for "misleading" marketing.



Sutter Health

continued from page 4

quo in South County. The changing event that may be drawing Sutter and Watsonville Hospital together include: Watsonville Hospital's need for capital to complete construction of their proposed new hospital campus, and Sutter Health's on-going demand for a nearby acute care facility to support their surgical center presently under construction in Mid-County, their existing physician group and their soon-to-be licensed Santa Cruz County branch of the Omni HMO plan.

Even though Watsonville Hospital's bottomline is weighted down with debt (\$18 million in existing bond debt with another \$20 million anticipated with the groundbreak-

ing of their new campus on Airport Blvd.) and even though Watsonville Hospital's only facility was severely damaged in the 1989 earthquake (the state recently valued the hospital's plant and property assets at less than \$2 million), Watsonville Hospital may still possess much to sell to the right partner. And, Sutter health may be just that partner.

The Right Stuff

What makes Sutter a viable partner is just a bit more tricky to understand and is slightly more complicated than the fact they already have a doctor's group in the area and are about to open a new mini-hospital.

While Sutter can now boast controlling interests in 15 hospitals, with 3,000 doctors in practice, to achieve their goal of creating an integrated

health system, Sutter officials will need to make sense of the variety of facilities and assets they control in geographically diverse markets. This is true in Santa Cruz, as it is true in the Bay Area.

For instance, owning an individual physicians group unconnected to any other provider within a single market probably won't offer much competition to another physicians group that has established a partnership with a hospital and/or a major insurance carrier. Having more than a single component or even most of the pieces of an integrated network may be worse in a market than only controlling a single resource. Or, at least a player has a lot more to lose and will appear to other players in the market as capable competitors ready to rumble.

To date Watsonville Hospital has remained passably profitable by maintaining a low profile, non-aggressive presence, while Sutter Health has been the focus of efforts to open a multi-million dollar physician network in North County aimed at securing a competitive framework in which independent doctors can practice in competition with doctors at Santa Cruz Medical Clinic, a doctors group in which Sutter owns an interest.

Getting To Know Us

Sutter Health was originally invited to Santa Cruz County by the president of Santa Cruz Medical Clinic, Wayne Boss.

Boss was stung when his plans to purchase AMI's Community Hospital fell short, and sponsors of Dominican Santa Cruz Hospital bought the only other competing hospital in North County in 1990.

Boss vowed that someday, somehow he would be instrumental in plans to open another hospital to compete with Dominican. To attract suitors, he held out the multi-specialty physician group he worked for to a group of

continued on page 8

health care executives who were quickly gaining a reputation for buying just about anything in Northern California that was for sale in the health care market. Sutter Health, like many other multi-hospital system, was especially interested in well organized and profitable physician groups in small communities positioned to feed Sutter's big physician groups in the Bay Area with specialized medical referrals.

It is commonly said and not denied by Sutter, that part of the dowry to get better acquainted with the Clinic doctors was the construction of a mini-hospital. But to afford such a wedding present, Sutter Health is going to have to make sense of the entire market, and be able to compete throughout the county.

Locally, Sutter has purchased a one-third interest in the Santa Cruz Medical Clinic and has spent \$20 million in constructing a 30-bed acute care hospital. However, even a nearly \$30 million investment is not enough.

Sutter still only holds two of the three integral components necessary to launch Sutter's HMO sales in Santa Cruz County, or support a regional market along the Central Coast. That is unless Sutter can negotiate a contract with one of the existing full-service hospitals in the coun-

ty, Sutter will likely have to settle on a small piece of the existing market and potentially a future brimming with competitive disadvantages.

The Good and The Bad

If Watsonville Hospital administrators are to purchase nearly \$20 million in property and spend more than \$40 million to construct a new hospital campus in South County, then Watsonville Hospital officials will have to find a capital partner, and a capital partner with deep pockets. Whether or not Sutter Health proves to be the successful bidder, change is in store, especially for independent doctors practicing in South County.

Unlike their counterparts in North County where a growing dominance by Sutter's partly-owned affiliate Santa Cruz Medical Clinic has caused many physicians to choose sides and maintain a contractual relationship with one of the two principle players (Santa Cruz Medical Clinic or Physicians Medical Group), South County practitioners have mostly had the choice of remaining in unaffiliated, independent practice.

However, many of these same doctors are already aware and facing new competition with the opening of a Santa Cruz Medical Clinic office in Watsonville, and are likely more closely watching the moves made by Sutter. One

MCP MAR 7-20, 1995

specific question for many doctors will be what can come of their relationship with the North County physicians collective if Sutter affiliates with Watsonville Hospital, and what changes are in store for the contracts they currently service in the South County.

Helping to hold the line on a dwindling fee-for-service market have been contracts these physicians have signed through Physicians Services Inc., a contracting firm separately sponsored by both Dominican Santa Cruz and Watsonville Community Hospitals, and a group that works in conjunction with Physicians Medical Group. However, should Watsonville Community Hospital opt to align with Sutter Health, contracts held through PSI would likely be contested, leaving South County independent physicians caught in the middle of a range war that would presumably leave few independent survivors in the market.

"I'm not certain what Sutter's affiliation with Watsonville Community Hospital would mean in terms of our existing relationships, although I am certain we will find ways to be sure members in our established plans are provided care and will have access to our full range of quality services throughout the county," said Joe Wierzbza, executive director of PSI and Physicians Medical Group. □