LEADER (U.S.)

SKILLFUL OPERATION

A Surgeon Earns Riches, Enmity By Plucking Profitable Patients

Specialty Hospitals Go Public, Sparking Ire in Rapid City; Older Facility Faces Losses

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RAPID CITY, S.D. -- In a 2000 speech, neurosurgeon Larry Teuber asked rhetorically why doctors would want to open a hospital dedicated to surgery. "Profit, profit, profit," ran his answer. When it comes to taking business from general hospitals, "you can't believe how easy it is," he said.

Dr. Teuber, the founder of the Black Hills Surgery Center here, soon proved his point. The company that owns Black Hills went public last year, bringing Dr. Teuber a $9 million payday. He and his wife own six airplanes and a vacation home in Jackson Hole, Wyo. When his children's hockey teams needed a rink, he put up $600,000 to help build one.

What Dr. Teuber doesn't have is many friends at Rapid City Regional Hospital, the nonprofit general hospital where he used to perform surgery. Regional posted an $8.3 million operating loss last year and has seen its debt rating downgraded. It says Dr. Teuber's surgery center has siphoned away healthier -- and more profitable -- patients. Dr. Teuber says his rival's problems stem from poor management and inefficiency.

The debate in Rapid City, a city of 60,000 people near Mount Rushmore, mirrors national concerns about specialty hospitals, which are typically doctor-owned for-profit facilities that focus on a narrow range of services such as heart or orthopedic surgery. Critics say specialty hospitals harm hospitals that serve poorer and sicker patients, and lead to waste of health-care dollars by driving people to get unneeded surgery. Since Dr. Teuber's center opened in 1997, the rate of outpatient surgery in Rapid City has doubled. It now has one of the highest rates of back surgery in the country, according to data compiled by Dartmouth Medical School researchers.

Dr. Teuber and others in the business say specialty hospitals are more efficient and give better care because they focus on a few procedures. If surgery rates go up, they say, that suggests more people are getting access to useful procedures.

There are about 100 specialty hospitals in the country, most of them concentrated in states such as South Dakota and Texas that don't have broad restrictions on opening hospitals. In 2003, Congress imposed an 18-month ban on new specialty hospitals, responding to concerns raised by the American Hospital

Association that they were cherry-picking the most profitable patients. The ban expired June 8, and Congress is debating whether to extend it.

Few specialty-hospital companies are publicly traded, so the listing of Black Hills' parent gave an unusual glimpse into how much doctors can make when they own a hospital stake. Medical Facilities Corp., which owns 51% of Black Hills and three other specialty hospitals, went public on the Toronto Stock Exchange last year and now has a market capitalization of just under $300 million. The offering fetched $165 million, of which $145.8 million went to 88 doctors and a handful of other investors in the hospitals. Dr. Teuber says he received about $9 million.

The 39 owners of Black Hills, of whom 35 are doctors, together received $37.6 million in profit distributions between 2001 and 2004 and an additional $65 million in the stock offering. For the doctors, that money comes on top of the fees they earn each time they perform surgery.

The success of specialty hospitals illustrates how many doctors, feeling squeezed by health insurers and malpractice-insurance premiums, have found new ways to prosper. Some are trying to get in on the boom in medical imaging via fees for referring patients to scanning centers. Others get paid by pharmaceutical companies to lecture about the companies' drugs.

The 49-year-old Dr. Teuber painted store-window signs and served in the National Guard to pay his way through South Dakota State University, where he majored in economics. Enlisting in the Army, he learned to fly helicopters and served as a surgeon in Germany during the first Gulf War. His hobbies today are flying planes and hunting pheasants.

Dr. Teuber says his varied experience has given him a different perspective on medicine. "Most doctors don't know how to run a business or how to compete," he says. "They don't know how to step away from the emotion of it."

At one point, Dr. Teuber sent anonymous letters to Regional patients encouraging them to sue a doctor there for malpractice. His bare-knuckles strategy has cost him some friendships. Timothy Frost, a radiologist who went to medical school with Dr. Teuber and practices at Regional, says he no longer speaks with his old colleague. Dr. Frost's wife was maid of honor at Dr. Teuber's wedding, but the wives no longer socialize. Black Hills "has spelled the end of any true collegiality in the Rapid City medical community," says Robert Ferrell, a Regional surgeon.

Regional is a typical general hospital. It has an emergency room and 366 beds. It handles nearly all the births in town, performs cancer and cardiac surgery, and cares for the mentally ill. The hospital has linoleum floors, shared rooms for most patients and a menu that runs toward meatloaf.

At Black Hills, there is no emergency room or maternity ward. Eighty percent of its procedures are either in neurosurgery -- the brain and the spinal cord -- or for orthopedic problems involving bones, ligaments and the like. Most patients stay only a day or two in one of its 23 carpeted private rooms, each of which comes with a laptop computer, wireless Internet service and chocolates. Recent menu selections included prime rib, crème brûlée and a choice of wines.

Dr. Teuber receives regular income from at least three sources. As president of Medical Facilities and an executive of Black Hills, he draws a $268,388 annual salary. When he personally performs surgery at Black Hills, he receives fees. And because he retains a part-ownership stake in Black Hills, he receives a monthly distribution from the surgery center's profits.

Black Hills had $19.2 million in net income on revenue of $45.2 million last year, according to Medical Facilities filings. Regional's $8.3 million operating loss came on revenue of $247.5 million, according to its annual report. Its net income, which also includes investment returns, fell to $187,155 last year from $21.5 million in 2001.

Regional says it needs -- but can't afford -- another endocrinologist to help treat the large local population of diabetics. It went without a child psychiatrist for four years until recently to economize. Regional says 51 of its nurses have been hired away by Black Hills, driving up its cost of recruiting nurses to $3.3 million a year, more than six times what it spent before its rival opened.

Figures on outpatient orthopedic surgery illustrate the damage at Regional. Between 1997 and 2003 the number of such operations fell by 52% to 845 cases. The proportion of the patients who had private insurance, which pays more generously, fell to 19% from 39%.

Regional says its surgical patients tend to come to the operating table nowadays with more ailments. That hits the bottom line because Medicare and private insurers pay a flat fee for many types of surgery, regardless of the patient's underlying health. Black Hills acknowledges it treats fewer of the complicated cases.

An example is hip replacement, one of the most common types of orthopedic surgery performed at Black Hills and Regional. In Rapid City, Medicare pays $9,700 for a hip replacement. A recent study by the Medicare Payment Advisory Commission, a federal body that advises Congress on Medicare issues, suggests that a hospital replacing the hip of an otherwise healthy patient would keep about $1,350 of that after costs. But replacing the hip of a sick patient -- say, one with diabetes, emphysema and heart problems -- would saddle a hospital with a loss of about $4,000 because those patients often require specialized anesthesia, extra nursing care and a longer hospital stay.

In general, Regional has been saddled with "a monopoly on low-paying services," says Charles Hart, chief executive of the health system that owns the hospital. One example is its neonatal intensive care unit, which wrote off $13 million in uncollected charges from the middle of 2003 through end of last year.

One recent morning in the unit, a 37-day-old baby who weighed just one pound at birth was sleeping in a $30,000 incubator. The child required intensive nursing care and was expected to remain in the hospital for several months, said his doctor, Steven Benn.

The baby's mother was a Medicaid patient, which meant that Regional would only recover about half of the $465,000 in costs that it expected to incur in caring for the infant, the hospital said. Patients on Medicaid, the federal-state program for the poor, account for 13.3% of Regional's total. At Black Hills, the figure is 4%.

Dr. Teuber has little sympathy for Regional. He says providing services like neonatal care and an emergency room are part of the public mission that qualifies Regional as a nonprofit and gains it a tax exemption.

Dr. Teuber says Regional administrators have gotten too comfortable with the hospital's longtime monopoly status. For example, when Regional does a hip replacement it lets the surgeon choose the brand of artificial hip. That means many brands are used, and Regional pays a higher price for each. Black Hills, by contrast, uses a single brand and negotiates deep discounts with the supplier, Dr. Teuber says.

Regional's leaders are paid handsomely by Rapid City standards. According to the hospital's 2003 report to the Internal Revenue Service, the top-earning doctor at Regional earned $480,000 while Dr. Hart's predecessor as chief executive was paid $410,000. Dr. Hart is paid $346,000 a year.

Amid the competition for patients, the frequency of surgery in Rapid City has grown rapidly. Outpatient surgeries -- those that don't require a hospital stay -- rose to 45 per 1,000 people in 2003, according to numbers provided by the hospitals. That's more than double the rate in 1997, the year Black Hills opened. Inpatient surgeries were up 50% to 15 per 1,000.

Doctors who work at Black Hills reject the notion that patients are getting unnecessary surgery. The doctors say they serve many patients who previously would have traveled far from Rapid City or suffered in silence because the city was short of good surgeons.

Competition between the two hospitals has been especially fierce in neurosurgery, Dr. Teuber's field. Regional performed 764 neurosurgery operations in 1996. By 2000, the number had dwindled to just 187. Regional began to fight back. In 2001 it recruited Steven Schwartz, who was fresh out of residency. Although not yet board-certified in the specialty, Dr. Schwartz quickly started doing as many as several procedures a day. That year, the number of neurosurgery cases at Regional rose to 336, and it continued climbing to 531 in 2002.

In early 2002, Dr. Teuber confirms, he anonymously mailed letters to three of Dr. Schwartz's patients, alleging their operations may have been botched. He says he heard about the cases from doctors who consulted him. He enclosed with the letters a photocopy of a malpractice lawyer's advertisement from the phone book. Dr. Teuber says he mailed the letters because Regional had been covering up for the surgeon's poor work. The hospital denies that.

Dr. Schwartz has since had many malpractice suits filed against him. At least 20 are still pending, including a suit brought by one of the patients Dr. Teuber prodded. Many of the suits also name Regional. They allege that Dr. Schwartz performed unnecessary surgery, operated on the wrong side of patients' spines and fused the wrong disks in patients' backs. The South Dakota State Board of Medical and Osteopathic Examiners later placed Dr. Schwartz on probation. His lawyer, Lonnie Braun, denies the allegations of malpractice.

Some of the plaintiffs say Regional protected Dr. Schwartz because it was under competitive pressure. A suit brought by Miriam Conley, a Rapid City woman who alleges Dr. Schwartz operated on the wrong disk in her back, says Regional "intentionally concealed" his mistakes because his surgeries otherwise "would be performed in facilities competing with Rapid City Regional Hospital."

Regional was forced to pay a $6 million Medicare fine in late 2002 to settle federal allegations that it gave some local cancer doctors office space, staff and other benefits to induce them to refer patients to the hospital. Federal law bars inducements for Medicare-patient referrals. Dr. Teuber prepared an inch-thick, bound paperback book detailing the case, and he says his staff placed copies in the mailbox of every doctor at Regional.

As a result of that incident and the anonymous letters, Regional took away Dr. Teuber's privileges at the hospital, meaning he could no longer perform surgery there. His neurosurgery-practice partners at Black Hills soon quit the staff of Regional or took leaves of absence.

Previously Dr. Teuber and his partners helped cover emergency-room calls at Regional in exchange for operating privileges there. Now Regional says it has to hire out-of-state neurosurgeons, at a cost of about

$21,000 a month, to provide that coverage.

Despite the animosity, some at Regional acknowledge that competition has prodded the bigger hospital to improve service. Regional is building a new floor of private patient rooms and offering valet parking. Dr. Teuber calls the changes "wonderful."

"I like competition," he says. "It's good for every one of us."

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