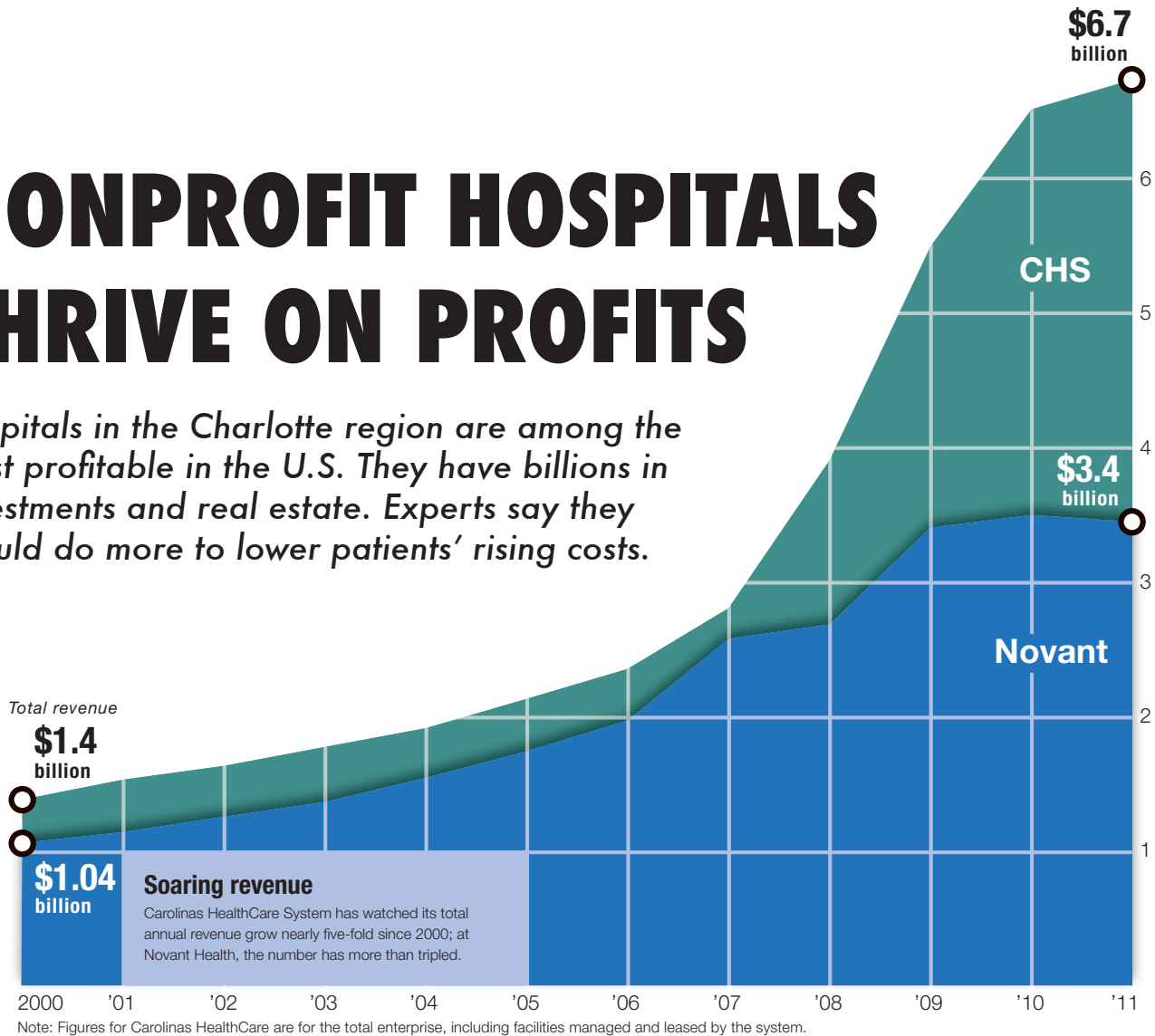


NONPROFIT HOSPITALS THRIVE ON PROFITS

Hospitals in the Charlotte region are among the most profitable in the U.S. They have billions in investments and real estate. Experts say they should do more to lower patients' rising costs.



By Ames Alexander, Karen Garloch and Joseph Neff

First of five parts

Nonprofit hospitals in the Charlotte region are respected community institutions. They save lives, heal the sick and provide good jobs.

At the same time, most of them are stockpiling a fortune.

Their profits have risen along with their prices. Top executives are paid millions as their hospitals expand, buy expensive technology and build aggressively.

And they benefit each year from a perk worth

millions: They pay no income, property or sales taxes.

These institutions were created with charitable missions. But many don't act like nonprofits anymore. In their quest for growth and financial strength, they have contributed to the rising cost of health care, leaving thousands of patients with bills they struggle to pay.

An investigation by The Charlotte Observer and The News & Observer of Raleigh found that many Charlotte-area hospitals:

- Generate some of the nation's largest profit mar-

gins. Despite the Great Recession, they have amassed billions of dollars in reserves.

- Inflate prices on drugs and procedures, sometimes as much as 10 times over costs. Hospital prices in the region are about 5 percent higher than the national average and comparable to those of larger cities, such as Chicago, Dallas and New York City, according to Aetna insurance company.

- Hike prices almost every year. Blue Cross and Blue Shield of North Carolina, the state's largest health insurer, says its total cost per hospital admission went up nearly 40 percent from 2007 through 2010.

- Pay their top executives millions. Nineteen officials at Carolinas HealthCare System and Novant Health got total compensation exceeding \$1 million in 2010 or 2011.

All of this is entirely legal. No laws limit profits, charges or executive pay for nonprofit hospitals.

Hospital officials say they're simply acting as they must to survive. They point to a U.S. health care system that rewards hospitals for providing more sophisticated services to meet consumer demands.

"The trajectory that we are on in health care spending is not sustainable," said Michael Tarwater, CEO of Carolinas HealthCare.

He said patient expectations are: "I want the best. I want it now. I want it close. And I don't care what it costs. Those are the demands in which this system grew up."

Hospital leaders say profits support their mission of caring for all patients, wealthy or poor. They say they need to pay competitive salaries to attract talented leaders. And they say they need to operate like businesses to survive in turbulent times.

But in many important ways, nonprofit hospitals differ from private businesses. They don't answer to stockholders. They don't compete on price. They don't even tell customers what they charge.

Critics say many hospitals aren't just surviving, they're thriving - and could afford to make medical care less expensive for everyone.

Nonprofit hospitals have become part of the problem, critics say. By consolidating into large systems, hospitals gain leverage to negotiate ever higher

payments from insurance companies.

That means patients and employers pay more for treatment and insurance - to the point where a single medical catastrophe can be financially devastating.

As hospitals grow, critics contend they are straying from their charitable missions.

"There's no accountability anymore," said Adam Searing, project director for the N.C. Health Access Coalition. "They started as these social welfare experiments, with all this commitment. ... What they should work for is that no person has to go bankrupt or lose their house to pay their hospital bills. ... That's not a very high standard."

Birth of a giant

To understand what's happening nationally, one need look no farther than Charlotte's Dilworth neighborhood, where North Carolina's largest hospital system got its start.

Carolinas HealthCare System began in 1943 with a 325-bed hospital called Charlotte Memorial, which struggled financially for decades.

Its leaders decided they needed to grow to survive. They built a system that could attract paying patients while continuing to care for the uninsured. It worked.

Over the past 30 years, they have transformed it into a juggernaut. It's now the country's second-largest public hospital system, behind only the nationwide system of Veterans Affairs hospitals.

One of the benefits of that growth is access to quality medical care. Carolinas HealthCare offers one of five organ transplant programs in the state and operates the region's most comprehensive trauma center, where accident victims frequently arrive via medical helicopter. Five-year-old Levine Children's Hospital has brought new pediatric specialties to Charlotte, and Levine Cancer Institute has recruited specialists from such respected institutions as the Cleveland Clinic.

With nearly \$7 billion in annual revenue, Carolinas HealthCare runs about 30 hospitals. It owns more than \$1 billion worth of property in Mecklenburg County alone, and it has more than \$2 billion in investments.

In the five-year period ending in 2011, it spent \$1.8 billion on capital projects.

Growth at Novant Health, the region's other major hospital system, has been almost as dramatic.

Novant owns 13 hospitals, including the three Presbyterian hospitals, and has total annual revenue of more than \$3 billion. The system had about \$1.6 billion in cash and investments in 2010 - a three-fold increase over the decade.

The two chains own all eight hospitals in Mecklenburg.

As hospital systems have grown, experts say, they've been able to use their market power to demand higher payments from insurance companies. And that has allowed them to grow even more.

While volume business at Wal-Mart and Target has led to lower prices, the opposite is true in the hospital industry. Hospitals don't compete on price. They compete by offering more high-tech and costly services.

"John Q. Citizen is who winds up paying for this. Not big bad insurance companies ...," said Martin Gaynor, professor of health policy at Carnegie Mellon University. "It's actually taking money out of everybody's paycheck."

Inflated prices

Across North Carolina, hospital prices have surged.

They are more than 10 percent higher than the national average for Aetna, said Jarvis Leigh, a network vice president in the Carolinas.

According to the 2011 "State of the Hospital Industry" report published by Cleverley and Associates, an Ohio-based consulting firm, Charlotte-area hospitals receive more money for treating each patient, on average, than those in most other large urban areas. This despite the fact that their average cost of treating those patients is lower.

Like others around the U.S., hospitals here boost their revenue with substantially marked-up prices on drugs and procedures.

Carl King, head of national contracting for Aetna, said insurance companies usually pay 40 percent over a hospital's cost as hospitals seek to make up for

losses on government insurance programs.

While it's unclear how markups in the Charlotte area compare with those elsewhere, the Observer found inflated prices on more than a dozen local hospital bills, including:

- Lake Norman Regional Medical Center, a for-profit hospital in Mooresville, billed one patient about \$3,000 for two CT scans in 2010. That was more than four times the hospital's average cost, according to American Hospital Directory, a service that uses federal Medicare cost reports to examine hospital finances.

- Presbyterian Hospital billed the state \$15,840 in 2010 for use of its cardiac catheterization lab after treating a prison inmate. The average cost for using its cath lab: about \$1,064. The bill was covered in full by taxpayers.

One patient, Robert Talford, was so outraged by his 2007 bill from Carolinas Medical Center that he has taken the issue to the N.C. Supreme Court.

Talford refused to pay the bill after discovering the hospital charges on some drugs were up to 24 times higher than what those medications cost him at the pharmacy. He has asked the court to determine whether those charges are reasonable.

Such markups trouble Jason Beans, the CEO of Rising Medical Solutions, which examines medical bills for payers.

At the newspapers' request, Beans' firm examined bills from various North Carolina hospitals and found possible markups as high as 500 percent.

"Everyone blames the (insurance) carriers, but what the hospitals are doing in these situations is egregious," Beans said. "No other industry can justify charging markups of 500 percent. Health care is often a need, not a want. The system is so broken."

Hospital officials defend their prices, saying their charges for drugs and tests must cover overhead. They say they must mark up prices for those with private insurance or they'd be ruined by losses from treating patients who are covered by Medicare and Medicaid or who are uninsured.

Jim Tobalski, a spokesman for Novant, said Presbyterian does not typically collect such large amounts for services such as the cardiac catheterization lab.

That's because insurers and government agencies usually pay hospitals much less than full charges.

Tarwater, the Carolinas HealthCare CEO, said it's unfair to compare what retailers and hospitals charge for a pill because hospitals pay to have the drug shipped, repackaged, checked and administered.

Hospital officials say they've worked to reduce costs for patients.

Carolinas HealthCare has saved \$120 million in the last 10 years by consolidating, reducing duplication, rebidding contracts and "finding better ways to do things," Tarwater said.

A profitable time

It has been a good decade for Mecklenburg's hospitals.

Despite the recession, all were more profitable in 2010 than a decade earlier.

Hospitals in the Charlotte region are more profitable than those in all but one of the nation's 40 largest urban areas, according to the Cleverley report.

Data from the N.C. Hospital Association show that hospitals in the multi-county Charlotte area had an average total margin of 12 percent in 2010 - far higher than those in other parts of the state.

Novant-owned Presbyterian Matthews was the state's most profitable general hospital in 2010, with a 35 percent total profit margin, according to the American Hospital Directory, a service that examines hospital finances using Medicare cost reports.

CMC-University, part of Carolinas HealthCare, had a total margin of 26 percent in 2010.

Gerard Anderson, director of the Johns Hopkins Center for Hospital Finance and Management, said margins in Mecklenburg suggest hospitals here "are charging a whole lot for health care services."

"Anyone with insurance is paying prices substantially higher than they should be paying," Anderson said. "That's outrageous."

Officials at Carolinas HealthCare argue that the figures for their individual hospitals are misleading. They contend that it's inaccurate to use Medicare cost reports to calculate profit figures for hospitals within a large, multi-hospital system. Instead, they say, it's more accurate to look at the margin of the entire

"It's a horse race right now. (Hospitals) are trying to gain more and more market power (to prepare for) the changes that are coming."

Dr. Donald Berwick, former administrator of the Centers for Medicare and Medicaid Services

system.

Federal officials say the figures for individual hospitals should be reliable if hospitals report accurately.

Carolinas HealthCare's core operation in Mecklenburg, Cabarrus and Lincoln counties - which also includes doctors' offices, clinics and other facilities - had an average total margin of about 7 percent over the past three years. Novant had an average total margin of about 3.5 percent over that period.

Across North Carolina, healthy profits aren't universal. About a third of hospitals - most of them small and rural - reported losing money in 2010. CMC-Lincoln, which is run by Carolinas HealthCare, posted a \$3.3 million loss that year.

But on the whole, North Carolina hospitals are more profitable than most, according to data from the American Hospital Association. In 2010, the total profit margin for North Carolina hospitals was 9.3 percent. That's about 2 percentage points more than the national average - and higher than it was a decade earlier, when the economy was stronger.

Officials at Carolinas HealthCare and Presbyterian say they're profitable because the Charlotte region is the most populous in the state and because their hospitals operate efficiently.

Presbyterian Matthews, for instance, operates at near capacity, says Paul Wiles, the recently retired CEO of Novant.

But Wiles acknowledged that North Carolina is a good place to run hospitals, largely because of low labor costs and insurers that are "pretty good to work with."

Margin and mission

Just because a hospital is a nonprofit doesn't mean it makes no profit. Unlike for-profit companies, which use their profits to pay dividends to stockholders, nonprofit hospitals must plow extra revenue back into their organizations.

Hospital officials say they invest in facilities, staff and equipment that the community needs - and demands - often without regard for profit.

Carolinas HealthCare, for example, has proposed building a psychiatric hospital in Huntersville, which is expected to lose money. But they say they're doing it because the area needs more services.

Also, the system's four primary-care clinics in Charlotte serve more than 70,000 low-income patients a year who might otherwise have relied on more expensive emergency rooms for basic care.

"Because we run our health care system like a business, because we try to do things to make sure we're fiscally sound, we're able to do those things," said CEO Tarwater. "If your mission was solely to take care of the indigent, you wouldn't stay in business very long. ... Without margin, you can't have mission."

Even after spending more than \$260 million on financial assistance and discounts to uninsured patients, Carolinas HealthCare made a profit of \$428 million in 2010.

Kevin Schulman, director of Duke University's Center for the Study of Health Management, says large systems with high profits are spending excessively on new buildings, new services and high salaries.

"They have more margin than meets the mission," Schulman said. "What are they going to do with all the money they made? They can't give it to shareholders. They put it all into infrastructure. ... It leads the managers of the hospitals to build an ever more expensive delivery system."

Schulman said that hospitals make choices about how they "deploy their capital against their mission" and that they could choose to make health care more affordable.

"Do we want to tax every employer by having them pay higher health care costs? Or should we

make the employers more profitable and the hospitals less profitable?"

Consistent profits have allowed Carolinas HealthCare and Novant to amass large cash reserves - more than \$2 billion and \$1.6 billion, respectively.

Officials say this allows the systems to maintain good credit ratings and borrow money at favorable rates. It lets them build new facilities, add technology and maintain existing buildings and equipment.

What's more, they say, it may help them weather the coming financial storm.

The coming 'horse race'

Under health-care reform, scheduled to become fully effective in 2014, the federal government plans to cut Medicare reimbursement to hospitals and transfer more responsibility for Medicaid to the states. In turn, states will likely push costs to counties and hospitals.

"We have looked at the impending future and tried to be prepared for it," said Jim Hynes, chairman of the board at Carolinas HealthCare. "We're going to have to have strong finances ... to sustain ourselves through the onslaught that is coming."

While hospital growth and consolidation have been occurring for years, the federal Affordable Care Act is spurring more of it, experts say.

The law calls for creation of networks of hospitals, doctors and other medical providers. But that sort of consolidation almost always leads to higher prices, studies have shown.

"It's a horse race right now," said Dr. Donald Berwick, former administrator of the Centers for Medicare and Medicaid Services. "(Hospitals) are trying to gain more and more market power (to prepare for) the changes that are coming."

With those changes, many experts predict hospitals will continue to raise prices.

Asked why, Johns Hopkins' professor Anderson said the answer is simple: "Because they can."

Alexander: 704-358-5060

Garloch: 704-358-5078