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Blue Cross' power over Chicago medical care grows

By Mike Colias
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Denis Bartz thought his business dodged a bullet late last year when its health insurer pulled out of the market. UniCare Inc. advised him and 180,000 other policyholders to sign up with Blue Cross & Blue Shield of Illinois, which offered comparable rates and benefits.

Relief turned to dismay when Blue Cross hit him with a 30% rate increase effective May 1, tacking $11,000 onto annual health care costs for seven employees of his Oak Lawn dental practice. "It was alarming," Dr. Bartz says. Several local brokers say his increase was typical of small groups UniCare handed off to the region's largest health insurer.

Local hospital execs were grumbling, too. Blue Cross' lower payment rates for medical services will cost some hospitals as much as $2 million when patients switch over, one consultant estimates.

Denis Bartz's switch to Blue Cross from UniCare has been an expensive one: The cost to cover health care for seven employees at his Oak Lawn dental practice has risen by 30%.

ERIK UNGER

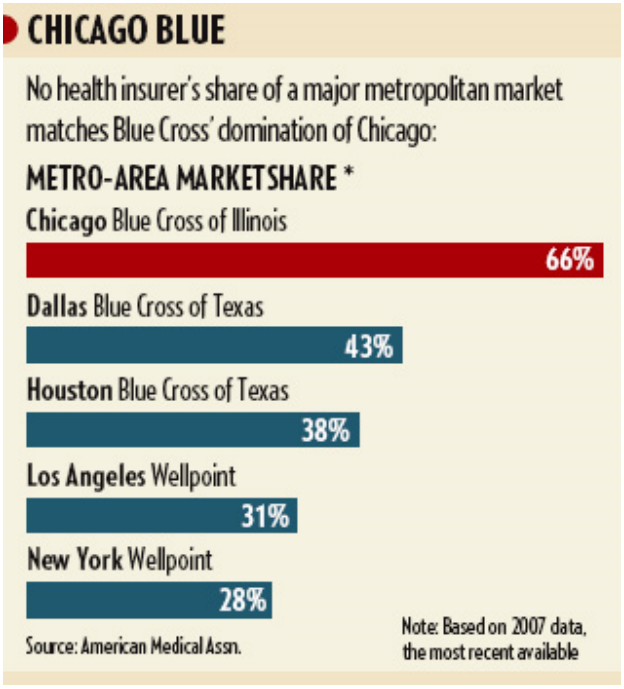
UniCare's retreat from Chicago shows how Blue Cross' expanding market power affects workers, employers and medical providers. With little pressure from competitors and scant regulatory oversight, Blue Cross has broad freedom to raise premiums and freeze out hospitals.

No other insurer dominates a big metropolitan market the way Blue Cross does Chicago, where it controls two-thirds of the private health insurance market, according to a report released in February by the American Medical Assn. As its marketshare grows, so does its influence over the cost and availability of health care in the Chicago area.

The dearth of competition in the health insurance industry became a flashpoint in the yearlong reform debate, during which congressional Democrats argued unsuccessfully for a government-run "public option" to compete with dominant carriers like Blue Cross. The Chicago-based AMA says highly concentrated insurance markets result in the "exercise of health insurer monopoly power — raising and maintaining premiums above competitive levels — instead of enhancing efficiency and passing the benefits of consolidation on to consumers through lower premiums."

The reforms Congress enacted could further strengthen Blue Cross of Illinois' hand. It's well-positioned to win the bulk of the hundreds of thousands of Illinois residents who will qualify for federal help to buy policies in the individual market, where Blue Cross is especially strong. More small players could fold if they have trouble meeting new requirements aimed at paring insurers' costs.

The Blues' expanding muscle squeezes the bottom lines of medical providers, especially hospitals, many of which have little leverage to negotiate with an entity that often insures more than a quarter of a hospital's patients. That makes it tough for smaller insurers such as UniCare, which lack the heft to negotiate Blues-like payment rates for doctors and hospitals.



"It became very difficult to compete with those plans that have an economy of scale and can offer more competitive rates on their products," a UniCare spokesman says.

More casualties would leave fewer options for employers, a climate ripe for premium increases, experts say.

"The exit of another carrier could lead to higher premiums, fewer options for employer groups and less clout for providers," says Roy Moore, an analyst who studies the Illinois insurance market for HealthLeaders-InterStudy, a Tennessee-based research firm.

In a statement, Blue Cross says there is "significant competition" in the state's health insurance market. It points to a 2008 finding by the state Department of Insurance that the departure of several carriers in previous years "does not appear to have significantly impacted the availability and affordability of coverage offered in the individual, small group or large group marketplace."

Illinois' Blue Cross plan, owned by Chicago-based Health Care Service Corp., which also owns Blues plans in Texas, Oklahoma and New Mexico, enjoys entrenched advantages over competitors. Its network includes most of the Chicago area's physicians and all of its roughly 100 hospitals — none can afford to be left out. That leaves most hospitals, especially smaller, independent ones, with little bargaining power. Blue Cross typically reimburses hospitals at rates about 10% to 25% below those of the market's other sizable insurers, according to hospitals and industry insiders.

"Every patient that goes to the Blues from another carrier is a direct hit to our net revenue and income," says an executive at one of the city's big hospitals. Like many hospital execs interviewed for this story, he requested anonymity to avoid antagonizing Blue Cross.

'SIGNIFICANT RISKS'

Yet it's not clear that Blue Cross' big cost advantage translates into lower premiums. The state doesn't require insurers to publicly disclose premiums on group policies sold through employers. Premiums for group policies vary based on demographics and other factors.

Average annual premiums for all insurers in metropolitan Chicago are slightly higher than in other large cities, federal data show. Individuals paid $4,524 in 2008, 3% more than the average of the 20 largest U.S. markets. Family plans went for $12,614, 1% more than the average.

A recent state analysis of rate hikes by Illinois insurers since 2005 shows Blue Cross' increases ranged from 3% to 19% on various plans, less than competitors'.

' It became very difficult to

Blue Cross says that, by state law, rate increases for small groups like Dr. Bartz's dental practice are determined by their health status and subject to caps. It says the state authorized it to adjust rates for UniCare customers to the "correct level" over a two-year period. The insurer says it took on "significant risks" to guarantee coverage to UniCare members, even those with pre-existing conditions. "Had we not offered guaranteed-issued policies to them, thousands of UniCare members might have lost their coverage completely."

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— UniCare Inc. spokesman

Local brokers say Blue Cross' prices usually are competitive, but often not the lowest. Still, employers often are willing to spend more for Blue Cross because of its broad network of doctors and hospitals and a reputation for reliable customer service, says Brian Diedrich, a senior managing director and broker at Chicago-based Mesirow Financial Holdings Inc.

The insurer benefits from a potent brand polished by ubiquitous local advertising and a No. 1 ranking in J. D. Power & Associates' most recent survey of customer satisfaction with Chicago-area health insurers.

Blue Cross' sharp elbows on hospital prices benefit employers, business groups say. Most big companies are "self-insured": They cover employees' health care costs but pay a fee for access to an insurer's network of doctors and hospitals. Blue Cross generally can offer employers the deepest discounts on hospital services.

"We have to rely on Blue Cross to carry that water," says Larry Boress, president of the Midwest Business Group on Health, a coalition of large employers based mostly in metro Chicago. "They're the ones paying the providers directly, and they're able to put those things into their contracts that promote safety, quality, efficiency and transparency."

Recently Blue Cross, led by new CEO Karen Atwood, has signaled a willingness to use its girth to help hold down health care costs. Last year it enrolled 20,000 patients in a pilot program to better coordinate care between primary care doctors and specialists.

Soujanya Pulluru, a family practitioner in Naperville, says her asthma patients enrolled in the pilot were given monitoring devices to track their symptoms. "It's decreasing costs because all these patients with shortness of breath aren't freaking out and going to the emergency room," she says.

Blue Cross also has spent more than $50 million since 2005 on incentive payments to physicians at Advocate Health Care, the state's largest hospital system, for improving the management of patients with heart disease and other chronic illnesses.

DOUBLE-EDGED SWORD

Still, experts say having a major insurer throw its weight around with providers can be a double-edged sword if other carriers are driven out because they can't compete on cost.

"Employers do benefit from a dominant insurer driving down premiums by paying providers less, but there's only so much water you can squeeze from that rock," says Leemore Dafny, a Northwestern University health care economist. "If other insurers feel like they can't get reasonable provider discounts to compete with Blue Cross, you could see more of them exit the market."

Some employers who insure their own workers and use Blue Cross' network complain that it's tough to tell just how deep a discount they're getting. Most insurers negotiate a discount off a hospital's "sticker price" for services and pay claims based on that discounted price. But Blue Cross applies an

Local Blue Cross not shy about yanking coverage

Blue Cross & Blue Shield of Illinois appears to be an aggressive practitioner of "rescission," or canceling health insurance after policyholders become sick and need medical services.

Illinois had 5,279 policy rescissions from 2004 to 2008, more than any other state, according to a survey released in December by the National Assn. of Insurance Commissioners.

The report did not name the insurers, but Blue Cross was

average discount price for the hospital the employee uses. Because employers don't see the discounts applied on a claim-by-claim basis, some wonder if the insurer is passing along the full discount.

"That's the suspicion, that there's possibly some money, some discounts that aren't being passed on," says Kristina Gaughan, director of a coalition of 43 unions representing 130,000 members, most using the Blue Cross network. "A lot of us would really like to know what the true cost is."

Michigan's Blue Cross plan faces a class-action lawsuit from employers who claim they're not receiving the full discount under the Blues network.

Blue Cross of Illinois says it monitors the system to "ensure customers get the full value of negotiated discounts." Also, the process is externally audited each year and vetted by state insurance regulators.

PAYMENT PLAN

Many hospitals also say the way Blue Cross pays them for services is short on transparency.

When most insurers negotiate discounts on hospitals' sticker prices, they apply that rate when paying a claim. For example, an insurer might negotiate 50% off the hospital's full charge of $2,000 for a colonoscopy, paying the hospital $1,000 when the claim comes in.

Blue Cross, however, makes a weekly bulk payment to hospitals, based on an estimate of what those claims will be, at the full sticker price. After processing the actual claims weeks later, it applies the discounts and takes money back from the hospital.

Some cash-strapped hospitals like the system because it can provide tens of millions of dollars in upfront cash flow. But others say it's an administrative headache that obscures how the claims are paid.

"It's extremely difficult to determine whether you're actually getting paid what you should be," an industry executive says.

Critics say the Blues use the payment system as a weapon against hospitals during disputes. In recent years, Blue Cross cut off reimbursement payments to hospitals that terminated their contracts with the insurer, claiming they owed it millions of dollars fronted to them for future claims. It used the tactic in contract battles with Condell Medical Center in 2007 and Rush University Medical Center a year earlier.

Blue Cross says it has a fiduciary responsibility to collect that money if a hospital terminates its contract. The goal of the payment system, in place for almost 50 years, is to provide "prompt and predictable payments to hospitals." It acknowledges that it "may require some extra bookkeeping" but says it amounts to an interest-free loan of $2 billion in aggregate to Illinois hospitals.

the state's dominant carrier during that period and rescinded at least 1,000 policies a year through a subsidiary, Hallmark Services Corp. in Naperville, according to a person familiar with the operation.

Many of the policy cancellations rooted out legitimate fraud. But sometimes policies would be canceled based on "technicalities," such as when applicants inadvertently left out details of their medical histories on enrollment forms, the person says.

The office also handled rescissions for New Mexico's Blues plan, which controls more than half of that state's market. Like the Illinois plan, it's owned by Chicago-based Health Care Service Corp.

Insurers in New Mexico canceled policies at a rate six times the national average, making it the only state with a higher rescission rate than Illinois.

Health insurers sometimes retroactively nix policies if they determine a member didn't properly fill out the enrollment application — neglecting to mention a pre-existing condition, for example.

The practice drew scorn in Congress during the push for health reform and will be banned starting Sept. 23 under the new law, except for cases in which applicants knowingly lied on their enrollment forms.

Blue Cross says it's setting up an outside review system for policy cancellations. But it maintains that its policy already is to cancel only in cases of "fraud or material misrepresentation."

Even though the new laws forbidding the practice kick in this fall, UnitedHealth Group Inc., Aetna Inc. and other major insurers also have said recently that they'll comply with the rule ahead of time, following pressure from congressional Democrats.

Mike Colias

Industry executives point to the Condell skirmish as the prime example of why it's so hard to take on the Blues. The Libertyville hospital became the only local facility in recent years to leave the insurer's main provider network; it terminated its contract when Blue Cross rejected a request for a rate increase of more than 30%.

A nearly 20% plunge in Condell's patient volume, and the refusal of Blue Cross to pay current claims, swung Condell from a $6-million operating profit to an $18-million loss over one year, according to a person familiar with the situation. Advocate acquired Condell in 2008 and mended fences with Blue Cross.

PROFITABLE CHANGE

Health Care Service was a struggling non-profit quasi-charity in 1982 when it switched to its current structure as a mutual reserve company, owned by its policyholders. That move freed it from state regulation of its insurance premiums. It also coincided with the industry's shift toward more-flexible benefit plans like preferred provider organizations, which favored the Blues' already-wide network of hospitals and physicians.

That advantage, combined with big investments in improving customer service, attracted big accounts like Ameritech, the city of Chicago and Cook County, and dozens of unions. Growth accelerated in the mid-1990s with the formation of a nationwide affiliation among Blue Cross plans, allowing the Illinois plan to land national employers such as Wal-Mart Stores Inc. Along the way, Blue Cross' growing ability to check hospital prices has provided "a key advantage relative to many of its competitors," Fitch Ratings said in a March report.

Health Care Service has been the nation's fastest-growing and most-profitable big health insurer for the last several years.

With 12.4 million customers, its membership growth rate was best among the 10 largest insurers from 2004 to 2008, the latest data available, according to Moody's Investors Service Inc. The company has the highest financial rating among 78 health insurers tracked by A. M. Best Co., a New Jersey-based insurance-rating firm. Its $6.5 billion in capital reserves gives it the industry's largest cushion with which to pay claims.

Its average net profit margin of 6.7% from 2005 to 2008 was best among the 10 largest insurers, according to Moody's data. It spent an average of 82.2% of revenue on medical claims over that stretch, about average for the group.

It posted $17.3 billion in premium revenue and $514 million in profit last year, down 31% from 2008, and roughly half of the more than $1 billion in income it reaped annually from 2004 to 2006.

Higher medical costs, smaller gains on its investment portfolio and "some limited competitive pricing decisions" pressured earnings last year, Moody's says.

The corporate parent has rewarded its executives with pay packages that often eclipse compensation at larger, for-profit health insurers. Former CEO Ray McCaskey, for example, was paid a combined $36 million over the past three years. Current CEO Patricia Hemingway Hall made $8.7 million in 2009, her first year.

Ellen Brull, a family doctor in Niles, has mixed feelings about the Blues' growing presence here. More than half of her small practice's revenue comes from Blue Cross, which "is pretty good to work with from a day-to-day standpoint," she says. "They pay on time."

Still, she had several UniCare patients who switched to Blue Cross HMO, which pays lower rates. And she's concerned that Blue Cross' growing marketshare could allow the insurer to lower its payment rates to physicians.

"If you become dependent on one carrier, that's bad for market competition," she says. "What can you do? They're 50% of my practice. It would be kind of hard to walk away."