

Why Marin's Hospital Services are in Jeopardy, and What Must Be Done Now to Preserve Marin General Hospital

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The board of the Marin Healthcare District is confronted with two politically charged questions. First, should the District attempt to operate Marin General Hospital (MGH)? Second, if the District does not operate MGH, who should do so?

The Current Situation in Marin

Sutter Healthcare is a large hospital system that has operated MGH for over a decade. There has been controversy over Sutter's past actions, resulting in litigation and the recent settlement agreement whereby Sutter will return control of MGH to the District. Sutter and Kaiser are the only hospital operators currently providing acute care hospital services in Marin. Both have invested millions of dollars in Marin, and will continue to compete for health care business after MGH is returned to the District.

Marin County has fewer than 260,000 residents, of which 100,000 are in Kaiser, 45,000 receive inpatient services outside Marin, and 50,000 use Sutter's Novato hospital. Marin's small market will not support three hospital operators.

The Problems Confronting Marin General Hospital

The health care industry presents unique problems for hospitals, including:

(1) **Lower Payment Per Service.** Different hospitals receive different amounts of payment from private payers (*e.g.*, HMOs) depending on the hospital's market power. Small community hospitals have less market power than larger hospital systems, and typically receive less payment per service than do the larger systems.

(2) **Fewer Profitable Services.** Some hospital services earn a profit (*e.g.*, cardiology services) while other services typically result in a financial loss (*e.g.*, emergency services). Hospitals subsidize their financial losses by providing profitable services. If a hospital's competitors provide only the profitable services, and take this business away from the community hospital, the community hospital will be less able to subsidize the community's unprofitable services.

(3) **Less Revenue and More Expense.** The government requires hospitals to provide services that generate financial losses (*e.g.*, emergency services must be provided to indigent and

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underinsured patients). In addition, hospitals must incur substantial expenses mandated but not funded by the government (*e.g.*, seismic upgrade requirements must be met; a specified number of nurses must be available depending on patient volume).

(4) Regulatory Costs. Payer and government regulation have become so complex that hospitals must have sophisticated information systems and numerous support personnel costing tens of millions of dollars.

(5) Fewer Physicians. There is an alarming scarcity of physicians, nurses and other health care professionals in many parts of the United States. Without these professionals, a hospital cannot provide services to its community.

Should the District Operate MGH?

The District is currently considering a ballot measure that seeks voter approval to issue bonds for hundreds of millions of dollars. These funds would finance MGH's building improvements and new equipment. The District would then operate MGH.

District operation of MGH will not be successful for several reasons, including:

1. Competition. Sutter will continue to provide health care services in Marin after the District resumes control of MGH. Sutter will compete against the District by providing only the profitable services, thereby reducing the District/MGH's access to patients who can pay for their services. Sutter will align itself in various ways with physicians who control patient referrals to those profitable services. Sutter may develop specialized facilities, and market its superior facilities to the community. In contrast, the District will attempt to provide a full range of hospital services, many of which are at a financial loss. Marin residents will have a choice as to where they receive profitable services: either utilize a new facility with state-of-the-art equipment as recommended by their Sutter-affiliated physician, or ignore their physician's recommendation and utilize the less desirable facilities at MGH.

2. Payer Contracts. The District will not have sufficient market power to obtain favorable payments from private payers. In comparison, Sutter receives very favorable payments from payers. MGH's revenues could easily decrease 25 percent or more from its current levels once Sutter returns MGH to the District. In Marin, twenty-six percent of the population is either Medicare, Medi-Cal or uninsured patients. The District/MGH will provide services to these patients at a financial loss, but is unlikely to earn the revenues from private payers that are needed subsidize those losses.

3. Capital. MGH may need hundreds of millions of dollars to pay for facility improvements, new equipment, information systems and operational infrastructure. Sutter will take profits away from MGH, reducing MGH's revenues and access to capital. Lenders will be hesitant to lend money to the District due to its decreasing revenues. The District will be unable to improve and properly operate MGH. Profitable patients will increasingly go to Kaiser, Sutter and San Francisco hospitals, further worsening MGH's financial problems.

4. Physician Support And Recruitment. One of the most important issues is whether the District's operation of MGH will support community physicians and other health care

professionals. MGH must support the income of the community's existing physicians, and also provide financial incentives to recruit new physicians into the community.

Hospitals regularly support physician practices in a myriad of ways, including: the capitalization of a physician foundation that subsidizes physician practice expenses (*e.g.*, Sutter has established a "foundation" to support its physicians); the development of various economic arrangements that supplement physician incomes (including service contracts and joint ventures); and financial support for physician marketing and recruitment activities. The District, however, will have few resources to support its existing physicians, especially compared to Kaiser and Sutter. Physicians who remain loyal to MGH will not thrive.

MGH also needs to recruit new physicians into the community. This is a difficult challenge for numerous reasons, including: (1) many parts of the nation are experiencing a severe shortage of physicians, giving physicians many attractive options on where to live and practice; and (2) housing costs are comparatively high in Marin for a new doctor. MGH's physician recruitment problems will be worse if the District operates MGH. First, MGH will be the least attractive option of the three hospital competitors (Kaiser, Sutter and the District). Physicians will want to align themselves with the strongest competitors (*i.e.*, Sutter or Kaiser). Second, the District is unlikely to afford the necessary costs of recruitment. The standard physician recruitment package can cost between \$200,000 to \$500,000 per recruited physician. The District/MGH will not have the financial resources to fund the competitive recruitment and retention programs offered by Kaiser and Sutter.

5. Reduced Profits And Services. It is not clear whether these and other problems will cause MGH to close. It is clear that MGH will experience a significant reduction in its net earnings as payer reimbursement decreases and Sutter competes effectively against MGH for profitable services. MGH will be left with the expenses of providing many unprofitable services, but will have reduced means of paying for those services. MGH will have less capital for buildings, equipment, nursing and other staff salaries, information technology, infrastructure and physician support activities. MGH's inability to fund health care services of equal quality as those provided by Kaiser and Sutter will make it a less attractive option for patients. Physicians will align with Sutter and Kaiser, leaving MGH with fewer physicians to serve its patients. MGH will reduce its services in an attempt to stay financially viable, possibly affecting services such as: mental health, maternal/infant, emergency, trauma, public health, disaster response, safety net primary care for medically indigent populations, and numerous county programs.

Who Should Operate MGH?

If the District does not operate MGH, who will? A hospital operator is not likely to operate MGH because such operators are not willing to: invest capital in MGH; and compete against two well-financed competitors (Kaiser and Sutter) who are already well-established in the small Marin market. For many of the reasons that the District is likely to fail, most hospital operators know that they also might fail if they try to operate MGH.

Large for-profit hospital systems, such as HCA or Tenet, would be able to provide the capital and expertise needed by MGH, could use market power to obtain favorable payment from private payers, and would have the resources to recruit physicians. They are not, however, eager

to expand their presence in California, which is a particularly difficult business environment for hospitals. Nor will they deploy their capital in markets that are less likely to provide the best return on investment for their shareholders. Smaller for-profit hospital operators often seek to acquire distressed hospitals, but their typical business model is to eliminate as many unprofitable services as possible and/or to change the focus of the hospital. Marin residents might discover that such operators curtail services and/or provide a different quality of service.

Catholic Healthcare West, Adventist Health, Providence and St. Joseph Health System are large non-profit systems that have access to capital, market power to obtain favorable payer contracts, and resources to recruit physicians. These systems are unlikely, however, to invest hundreds of millions of dollars into a relatively small market where Kaiser and Sutter are already established. Likewise, the large nonprofit hospital systems in San Diego or Los Angeles will not be interested because operating MGH would not further their missions, would not provide any market advantage to them, and would most likely worsen their operational efficiencies. Regional nonprofit hospital systems (*e.g.*, John Muir Health System and NorthBay Healthcare System) are unlikely to be interested in MGH. They will not want to expand outside their regions into a market with limited potential, for the purpose of competing with Sutter under disadvantageous conditions. Specialty systems such as Mayo Clinic seem unlikely candidates, but could be contacted. UCSF is an academic institution, and is not focused or particularly experienced in the management of satellite hospitals. UCSF also is unlikely to provide substantial resources to MGH because it (UCSF) has significant needs of its own.

Finally, Sutter is financially strong and capable of providing the capital, favorable payer contracts, information technology, infrastructure and physician practice needed by MGH. Unlike the other hospital operators, Sutter is not discouraged by competition in Marin. There are, however, several problems with Sutter operating MGH. First, some community members believe that Sutter provides inferior health care services based on past incidents. Although Sutter's reputation for quality is equal to that of other large health care systems, the District should study this issue carefully. A second problem is that Sutter has a strong reputation for negotiating tough contracts against unions and nurses, and those important MGH personnel may oppose Sutter. The third problem is that Sutter might not be interested in operating MGH. Sutter is probably very happy with the current settlement agreement, which allows it to profitably compete against the District. Sutter also is probably very tired of the community animosity and lawsuits, and might not be interested in further relations with a hospital district.

The District Must Take Action Now

There are two reasons why the District must take immediate actions to protect MGH. First, Marin County is at serious risk of losing critical health care professionals. Many health care professionals in Marin believe that operation of MGH by the District is unlikely to be successful (for the reasons explained above). There is much talk about physicians leaving the community or retiring early, thereby worsening Marin's current shortage of local physicians. Recently, two breast cancer surgeons who were also part of MGH's trauma service announced they are leaving the community for several reasons. If the community's health care professionals are not assured that there will be a financially viable operator for MGH, Marin may lose even more health care professionals.

The second reason is that the District may soon lose its ability to even discuss MGH with Sutter. Currently, Sutter does not appear to have decided what actions it will take in Marin, but it may soon decide with finality that it wants to compete against the District. Once Sutter commits substantial capital to compete against MGH, the District's option to ask Sutter to operate MGH may be lost. Sutter needs to be told immediately (*i.e.*, before it commits capital to a competitive course of action) that the District is willing to let the voters decide at the next election whether the District will operate MGH or whether a selected hospital operator (possibly Sutter) will operate MGH.

What Should the District Do Next?

To best protect MGH's options for successful operation, the District board should:

(1) Immediately contact all likely candidates for operating MGH to determine if there is any interest. Most importantly, the District board should contact Sutter and community physicians to inform them that the District is serious about seeking voter approval to transfer or lease MGH to someone who can successfully operate the hospital.

(2) Continue to collect and verify the facts relevant to this decision, and make all of it available to the public. At the same time, determine the specific legal requirements for transferring MGH to another entity.

(3) Identify and select a hospital system that is willing to operate MGH. Negotiate the terms of an arrangement with that hospital system, the specifics of which should be finalized to the extent required by law for a ballot measure authorizing the arrangement.

Some might argue that a specific hospital operator does not need to be identified on the ballot measure. This would be a mistake. Voters need to know exactly what are their options and be given the relevant information to make a decision. A vague ballot measure asking voters whether an unspecified hospital system should operate MGH would only: (a) delay the process (probably requiring another more specific vote at a subsequent election), (b) be more costly, and (c) increase the risk that potential operators would lose interest in MGH. Such delays could result in more physicians leaving the community.

(4) Place two ballot measures before the voters. Voters should be given a clear choice between the following two measures:

Ballot Measure A: The District will issue bonds to rebuild MGH, and the District will continue to operate the hospital. The District would issue a parcel tax bond (which would increase homeowners' property tax) and a general obligation bond. If this bond measure passes and the second measure fails, the District would own and operate MGH. If both measures pass, the District board would have the power to either issue the bonds or enter into the negotiated arrangement with the selected hospital system.

Ballot Measure B: The District will transfer or lease MGH to the specified hospital system under terms negotiated between the parties. The negotiated terms would be made public to the voters. If Ballot Measure A fails, and Ballot Measure B passes, the selected hospital system would operate MGH under the negotiated terms.

Conclusion

Some residents of Marin are likely to disagree with a conclusion that the District cannot successfully operate MGH. I believe that such persons do not fully understand the effect of competition in a small market, or they underestimate Sutter's acumen in maximizing profits in the complex health care industry.

Time is running out. Physicians, Sutter and other providers need to know immediately that the District is willing to let voters decide who will operate MGH. As time passes, the community's options for a successful MGH are likely to be reduced. Community leaders must educate voters as to what are the issues and what is at stake. After that, the voters will decide what health care they will receive in Marin.