Jim McSweeney Notes on Cirrus Health November 24, 2006 Letter to Bob Edwards and Steve Pease November 27, 2006

Disparity in Personnel Costs

In our view, Cirrus' comments don't address the central issue, which is: Does Cirrus have the ability to furnish the services Sonoma Valley Hospital is currently providing, and accommodate substantially increased outpatient surgery volume, at a fraction of our personnel cost?

Cirrus states that that SVH operates with both a high cost per FTE and with more FTEs per occupied bed relative to other hospitals.

With respect to the high cost per FTE, it is important to note that our salary scales in no area match Kaiser's, and are comparable to Sutter and Santa Rosa Memorial only for RNs and selected critical clinical personnel, such as imaging techs. Our wage rates for support and administrative personnel are uniformly below of the surrounding hospitals. The Hospital Council of Northern California recently engaged a consultant to review the wage data included in the Medicare cost reports submitted the eight hospitals in the county. (This effort is undertaken periodically to ensure that our area's Medicare wage index is not understated.) Based on that review, SVH's average wage rate is second lowest and our benefits the very lowest. It is difficult to understand how Cirrus will be successful in attracting employees at even lower compensation levels, given the high local demand for health care personnel.

While it is true that our FTEs per occupied acute bed are higher than the examples cited, that doesn't mean that it is feasible to operate SVH at those levels. In fact, we don't believe the examples are relevant to this question, for a couple of reasons. Petaluma Valley is operated by Santa Rosa Memorial Hospital, which is located nearby and therefore can provide centralized management and support. More importantly, these industry standards relate to hospitals of an entirely different scale and with a much different service mix. These factors are illustrated by looking at Marin General Hospital ("MGH"), the other example cited.

Based on the latest publicly available OSHPD data, MGH has more than six times the acute inpatient days as we do. While this scale difference allows Marin General to spread its fixed personnel costs more effectively than we can, it does not mean that we (or Cirrus) can simply eliminate those fixed costs and thereby reach the FTE ratio MGH achieves.

In addition to the scale factor, our mix of business is substantially different, by orders of magnitude, than MGH's. (And presumably from the 'typical' hospital.) Based on OSHPD revenue data, about 34% of MGH's patient volume is outpatient. At SVH, the figure is 50%. But even this 50%figure is misleading, because about a third of our inpatient revenue derives from our SNF, a business line not present at either MGH or at most 'typical' hospitals. If you exclude SNF revenue from our equation, our outpatient percentage increases to 65%. If you work through the numbers, you quickly find that our outpatient volume, relative to our acute activity, is more than four times greater than that found at MGH. That's why the FTE ratios for the 'typical' hospital aren't particularly relevant in our situation.

Again, the actual question is not whether our FTE ratio and resulting personnel costs are 'high', but rather, can Cirrus operate the hospital it proposes (which has more volume than the facility we operate) at a third of the personnel costs. We have provided Cirrus with a department by department list of our FTEs, so they should be able to identify very specifically, where they would reduce employment. As I stated to HFS previously, there are $14.2 million in personnel costs associated with the ER, acute inpatient, OB and SNF alone. Cirrus proposes roughly the same amount for the entirety of its personnel costs. Cirrus may be able to operate the facility more efficiently that we can, but I don't see how they can eliminate support, administrative and ancillary costs entirely.

Hospital Size

While we haven't engaged in a programming exercise *with* Cirrus, we have completed an exhaustive effort with Anshen and Allen. They completed a detailed, department by department architectural program to determine the number of square feet required for the service levels projected by the professional demographic study we commissioned. Both the demographic study and architectural program were peer reviewed (twice and three times, respectively). As a result of these peer reviews, the projected service levels were reduced and square feet cut from the initially proposed program. The result is that in order to accommodate the projected volume, roughly 135,000 square feet are required. Anshen and Allen have told us that they do not believe a smaller hospital is feasible, and we are confident they are correct.

Given the work we have completed, we cannot reconcile the 70,000 square feet Cirrus proposes with the program we have developed. In fact, we would expect their plan to contain more square feet, given that they are proposing a cath lab, one more ER bay and an additional operating/procedure room.