A Historical Perspective

In 2009, like many other small hospitals faced with changes in healthcare delivery and financing, WestCare and Haywood were evaluating the possibility of partnering with a larger hospital system. The hospitals were looking for economies of scale, better purchasing arrangements with suppliers, and better contracts with payers. The hospitals hoped to become more efficient and effective by using experts the larger facilities could provide as advisors. They were hoping to find a capital partner that could help pay for new facilities and equipment.

Multiple potential partners were evaluated. There were three finalists Mission, Novant and Carolinas. Novant withdrew. Mission gave a very poor presentation and was not chosen as a partner by either WestCare or Haywood. In Carolinas initial presentations, they emphasized that they would partner with both hospitals in a way that would build on each hospitals individual strengths and allow each hospital to develop to be the best they could be in their own community. In subsequent discussions, Carolinas agreed to manage both hospitals but would only partner if WestCare and Haywood affiliated.

Neither WestCare nor Haywood had planned to affiliate. The fact that they were looking at partners together was an historical accident related in part to help WestCare gave Haywood physicians during the Medicare crisis. In addition, there was fear of competition, what might happen if one partnered effectively and the other did not. Neither WestCare nor Haywood had much direct interaction before these discussions. They were nominally competitors but for the most part provided similar services to different population groups. The physicians at each facility did not compete but they also did not interact significantly. There was concern about how the business model would work as the hospitals were so similar in the services they provided and so different in the populations they served. There was uncertainty but not hostility so after much discussion and negotiation, MedWest was formed.

In 2010, at WestCare, there was a very short honeymoon period after which things just went from bad to worse. WestCare's senior management team had been replaced by Haywood's team as part of the affiliation process. WestCare's mid level management team was dismantled over the first six to nine months of the affiliation. The new team from Haywood never seemed to be on site at Harris. There was no direction. Nothing seemed to get done. New programs were started then abandoned. Day to day operations were in shambles. Staff were dismissed or quit in frustration. If physicians, managers, or staff questioned or objected to what was happening, they were branded as troublemakers. Patients rebelled at being referred to Haywood rather than Mission. Talk began in the community that WestCare had changed and census dropped. Employee morale plummeted. Physicians were angry and frustrated.

Multiple meetings were held with the MedWest administrative team over months trying to fix things. Nothing changed. There was a progressive loss of belief and confidence in management. In May 2011, there was an open confrontation with the Administration at the WestCare Medical Staff meeting. That led to a series of ineffectual meetings with the Joint Advisory Committee which included members of the Board, Administration, and Medical Staff. There was no resolution of the on-going problems as a result of these meetings.

As part of the effort to resolve problems and improve communications, Mr Poore, the CEO of MedWest at that time, named a "kitchen cabinet", a group of the acknowledged physician leaders at WestCare. That group was to have regular meetings. Two meetings were held one in May and one in June. Mr Poore did not schedule any subsequent meetings.

The "kitchen cabinet" physicians continued to document a growing list of problems from July to October, 2011. These were presented to the Administration in individual and group meetings. When there was no response, the physicians requested a meeting with the WestCare Board in October. The physicians presented multiple issues to the Board. They gave specific examples of operational and financial concerns and raised questions about Carolinas management of WestCare and MedWest. Questions were asked about WestCare's reserves which by report had gone from $19,000,000 to $13,000,000 and days in cash on hand which had gone from the low 90s, to the mid 70s, to the high 50s. Questions were asked about rumors that vendors were not being paid. Questions were asked about whether allocation of expenses was effectively documented and whether transfer of revenue and reserves was appropriately justified. The physicians asked the Board to consider withdrawing from the affiliation with Haywood and to evaluate partnering with Mission.

A series of meetings with the physicians and the WestCare Board's Executive Committee were held in November and December to respond to these questions and concerns. There was frank discussion but no action. Reports about finances and operations promised in October were never delivered. The physicians were increasingly concerned about dithering by the Board and stalling by the administration. As there seemed to be an impasse, the physicians asked Mission to meet to see if there was any alternative to the progressively deteriorating situation at WestCare and MedWest. The meeting with Mission was positive. There was agreement among the physicians that the Board should be asked to further evaluate Mission as a partner.

Day to day operations continued to deteriorate. Surgery at Harris was held because supplies were not available. There were more reports of vendors not being paid at both hospitals. There were new rumors that Haywood could not meet payroll and that Carolinas was offering a $5,000,000 loan and a $10,000,000 line of credit to be secured by the accounts receivable and a deed of trust from each facility. When those rumors were confirmed, the physicians demanded to meet with the Board.

<u>January Meetings</u>

That meeting was held on <u>Wednesday, January 4, 2012</u>. There was pointed discussion of continuing financial problems, operational issues, and distrust of Carolinas. The physicians reported on their discussion with Mission and asked the Board to meet with Mission and to seriously evaluate Mission as a partner. The physicians reviewed the Integration Agreement and showed the Board that the affiliation with Haywood could be "constructively terminated" based on Section 9.5 of that Agreement because of the "financial instability" demonstrated by Haywood's inability to meet payroll or pay vendors. The physicians were adamant that the Board should not approve the loan and line of credit planned for Haywood. The Board was told that physicians would leave the community if there were no improvements in operations and the loan was approved.

After the meeting, the Board asked that the physician group meet directly with Carolinas. That meeting was held on Sunday, January 8. The physicians presented a summary of their issues and concerns, their frustration with Carolinas management practices, their unwillingness to work with the MedWest administrative team, and their opposition to the loan and line of credit. No agreement was reached. Carolinas did offer to consider separate management teams for each hospital. A follow up meeting was arranged for the week of January 23.

The regularly scheduled meeting of the WestCare Medical Staff was held on Monday, January 9. There was lengthy discussion of the on-going problems and concerns. The entire Medical staff had serious concerns about Carolinas management and the financial problems underlying the proposed loan and line of credit. Because of those concerns, the Medical Staff voted overwhelmingly to ask the Board to meet with Mission and to evaluate partnering with Mission.

On Monday, January 9, an urgent WestCare Board meeting was called for Wednesday, January 11. The WestCare Board was e-mailed an extensive group of legal documents defining conditions of the proposed loan and line of credit from Carolinas to Haywood at 2:53 PM on Wednesday, January 11. The actual Board meeting started at 6:00 PM approximately three hours after the documents were distributed. No Board member had the opportunity to effectively review these documents prior to the meeting. Some were not even aware they had been sent.

At the beginning of the Board meeting, at least one member of the Board raised concerns that they had not had time to adequately review the documents. Carolinas response throughout the meeting was that something had to be done immediately and that there was no time to evaluate other options. Discussion focused on MedWest's financial plight given Haywood's effective bankruptcy and WestCare's loss of reserves and cash on hand.

The Board was to asked to approve a short term loan of $5,000,000 to Haywood to cover payroll, pay vendors, and meet other expenses. The Board was also asked to approve a revolving line of credit of $10,000,000 for Haywood. The Board was also told that WestCare was potentially in violation of its bond covenants and that the proposed new amendments to the Integration Agreement would satisfy the bank about that possibility. WestCare was not in violation of the bond covenants in 2009 when Carolinas and the MedWest administration took over management. By Section 4.3 b of the Integration Agreement, Carolinas was required to manage WestCare's bond commitments to BB&T so that WestCare's "property and affairs shall be arranged and managed so that they remain in compliance with all of the covenants and requirements of the Applicable Debt Instruments". Obviously, that did not occur.

The Board was asked to approve amendments to the Integration Agreement preventing WestCare from withdrawing from the affiliation with Haywood until all Haywood's obligations to repay the loan and line of credit were fulfilled. A question was raised about Section 9.5 of the Integration Agreement which would have allowed WestCare to withdraw from the affiliation with Haywood because of Haywood's financial instability. The question was not answered. Discussion was diverted. The Board was not presented with the possibility of withdrawing from the affiliation as an alternative to approving the loan and line of credit. The fact that the amendments effectively precluded WestCare from withdrawing from the affiliation with Haywood was not emphasized in discussion.

The Medical Staff request that the Board evaluate partnering with Mission was presented. The request was dismissed. Discussion was again diverted. There was no discussion about how evaluating other options like partnering with Mission might have better served WestCare's interests.

The lawyer who was represented WestCare at the Board meeting that night is associated with Parker Poe Adams & Bernstein LLP. One of that firms major clients is the Charlotte Mecklenburg Hospital Authority (Carolinas) according to the practice profiles section of the Martindale Hubbell Law Directory.

At the end of the meeting, the Board approved the loan of $5,000,000 and the revolving line of credit for $10,000,000 for Haywood. None of those monies were for use other than by Haywood for Haywood. No monies wee available to WestCare despite substantial capital needs at Harris. The Board also approved several amendments to the Integration Agreement. One amendment prevents WestCare from having discussions with any other potential partner. Another prevents WestCare from withdrawing from MedWest until Carolinas has no obligation to make revolving loans to Haywood under the Agreements, the loan and any line of credit are paid in full, and all monies due Carolinas under its management contract with MedWest are paid in full. Note that it is a revolving line of credit with Haywood able to borrow at need. The Board agreed to secure the loan with WestCare's accounts receivable and, if MedWest fails, a deed of trust to WestCare's holdings at Harris and Swain. Not all of the details are available but a $17,000,000 deed of trust has already been registered with Jackson and Swain counties.

WestCare's receipts and assets were not required to secure the Haywood loan or line of credit. Both could have been secured with assets on the Haywood campus. The only reason to require WestCare's guarantee and to amend the Integration Agreement was to make it effectively impossible for WestCare to withdraw from MedWest. In addition, Carolinas parent hospital is a county owned facility like Haywood. Carolinas knew the issues the Haywood Commissioners would have with giving a Deed of Trust on the Haywood properties. That is the other reason Carolinas presented the amendments to the West Care Board at the time it did and in the way it did.

Carolinas misled the Board at this meeting. They created a crisis atmosphere. They did not present or discuss all the options open to the Board whether they agreed those options were viable or not. They dismissed the serious concerns of the Medical Staff. This raises significant questions about their honesty and integrity. If nothing else, it was an aggressive power play unacceptable in a Board's relationship to its administrative team.

On Tuesday, January 23, the kitchen cabinet physicians met with Carolinas, the MedWest and Westcare Board Chairs, and the WestCare Medical Executive Committee. Carolinas presented their proposed changes in the administrative structure of WestCare and MedWest. They stated that WestCare was still operating at a loss and that there would be additional decreases in staffing.

Both Carolinas and the Board Chairs stated there would be no interaction with Mission. When questioned about the Medical Staff resolution of January 9, they simply re-iterated there would be no interaction with Mission.

There was heated discussion about the WestCare Board meeting on January 11. The physicians were critical about the time the Board had to review the documents, that Section 9.5 of the Integration Agreement was not presented and discussed as an alternative to the loan and amendments to the Integration Agreement, that WestCare had made open ended guarantees for Haywood's finances, and that Carolinas had failed in its responsibility to both hospitals, but particularly to WestCare, while seeming to further its own interests in sustaining the affiliation.

Carolinas was challenged to reassure the physicians that there had indeed been a real change in direction. They were asked how the Strategic Plan had changed or would change given the emphasis on separate campuses. They were asked about the pay off provisions guaranteeing the loan and line of credit. They were asked whether the ophthalmologist and neurologist that might work at WestCare would still be recruited to practices at Haywood and not locally in Sylva. They were asked about how an ER could be built at Harris and how needed x-ray, lab and other equipment would be purchased or replaced given the financial problems facing MedWest. No answer was given to these questions.

Is MedWest Viable

Significant concerns about the viability of MedWest remain unanswered. And if MedWest is viable, is it the right partner for WestCare?

Does MedWest work as a business? In 2009, neither WestCare nor Haywood planned to affiliate. The affiliation was mandated by Carolinas. At the time, there was concern that the benefits that normally make an affiliation successful were not there. The organizations were too much alike. Their service lines were effectively identical. No new service lines were added by the affiliation. Affiliation provided no economies of scale. Services still had to be provided at both facilities. Buildings, equipment, and supplies could not be merged. There were only so many staffing positions that could be operated at a system and not a local level. The hospitals served different patient populations almost exclusively. Their medical staffs were not integrated and interacted minimally. And at a basic level, neither hospital wanted to cut services or cede services to the other hospital. Incentives were not aligned. Events over the past two years confirm those concerns and indicate that the MedWest business model has not worked. Carolinas has acknowledged that by appointing a separate administrative staffs at WestCare and Haywood. Marketing will now focus on "My Community, My Hospital" and not on MedWest as a regional entity.

If MedWest does not work as a business, does it work medically? Do patients see a benefit in the affiliation? Do physicians? Physician and patient choices are critical to a hospital's and a health system's viability. Haywood primarily serves patients east of Balsam and WestCare serves patients west of Balsam. Neither patient group has historically used the other hospital to any great degree. In each community, physicians and patients prefer referral to Mission when care cannot be effectively provided locally. Neither physicians nor patients see referral to another MedWest facility as a "step up' in care. This is a major problem for MedWest which has to recapture patients from Mission and share patients between facilities to survive. Events over the past two years indicate that the MedWest medical model does not work.

The fundamental flaw in the MedWest concept is that WestCare's needs and Haywood's needs are in conflict. For the past thirty years Harris has been a regional facility. Harris has not served just Jackson County alone. The hospital and its physicians served a significant patient population from Macon, Swain, and Graham counties as well. Harris has been the provider secondary care and services west of Balsam. Harris has historically viewed Mission as both a competitor and referral partner but not as a major threat to its business. Haywood served Haywood County with little market penetration west of Balsam. Haywood has historical issues with its reputation in Haywood County. Because those issues and the proximity to Asheville, a significant percentage of Haywood's patient population have and still do choose to go to Mission and Asheville specialists. Given the out migration of local patients and the lack of a regional referral base, Haywood's medical community views Mission as a major threat. Events of the past three years have strengthened that perception. Those same events have placed Haywood and WestCare in competition not only with Mission but also with each other for the regional patient base. In its current financial condition WestCare cannot afford to cede patients, services, or financial subsidies to Haywood. History has shown that Haywood can at best subsist and slowly wither on its local and regional market share. The needs of the facilities are in conflict. Their incentives are not aligned.

The problem persists even if WestCare and Haywood are successful in recouping market share from Mission. Even if both facilities were financially viable today, they would face the same issues that led to the affiliation in the first place. Patients west of Balsam would still choose Mission over Haywood. Patients east of Balsam would still choose Mission over Harris. Neither facility would be in the position to develop new service lines and would face increased competition from Mission in sustaining existing services. There would still be competition between Harris and Haywood for patients and resources. Neither facility would be willing to cede services to the other. Neither could underwrite the development of new services at the other. There is no way to functionally integrate facilities and services into a single system unless one facility devolves. MedWest is not viable even without the current financial constraints on both facilities. Factoring in those constraints simply compounds the problem.

Haywood was marginally viable financially before the affiliation. They were generating a positive cash flow but not a sufficient profit to cover depreciation and service debt. They were forced to deplete their reserves when their debt was called during the Medicare crisis. Their financial instability was a major reason they were evaluating affiliating with a larger system in 2009. It can be fairly argued that Haywood was bankrupt January 1. They had overextended in part due to the expense of a new computer system, the costs associated with an aggressive building program, and the purchase of physician practices. They had no cash flow. By one report, there were less than ten days of cash on hand. There were no reserves. The loan and line of credit were needed to "support Haywood's operating cash flow needs for payroll, amounts payable to key vendors, and other operating expenses." There is serious question about whether Haywood can pay back the loan and line of credit and service its other debt at the same time because of that same lack of reserves, market penetration and profit margin, and the "other operating expenses". Haywood has no new revenue stream. If the federal subsidy for the computer system or some other temporary resource is used to pay the loan and line of credit, what resources are available to cover the other expenses?

Haywood can repay its debt and become financially viable long term only by taking local market share from Mission in Haywood county or by taking regional market share from WestCare or Mission west of Balsam. Neither seem likely. Mission is aggressively expanding services in Haywood county in response to Carolinas. Mission has purchased Tallulah Health Center in Graham county and continues to expand services in Macon county in partnership with Angel Medical Center. Both initiatives have decreased WestCare's market share in those counties. Haywood's market share was already minimal. In addition, WestCare has lost local market share in part in reaction to the national recession and in part related to the communities reaction to the affiliation with Haywood and the changes in operations at Harris that have occurred over the past two years. The departure of key physicians will increase WestCare's loss of market share in the short term critical to financial viability. Given the changes in its own financial condition, WestCare cannot afford to cede patients or services to Haywood. WestCare has to increase its own market share to survive. By the Integration Agreement, WestCare is obligated to share any profit or loss on a 50/50 basis with Haywood. By the new amendments, WestCare is now a guarantor of the Haywood loan and line of credit. The problem for WestCare is that even if it increases market share and revenue, it will be shackled by Haywood's debt in the short term and Haywood's market share in the long term. The problem for Haywood is WestCare's loss of market share and the departure of a significant group of WestCare's physicians. The problem for MedWest is that it fosters an adversarial relationship between WestCare and Haywood.

As part of the affiliation process that formed MedWest, Haywood and WestCare signed a Management Services Agreement with Carolinas. That agreement made Carolinas responsible for managing both organizations. MedWest has failed in large part because Carolinas has failed. Carolinas failed in their assumptions about the relationship between the hospitals and the communities they serve, in supervising the MedWest administrative team, and in managing operations and finances. There is little doubt that both hospitals are substantially worse off than they were in 2009. That is obvious from the financial data alone. There is little expectation that after two years of operational and financial mismanagement that things will improve going forward under Carolinas leadership. There is growing concern at WestCare that there is no escape from MedWest and no way to make MedWest work.

Partnering

At this point, neither WestCare nor Haywood appear viable without a partner.

For WestCare, Mission is still the most logical regional partner. Mission is certainly the preference of the patients and the communities WestCare serves. Patients west of Balsam see Mission as a historic resource and the natural partner for WestCare. They have not embraced MedWest and do not understand WestCare's involvement with Haywood or Carolinas. At many levels, WestCare and Mission complement each other. Geography makes it difficult for Mission to provide secondary care fifty to one hundred miles from Asheville. WestCare will never be a tertiary center. WestCare needs Mission to cement its position as the secondary center west of Asheville, to stabilize its referral base, and to satisfy its communities. Mission needs WestCare to cement its position as the regional tertiary center, to stabilize its referral base, and to forestall Carolinas. Incentives are aligned.

An argument has been made that the Haywood community could be appropriately served by Haywood operating as a critical access hospital with supplemental in-patient services at Mission and transformation of HRMC to primarily an outpatient facility providing emergency room, urgent care, ambulatory surgery, and other services to its community. Haywood surgical and specialty physicians could use Mission and outpatient oriented facilities in Haywood to maintain their practices. Proponents of this view argue that Haywood is not financially viable because of its lack of reserves, its historic market penetration and profit margin, and its current operating expenses and debt. They argue the market has already made its decision with the Medicare crisis and the financial crisis this December and that only outside intervention has kept Haywood open. The perception in the Haywood medical community is that Mission would benefit and Haywood would suffer if this happened. So for Haywood, Carolinas is the partner of choice. This is the heart of the issue for the Haywood community and its physicians and the reason that it is unlikely that there will ever be a super majority vote to dissolve MedWest.

Carolinas

Carolinas is not a disinterested third party whose only goal is managing MedWest operationally. Carolinas is a business. Carolinas is a management company not a hospital. Like any other business, it wants to make a profit and undermine its competition. Carolinas has an interest in undermining Mission. Any hospital system needs referrals to survive. That is true whether the system is WestCare, Mission or Carolinas. WestCare developed as a secondary center west of Asheville because it provided primary and specialty services to a significant segment of the population of four counties. The specialty services that evolved at Harris could not have been supported by Jackson county alone. Mission needs referrals from seventeen counties to sustain the secondary and tertiary services it provides. Carolinas Medical Center needs a significant market share in Charlotte and surrounding areas in both North and South Carolina to sustain its services. Carolinas mandated WestCare's affiliation with Haywood. In retrospect, that can be viewed as the initial step in a plan to challenge Mission. Carolinas then contracted to manage Murphy Medical center. Carolinas now manages facilities in WNC with significant market penetration in seven counties. They are developing a physician network one of whose measures of success is maintaining referrals inside the network. Until events forced them to re-consider, they viewed the market as a big ellipse from Asheville west. For the last two years, their marketing strategy focused on establishing MedWest as a regional entity covering that ellipse. Many at WestCare saw a plan to build Haywood to be a competitor with a Mission by siphoning off patients and resources from WestCare as part of that marketing strategy. The MedWest Strategic Plan as presented last fall would have initiated that process. Yet Carolinas denies any such intent. Nevertheless, while these activities and other activities like the aggressive building program at Haywood were presented as furthering MedWest, they served equally well as part of a long range plan to limit Mission's referral base and undermine Mission's ability to sustain its secondary and tertiary services. Mission certainly believes this is Carolinas intent.

Carolinas may be the only beneficiary of the turmoil of the past two years. That is ironic since they are in large part responsible for the current operational and financial issues faced by WestCare and MedWest. They did not supervise the MedWest administration effectively. They permitted Haywood to make capital investments they never would have been able to consider as an independent entity. Now, finances and operations at both facilities are in disarray. There are no resources to replace aging equipment at either facility or build a desperately needed ER at

Harris. There is an accelerating trend for WestCare's patients to transfer care to Mission. Yet the Integration Agreement and the amendments agreed to in January make it difficult to impossible for WestCare to functionally evaluate a different partner or withdraw from the affiliation. Haywood has no incentive to do so. By default, if finances do not improve rapidly, Carolinas is positioned to take over both facilities whether by purchase or by loans to sustain operations.

As a result of all this, eight physicians are leaving WestCare. Others are seriously evaluating leaving. No physician wants to leave an established practice and start over. No family wants to leave their home and friends. Each physician has his own reasons for leaving. But there is a common element of anger and frustration with day to day operations, concern about the financial viability of the hospitals, and distrust of Carolinas and the WestCare and MedWest Boards. The departure of these physicians increases the risk of closure or buy out of both hospitals.

Summary

MedWest has failed. The business model and the medical model do not work for all the reasons discussed. Management and the Boards have acknowledged that by committing to separately administer the facilities and by abandoning a regional marketing strategy for one that focuses on each facility locally. In the process, WestCare is has been significantly damaged operationally and financially. Physicians and patients are leaving. Westcare's historic mission to ensure access to secondary care on a local level in the sub-region west of Balsam is seriously compromised.

Carolinas has failed. In any other organization, a management group that bankrupted its facilities, drove off key personnel, operated in support of its own interests, and misled the Board the way Carolinas has would be fired. If the Board chooses to continue the relationship with Carolinas, it should define a process for going forward that commits Carolinas and Haywood to administer and market the facilities separately and prevents Carolinas from attempting to develop Haywood as a regional competitor to Mission. The communities west of Balsam will not support that role. The only result will be that Mission will compete more effectively in those communities. The risk of failure for both MedWest facilities will be substantial.

Despite the legal impediments in the Integration Agreement and its amendments, Westcare should withdraw from MedWest. The WestCare Board will need to evaluate Mission as a partner in that process. Events of the past two years have proven that Mission is the only partner acceptable to WestCare's communities. The communities will not support another external partner. The communities will not support Harris as a primary care hospital affiliated with Carolinas and referring patients to Haywood. Mission can be trusted to act in its own interest to help WestCare exit MedWest and to build a sustainable regional delivery system. And hopefully, the Board will have learned enough to negotiate more effectively.