CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY

Resolution No. 2005-14

Request of the Service Employees International Union for the California Health Facilities Financing Authority to support a request for the Attorney General's Office to investigate Sutter Health's requirement of the Pass Through Savings

August 31, 2005

PURPOSE OF REQUEST:

The Service Employees International Union ("SEIU") is claiming that Sutter Health is in violation of Section 15438.5(a) of the California Government Code (the "Authority's Act") namely, that it pass on to consumers the savings from its tax-exempt Authority bonds by lowering hospital prices or contain the rate of hospital price increases. The SEIU is seeking support from the Authority to adopt a Resolution for the Attorney General's Office to investigate Sutter Health's requirement for the Pass Through Savings as described in the Authority's Act.

BACKGROUND:

The Authority's Act states: "...that all or part of any savings experienced by a participating health institution, as a result of that tax-exempt revenue bond funding, be passed on to the consuming public through lower charges or containment of the rate of increase in hospital rates........"

In Sutter Health's most recent application submitted to the Authority in 2000, there was no savings associated with this financing since the issue refinanced variable rate debt with fixed rates. In its 1998 and 1999 application, Sutter Health described meeting the pass through savings requirement as:

"Sutter Health's fundamental mission is to enhance the health and well-being of the people in the communities we serve through compassion and excellence. Sutter Health's affiliated physician organizations, hospitals, home care and other programs provide many services to those in need of care, regardless of their ability to pay. Private, not-for-profit healthcare systems such as Sutter Health operate solely for the benefit of the communities they serve. If there are any revenues in excess of expenses, they are not paid out as dividends to share owners because there are no share owners. Any net income is reinvested in Sutter Health's fundamental non-profit mission to enhance access to health care services and improve the health of the communities we serve. The savings resulting from the proposed tax-exempt bond financing will enhance Sutter Health's ability to fulfill this mission and enhance community benefit services (including charity care) in an increasingly competitive health care environment."

The following is a summary of Sutter Health's estimated costs of providing services to the poor and broader community (dollars in millions):

	Years Ended December 31,	
	2004	2003
Services for the poor and underserved	$330	$288
Benefits for the broader community	484	361
Total unsponsored community benefit expense	$814	$649

Services for the poor and underserved include services provided to persons who cannot afford health care because of inadequate resources and/or uninsured or underinsured, as well as the unpaid costs of public programs treating Medi-Cal and indigent beneficiaries. Cost is computed based on a relationship of cost to charges. It also included the cost of other services for indigent populations, and cash donations on behalf of the poor and needy.

Benefits for the broader community include unpaid costs of providing the following services: treating the elderly, health screenings and other health-related services, training health professionals, educating the community with various seminars and classes, the cost of performing medical research and the costs associated with providing free clinics and community services. Contributions Sutter Health makes to community agencies to fund charitable activities are also included.

Since 1981, the Authority has issued $1.567 billion in revenue bonds for the benefit of Sutter Health. As of June 30, 2005, Sutter Health has $596,722,518 in bonds outstanding with the Authority.

ISSUE:

The SEIU is charging that Sutter Health is not in compliance with the Authority's Act citing increased pricing in recent years leading to higher than statewide consumer prices throughout the Sutter hospital system. Further, the SEIU references the California Public Employees Retirement System dropping 12 Sutter hospitals from its Blue Shield HMO network for high costs and failure to meet quality standards.

The SEIU is therefore requesting that the Attorney General's Office investigate if Sutter Health is meeting the requirements of the Authority's Act and provide a legal opinion as to any violations, and further seeks the Attorney General's Office guidance on actions available to the Authority in order to remedy any such violations. See Attached Memorandum for additional information from the SEIU.

RECOMMENDATION:

Staff recommends that the Board seek advice from the Attorney General's Office about what findings the Authority would need to make to find any borrower out of compliance with the Authority's Act pass through savings obligation, what process it needs to follow to make such findings, and what remedies exist in law if a borrower is found to be out of compliance.

Sutter's Track Record on Consumer Prices:

Rather than using its tax-exempt CHFFA bond debt to hold down consumer prices, Sutter Health has sharply increased its prices in recent years. Sutter's prices have now reached levels that far exceed those of other California hospitals.

- At CalPERS's request, Blue Shield conducted a 2004 analysis of more than one million paid claims and determined that Sutter hospitals charged prices 80 percent higher than the statewide average, and 60 percent higher than the Northern California average. Moreover, Blue Shield found that Sutter hospitals were seven of the ten most expensive hospitals in Northern California when adjusted for patient acuity.[2]

- Blue Cross identified a similar pattern in its 2004 analysis covering approximately 280,000 patients who are participants in CalPERS' Blue Cross PPO plans. The average cost of paid claims at Sutter hospitals was 73 percent greater than the average cost of all other CalPERS paid claims in the state.[3]

- A more recent Blue Cross analysis of paid claims data from all of Blue Cross's large employer groups found similar patterns. Covering the 12-month period ending April 2004, the analysis found that 71 percent of the Sutter facilities examined were more expensive than nearby hospitals selected by Blue Cross for comparison purposes. "In some cases, Sutter facilities charged two and even three times more than the comparison hospital for comparable admissions. The acuity-adjusted cost of Alta Bates Medical Center was nearly 200 percent higher than the comparison facility while Marin General Hospital's performance was 136 percent higher." [4]

- A 2005 report by the California Health Care Coalition described the results of an outside analysis of gross charge rates at Sutter hospitals. "The California Works Foundation purchased an analysis by Massachusetts-based MediQual, a national health data analysis firm, which used state hospital discharge data to compare the severity-adjusted cost performance of 19 Sutter hospitals with all other Northern California hospitals. In the aggregate, the analysis shows that these Sutter facilities charged more and that the difference was statistically significant. MediQual estimated the excess charges for all discharges assessed at the 19 Sutter hospitals to equal $758 million, or 13 percent higher than expected, based on the severity-adjusted performance of non-Sutter hospitals in Northern California." [5]

- In 2005, CalPERS eliminated 22 hospitals – 12 of which were Sutter hospitals – from its Blue Shield HMO network, citing high costs and the hospitals' failure to meet

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[2] Blue Shield of California 2004 CalPERS Pricing Presentation, May 8, 2003, p. 31.
[3] May 27, 2004 letter from Steven S. Scott, General Manager, Blue Cross of California, Public Entities Large Group Division to Jarvio Grevious, Assistant Executive Officer, Health Benefits Branch, CalPERS, Re: Setter Health Hospitals.
[4] California Health Care Coalition, "High Prices, Questionable Quality: A Program to Put Patients First in California Hospitals," April 2005, pp. 7-8.
[5] California Health Care Coalition, "High Prices, Questionable Quality: A Program to Put Patients First in California Hospitals," April 2005, p. 8.

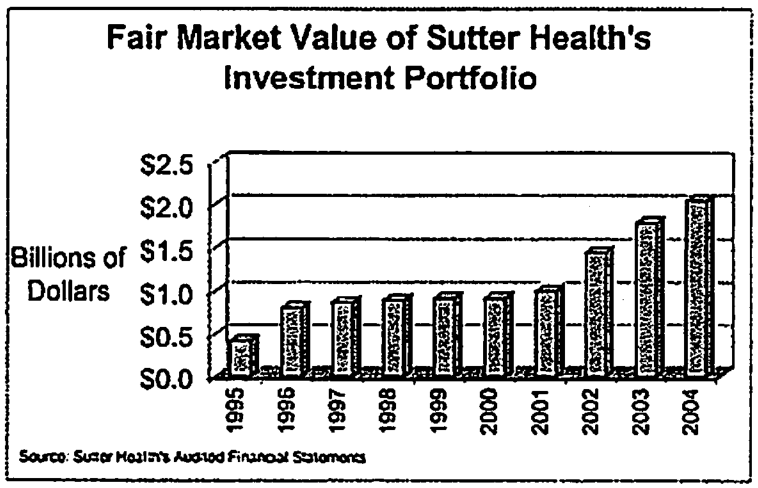
quality standards. CalPERS estimates that its elimination of the Sutter hospitals will save approximately $36 million to $50 million in annual health expenditures. In explaining its action, CalPERS reported that hospital prices were the biggest driver of CalPERS' skyrocketing health insurance premiums, which increased 55 percent during a three-year period and jeopardize the health coverage of 1.1 million state employees, retirees and their dependents. According to CalPERS, Sutter's pricing practices were particularly egregious. CalPERS eliminated more hospitals from Sutter than from all remaining California health systems combined.

While records indicate that Sutter's prices for insured patients are exceedingly high, the prices it charges to uninsured patients are even higher.

- Court records indicate that Sutter hospitals have routinely forced uninsured patients to pay prices that are 300% higher than those paid by insured patients for the same exact services.[6] For example, court records indicate that Sutter's California Pacific Medical Center charged one uninsured patient $9 for a single aspirin.[7]

- In 2004, Sutter patients filed three class-action lawsuits against the company for price-gouging uninsured patients and subjecting them to aggressive debt collection practices, which included suing uninsured patients in Superior Court, seizing money from their bank accounts and threatening to place liens on their homes.[8] While overpricing uninsured patients, Sutter spends far less than the average private hospital in California on charity care. In 2002, Sutter hospitals spent only 0.6% of its net patient revenues on charity care, substantially less than the statewide average of 1% spent by private hospitals.

Sutter's Track Record on Profits:



As a result of these sharp price increases, Sutter has experienced record profitability, earning nearly $1 billion in profits during the past two years. In 2003, Sutter hospitals together earned an operating profit margin of nearly 10 percent, approximately eight times the statewide average. In 2002, profit margins reached a stunning 33 percent at Sutter Tracy Community Hospital and nearly 20 percent at California Pacific Medical Center,

[6] Health Access and SEIU Local 250, "Your Money or Your Health: Discriminatory Pricing and Aggressive Debt Collection Practices by Sutter Health in San Francisco," May 2004, p. 5.
[7] Health Access and SEIU Local 250, "Your Money or Your Health: Discriminatory Pricing and Aggressive Debt Collection Practices by Sutter Health in San Francisco," May 2004, p. 5.
[8] Jef Whitehead v. Sutter Health, Superior Court of San Francisco County, Case No. 04434647, September 14, 2004.

Sutter's largest hospital and one of the largest hospitals in California.[9]

Sutter's extraordinary profits have allowed it to assemble a massive $2 billion investment portfolio. During the past three years alone, Sutter's operations have produced so much cash that it purchased nearly $1 billion in investments.[10] In 2003, Sutter Health paid record compensation of $2.3 million to its CEO Van Johnson – a 62% increase from the prior year. His compensation package included two bonuses totaling more than $900,000.[11]

Sutter's Description of How It Passes on Savings from CHFFA Bonds:

CHFFA requires applicants for bond financing to respond to the following question:

> "Section 15438.5 of the California Government Code requires savings resulting from the proposed tax-exempt on financing the transferred to the public via lower costs for delivery of health services. Describe how you intend to pass on the savings."

The following is Sutter's response to this question as contained in its application for Series 1998A Bonds ($175 million).[12] Sutter used identical language in responding to the same question for its Series 1999A Bonds ($138 million).

> "Sutter Health's fundamental mission is to enhance the health and well-being of the people in the communities we serve through compassion and excellence. Sutter Health's affiliated physician organizations, hospitals, home care and other programs provide many services to those in need of care, regardless of their ability to pay.
>
> "Private, not-for-profit healthcare systems such as Sutter Health operate solely for the benefit of the communities they serve. If there are any revenues in excess of expenses, they are not paid out as dividends to share owners because there are no share owners. Any net income is reinvested in Sutter Health's fundamental non-profit mission to enhance access to health care services and improve the health of the communities we serve. The savings resulting from the proposed tax-exempt bond financing will enhance Sutter Health's ability to fulfill this mission and enhance community benefit services (including charity care) in an increasingly competitive health care environment." *Source: Sutter Health Application for Financing to CHFFA for "Series 1998A Bonds," January 1998, p. 33.*

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[9] Office of Statewide Health Planning and Development, Hospital Annual Financial Data, 2002 & 2003.
[10] Ernst & Young, "Sutter Health: Audited Financial Statements," years ended 2001 through 2004, p.5.
[11] Sutter Health, IRS Form 990 for FY 2003.
[12] Of the $166.5 million in bonds proceeds, Sutter planned to spend $65.6 million for the purchase of Eden Medical Center. Following Sutter's acquisition of the Eden Medical Center (EMC), consumer prices at EMC increased sharply.

Proposed Resolution for CHFFA Board:

REQUEST FOR CALIFORNIA ATTORNEY GENERAL'S GUIDANCE ON SUTTER HEALTH'S COMPLIANCE WITH "SAVINGS PASS-THROUGH" REQUIREMENT OF CHFFA ACT

WHEREAS, a central goal of the California Health Facilities Financing Authority is to enhance the health and wellbeing of California residents by providing taxpayer-subsidized financing to nonprofit and public health care institutions to meet public health needs;

WHEREAS, Section 15438.5(a) of the CHFFA Act states that it "is the intent of the Legislature that all or part of any savings experienced by a participating health institution, as a result of that tax-exempt revenue bond funding, be passed on to the consuming public through lower charges or containment of the rate of increase in hospital rates;"

WHEREAS, CHFFA's "Bond Financing Program Application" requires applicants to describe how they will fulfill the "savings pass-through" requirements of the CHFFA Act: "Tab 5. Passing Through Savings: Section 15438.5 of the California Government Code requires savings resulting from the proposed tax-exempt bond financing be transferred to the public via lower costs for delivery of health services. Describe how you intend to pass on the savings." (page A-5 of August 2005 edition of application);

WHEREAS, Sutter Health is the second-largest holder of CHFFA bond debt, with $597 million in outstanding CHFFA bond debt as of May 26, 2005;

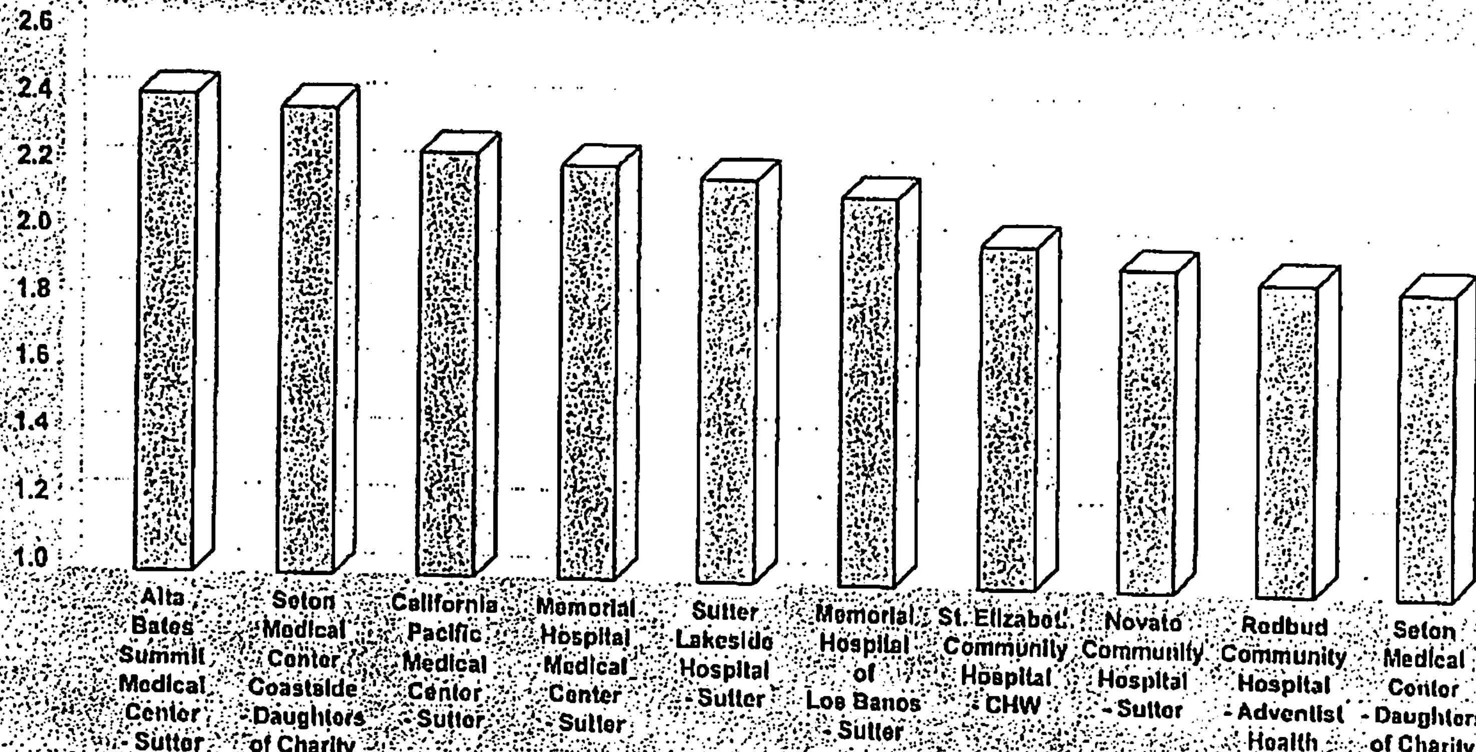
WHEREAS, numerous recent analyses of hospital paid claims data performed by Blue Shield California (on behalf of the Public Employees Retirement System) and Blue Cross indicate that Sutter Health hospitals charge prices 73 to 80 percent higher than the statewide average, and 60 to 62 percent higher than the Northern California average. Moreover, Blue Shield found that Sutter hospitals were seven of the ten most expensive hospitals in Northern California when adjusted for patient acuity;

WHEREAS, the California Public Employees Retirement System (CalPERS) – the largest purchaser of health care in California – recently removed nearly half of Sutter Health's hospitals from one of its health plans due to the Sutter hospitals' extraordinarily high prices and their failure to meet CalPERS quality standards. Due to high prices, more Sutter hospitals (12 facilities) were removed from the CalPERS health plan than were hospitals from all other California hospital systems combined (10 facilities);

WHEREAS, the CHFFA Board is duty-bound to enforce the provisions of the CHFFA Act by ensuring that savings are passed through to California consumers, especially in this era of skyrocketing health care prices that have left health care coverage beyond the reach of millions of Californians;

RESOLVED, that the CHFFA Board requests that the California Attorney General provide it with a legal opinion on whether Sutter Health's actions have violated the requirements of the CHFFA Act and furthermore seeks the Attorney General's guidance on the range of actions available to the Board in order to remedy any such violations.

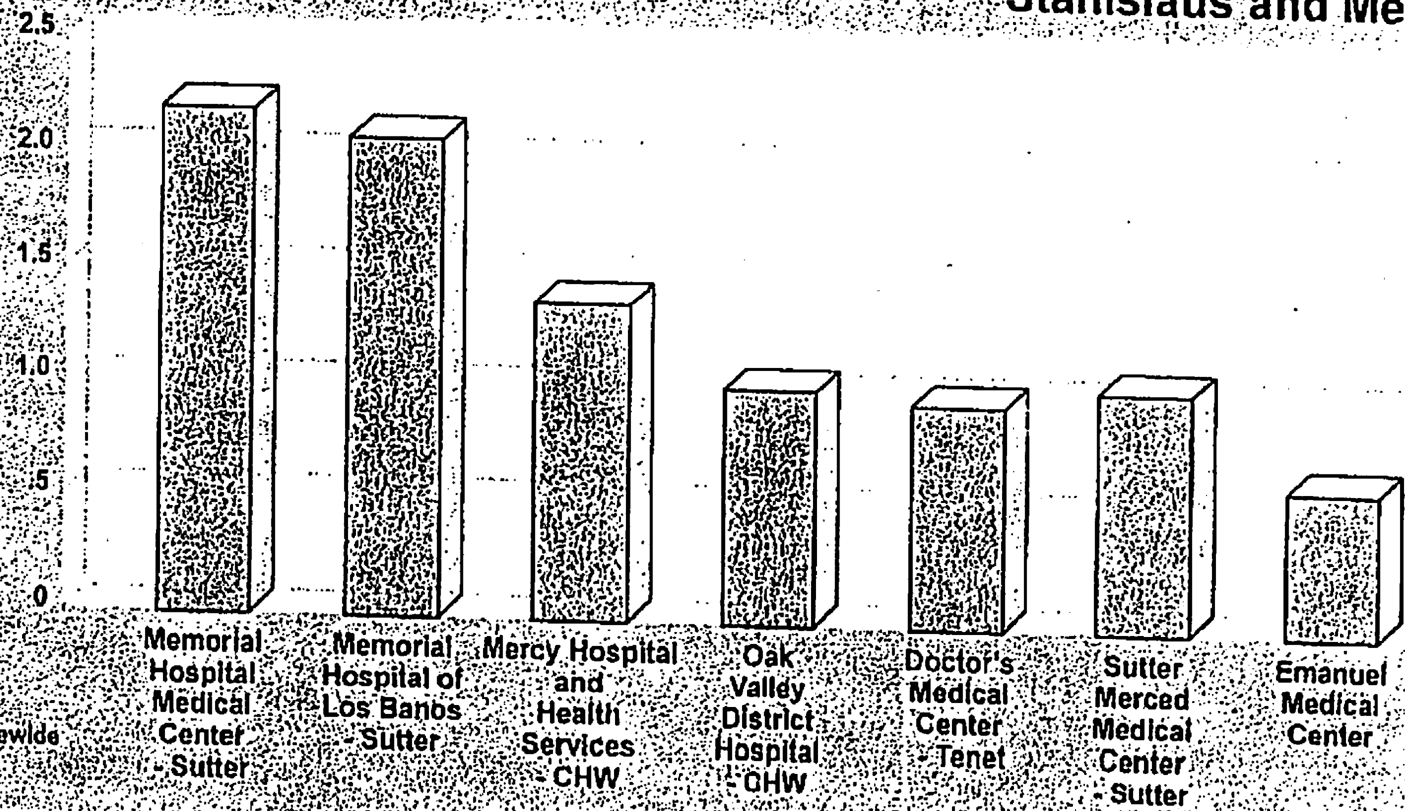
Most Expensive Northern CA Hospitals



* Based on statewide average of 1.0

Variation of Hospitals within a Region

Stanislaus and Merced



* Based on statewide average of 1.0

The CalPERS Board of Administration has elected to exclude a number of hospitals, and certain affiliated medical groups, from its network of facilities under the Blue Shield HMO plan effective January 1, 2005, for enrollees who are not covered by Medicare. The Board's decision secures the ability of CalPERS constituents to continue to have access to a health plan choice that offers comprehensive health care protection at an affordable price. The Board also recognizes that some CalPERS members will desire access to one or more of the facilities that will be excluded from the network of available providers. For that reason, the Board elected to continue to make available the full network of hospitals and physicians that are participating in the Blue Cross of California PPO network, under the PERSCare and PERS Choice health plan options. We offer our assurance to CalPERS and its constituents that our staff will be available to your members who change health plan options, to provide assistance throughout their transition to ensure that their access to health care facilities is made available without interruption.

Please do not hesitate to contact me should you have any questions.

Sincerely,

Steven S. Scott

BlueCross
of California

October 4, 2004

Sally Covington
Director
California Works Foundation
600 Grand Avenue, Suite 140
Oakland, California 94610

Re: Sutter Health Hospitals

Dear Sally:

Attached for your review is the analysis that was promised relative to the costs associated with Sutter facilities.

Of the list of Sutter hospitals, Sutter Memorial (003894), Laurel Grove (050095), California Pacific Medical Center (050208), Mills (050302) and Sutter Warrack (050728) have too small a case volume to provide a valid analysis, and have been excluded.

All this data is derived from our Hospital MCM system, which calculates hospital DRG case-mix adjusted performance measures for all BCC hospitals. This involves calculating the average cost per DRG for all our hospitals state-wide, and then comparing the weighted average cost per case for a specific hospital versus the state-wide average. The "Performance Ratios" we provide show the ratio of cost for the specific hospital to the "expected" cost derived from all other hospitals. A ratio higher than 1.0 indicates the hospital is more expensive than expected.

The attached spreadsheet has the following columns:

Sutter MedID

Sutter Facility (Hospital Name)

Sutter Performance Ratio (Payment Per Case). For example, the first listed Sutter hospital (Peninsula Hospital) has a cost performance ratio of 1.46, which means average cost per case for this facility was 46% higher than we would expect based on the state-wide average for this exact mix of DRGs.

Sutter Relative Weight. This is an index of DRG case-mix severity provided by CMS as part of the DRG grouper/pricer. Higher numbers indicate more severe case-mix. For Peninsula Hospital, this is 1.13, indicating a severity higher than average.

Other Performance Ratio. In this example, hospitals in the same geography have a cost performance ratio of 1.64 which is higher than the Sutter facility. Note, however, that the Relative Weight for the other hospitals is also higher (1.52) indicating they have a more severe case mix of patients. (The DRG case-mix adjustment procedure is designed to account for these differences, but it is not perfect, and it is useful to understand the differences in case-mix of the comparison hospitals.)

Ratio of Sutter to Other Hospitals. This is simply the Sutter Payment per Case Ratio divided by the other hospital Payment Per Case Ratio. If this is higher than 1.0, then the Sutter hospital is more expensive than the other hospitals. In general, these rations are higher than 1.0, reflecting the high costs for the Sutter facilities.

Please let me know if you have any questions. My telephone number is (818) 234-2597.

Best regards,

Richard Mahoney
Regional Vice President
Labor Trust Funds

RM:tc

Enclosure