



SPECIAL REPORT | Health care's painful price

Rising costs at hospitals hit insurers

CHARGES NOT DIRECTLY TIED TO TREATMENTS BOOST PREMIUMS

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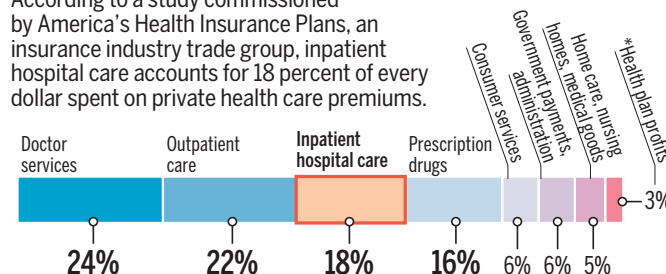
Behind every public uproar are some hidden facts. Here's one about rising health insurance rates in California: Sharp jumps in hospital costs are a big part of the story.

A Bee analysis of financial data from 300 hospitals statewide shows they collected \$25 billion from insurance companies between September 2008 and October 2009 — an increase of more than a third since 2005.

Hospitals are charging insurance companies, and by extension their customers, bil-

HEALTH CARE PREMIUMS BROKEN DOWN

According to a study commissioned by America's Health Insurance Plans, an insurance industry trade group, inpatient hospital care accounts for 18 percent of every dollar spent on private health care premiums.



*Consumer groups and some policymakers remain deeply skeptical about assertions being made by insurers about their profit margins.

Source: PriceWaterhouseCooper

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lions of dollars for expenses not directly related to care. These include new hospital wings, new technology and services for the uninsured.

Some providers, including Sutter Health in Sacramento, have negotiated reimbursement rates with "markups" more than double what it

costs them to provide services.

"It's become *en vogue* to crucify the insurance companies. ... It's the hospitals that hold insurance companies hostage," said Will Fox, a principal and consulting actuary for Milliman, a Seattle-based firm that has extensive experience studying hospital finances in

California. Fox has done work for insurance companies, government agencies and business groups.

Hospitals say their charges to insurers are justified and necessary. But their byzantine pricing policies make it difficult to understand why costs are rising so quickly.

Under state law, hospitals have to report the total amount of money they spend to provide services to insured patients each year, how much they bill insurance companies and how much they wind up collecting.

Based on those numbers, The Bee found that California hospitals charged insurers an average of 53 percent more than what they told the state it cost them to provide services. In 2005, the gap was 40 percent.

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HOW MUCH DOES IT COST HOSPITALS TO PROVIDE CARE?

In 2007, CalPERS and the Pacific Business Group on Health asked a Seattle-based actuarial consultant, Milliman Inc., to calculate hospital costs based on publicly available information to compare pricing policies and cost at California hospitals. Milliman developed a set of formulas for making its analysis. The Bee applied that methodology to the most recently available data to make a similar analysis for the Sacramento region.

The methodology involved:

1. GATHERING THE DATA

The California Office of Statewide Health Planning and Development collects financial and patient data from California hospitals, including how much money hospitals take in from such sources as insurance companies. Hospitals are also required to report how much they spend to provide services.

The Bee used the publicly available data, for the period between September 2008 and October 2009, to calculate how much money insurers paid each hospital, as well as how much it cost hospitals to provide those services. From that information, The Bee was able to estimate the difference between what insurers paid for services and what it cost each hospital to provide them.

2. EXAMPLE: SUTTER MEDICAL CENTER

The Bee first calculated an **Allowed/Billed Percentage**, which Milliman called a ratio: the percentage insurance companies pay the hospital on the amount billed for services provided, as negotiated in a contract between them.

The Allowed/Billed Percentage equals =

1. Amount the hospital billed insurance companies for inpatient and outpatient care.

During the period analyzed for Sutter Medical Center-Sacramento, this amount was:

\$805,085,003

PLUS +

2. Amount of capitation contracts, under which insurance companies make a fixed payment for every patient. Sutter:

\$47,963,576

MINUS —

3. Price adjustments pre-negotiated between the insurer and hospital. Sutter:

\$432,818,792

DIVIDED BY ÷

4. Amount the hospital billed insurance companies for inpatient and outpatient care.

\$805,085,003

So, Sutter's 2009 Allowed/Billed Percentage was: **52.2%**

The Bee also calculated a **Cost/Charge Percentage**, which reflects the relationship between how much a hospital charges and how much it actually costs to provide services. Because hospitals don't differentiate their costs for services provided to those with insurance and those without, The Bee used total costs for all patients to calculate the Cost/Charge Percentage.

The Cost/Charge Percentage equals =

5. Operating expenses, including everything it takes to run the hospital. Sutter:

\$654,559,847

MINUS —

6. Other operating revenue, including non-medical services, such as a cafeteria. Sutter:

\$27,675,229

DIVIDED BY ÷

7. Total charges for all patients, not just the privately insured. Sutter:

\$2,725,271,391

So, Sutter's 2009 Cost/Charge Percentage was: **23.0%**

3. USING THESE TWO FORMULAS, WE CAN THEN COMPARE SACRAMENTO AREA HOSPITALS

- The Bee applied the formulas above to a hypothetical hospital care procedure that costs \$10,000 (based on a statewide average).
- To account for factors such as the varying severity of medical cases at different hospitals, The Bee adjusted the cost of the theoretical \$10,000 procedure using a multiplier provided by Milliman to get "relative cost."

E. AMOUNT PAID ABOVE ACTUAL COSTS

Results of the analysis:	A. RELATIVE COST FOR PROVIDING \$10,000 WORTH OF HOSPITAL CARE	B. AMOUNT OF THAT COST PAID BY INSURERS	C. ESTIMATED ACTUAL COST FOR HOSPITALS TO PROVIDE THAT CARE	D. THE NEGOTIATED 'MARKUP'	Hospitals' estimated cost to provide medical care	Percentage above their costs hospitals charge their insurers
Sutter Medical Center-Sacramento	\$11,297	\$5,897	\$2,599	\$3,298		127%
Sutter Roseville Medical Center	9,910	5,775	2,605	3,170		122%
Sutter Auburn Faith Hospital	8,650	5,549	2,565	2,984		116%
Sutter Davis Hospital	9,638	5,404	2,611	2,793		107%
Mercy Hospital-Folsom	9,502	4,328	2,399	1,929		80%
UC Davis Medical Center	15,801	5,142	3,270	1,872		57%
Mercy General Hospital	11,522	3,464	2,335	1,129		48%
Methodist Hospital of Sacramento	9,255	3,398	2,302	1,096		48%
Mercy San Juan Medical Center	11,097	3,652	2,486	1,165		47%
Woodland Memorial Hospital	9,984	3,247	2,313	935		40%

REGIONAL AND STATE COMPARISONS

In another form of analysis, The Bee used hospital financial data to estimate how much insurers paid above hospital costs in the capital region and across the state:

	INSURERS PAID	HOSPITALS' COSTS	
CAPITAL AREA	\$1.81 billion	\$1.03 billion	76%
CALIFORNIA	\$24.77 billion	\$16.18 billion	53%

Note: The Bee's analysis included 300 hospitals across California, but did not include some specialty facilities such as psychiatric centers, state hospitals and Kaiser Permanente hospitals, which report data differently.

Sources: Milliman Inc., California Office of Statewide Health Planning and Development, Bee research by PHILLIP REESE and BOBBY CAINA CALVAN

Graphic by: ROBERT DORRELL rdorrell@sacbee.com

Providers: Uninsured, unpaid debts hike costs

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For this story, The Bee obtained data submitted to the Office of Statewide Health Planning and Development by hospitals across California between October 2008 and September 2009, the latest available period.

Insured carry heavy burden

Rising hospital costs reflect billions of dollars in spending on items that don't directly relate to caring for individual patients with insurance, but are nonetheless charged to their insurance companies. These costs get passed along in the form of higher premiums.

For example, hospitals charge insurance companies to recoup lost profits from meager Medi-Cal reimbursements and to provide care to the poor and uninsured.

The cost of caring for the uninsured and covering unpaid debts has risen substantially in recent years as the economic downturn leaves more people without income or coverage.

California hospitals are also facing costs of at least \$110 billion for construction to comply with state earthquake safety codes.

No one doubts the economic strains hospitals are under, said David Hopkins, director of quality measurement at the Pacific Business Group on Health. The group is a coalition of some of the state's largest employers, including the University of California, Wells Fargo and Chevron.

Still, Hopkins is not entirely sympathetic.

"They're collecting and making all this money for other reasons - and

because they can," he said.

Hospitals in the Sacramento area, for example, have expanded considerably in recent years. New wings, investment in medical technology and expansion of services may give hospitals a competitive edge on their rivals, but also add to their costs.

Rising salaries for nurses, pharmacists, imaging professionals, as well as compensation for administrators and staff, are some of the variables that go into a hospital's cost equation.

The prices insurance companies pay to hospitals result from intense negotiations, with providers pushing for the highest prices for their services and health plans pushing for deep discounts.

In Northern California, most hospitals now belong to large chains with the market power to largely dictate prices, according to researchers hired by the California HealthCare Foundation.

According to The Bee's analysis, Sutter hospitals have obtained better reimbursement rates from insurance companies than any other provider in the region.

As one of the region's largest systems, Sutter Health is a "must have" provider in an insurer's network because of its reputation among consumers, said William Sandberg, Executive Director of the Sierra Sacramento Valley Medical Society. Sutter Health leverages that power during negotiations, he said.

Hospitals' price-cost gap varies

Sutter Medical Center, for instance, received about \$420 million in pay-

ments for medical services from insurers between October 2008 and September 2009 - 127 percent more than it spent to provide those services, The Bee found.

At the other end of the spectrum is Kindred Hospital in Folsom, a small 39-bed facility that belongs to a national chain. It charged insurance companies 35 percent over cost.

Catholic Healthcare West, which operates the chain of Mercy hospitals in the Sacramento area, charged insurance companies anywhere from 40 percent to 80 percent above cost at its various capital hospitals, according to The Bee's analysis.

The UC Davis Medical Center received payments from insurers that were 57 percent above the hospital's costs. As with many other teaching hospitals, UCD's operating costs are significantly higher than those of Sutter or Mercy.

Sutter Health has faced scrutiny for its pricing practices before. Five years ago, CalPERS, the state's largest buyer of health services, forced one of its key insurers to drop 13 Sutter Health hospitals from its stable of providers because CalPERS deemed the Sutter facilities too expensive.

Sutter officials did not offer a direct rebuttal to The Bee's findings about its pricing rates, but said the non-profit health system, based in Sacramento, should not be judged on price alone.

Patrick Fry, the health system's chief executive officer, said the CalPERS action proves Sutter doesn't have the kind of market-controlling clout some of its critics describe.

Consumers, he said, should also consider value.

"When you go to a clothing store, do you know how much it cost to make? We buy things because we think the price is fair," Fry said.

Bill Gleason, a spokesman for Sutter Health, said the hospital system has kept price increases for insurance companies in the "single-digits" in recent years, but declined to elaborate.

"That's hugely important because of certain allegations by health plans who are pointing their fingers at health care providers," Gleason said.

He contrasted the "single-digit" rise in Sutter prices to the 39 percent increase in premiums announced earlier this year by Anthem Blue Cross on thousands of Californians with individual policies. The Blue Cross rate hike ignited a national debate over the rising cost of health care.

Gleason said the high quality of services provided at Sutter Health facilities saves on costs in the long run by reducing expensive follow-up care.

"We still have work to do to make our services even more affordable to patients, and we think we're making good progress," Gleason said.

Rising costs 'a mystery' to experts

Researchers for the California HealthCare Foundation call rising hospital costs "something of a mystery."

Writing in the February issue of Health Affairs, a policy journal, researchers for the foundation said expenses for hospital care rose an average of 10.6 percent a year from 1999 to 2005, far outpacing inflation.

Insurers and hospitals negotiate discounted rates, and hospitals have different price structures for each insurance network they decide to join.

In some cases, hospitals have blocked efforts to shed more light on their pricing policies. Revealing the information, they say, could reduce competition in the industry.

Jan Emerson, a spokeswoman for the California Hospital Association, said hospitals are up front with their

costs, as required by law. She noted that hospitals must provide a price quote to anyone who asks, and file menus of procedures and prices with the state.

"The health plans are trying to shift the blame because they are under attack," Emerson said. "It's outrageous that they are trying to shift blame. They should be looking at themselves."

Still, the state's accountability requirements for hospitals have been criticized as weak by some business groups, consumer advocates and others. The prices filed with the state, for instance, rarely reflect what consumers actually pay.

While existing law doesn't prohibit insurers from disclosing cost information, some hospitals explicitly prevent insurers from releasing it.

Sutter Health, for example, does not allow Aetna to publicize its negotiated prices with Sutter hospitals on the insurer's website. Aetna said the information would allow subscribers to comparison shop.

Cedars-Sinai hospital in Los Angeles, considered one of the state's priciest because of its popularity with the rich and famous, was the only other California hospital to prohibit use of its pricing data on Aetna's website, the insurer said.

Last year, the California Medical Association and the California Hospital Association helped defeat Senate Bill 196, which was aimed at giving consumers access to more information. The bill would have barred hospitals and doctors from refusing to allow insurers to reveal their pricing information to subscribers.

The legislation was supported by consumer groups and the insurance industry. They resurrected the issue last month in a new bill, Assembly Bill 2389. The Assembly Health Committee plans to hear it in May.

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