

September 5, 2016

## RATIONALE FOR REVIEW OF TAX EXEMPT STATUS OF SUTTER HEALTH AND AFFILIATED CORPORATIONS

**Summary:** The tax code requires all non-profit public benefit corporations to organize and operate exclusively for charitable purposes. Evidence that Sutter Coast and Sutter Health are not operating exclusively for charitable purposes includes the following:

- Refusal to comply with records requests from elected leaders
- False claims regarding hospital operations
- Refusal to release data on public health needs
- False claims regarding hospital profits
- Retaliation against dissenting physicians
- Charges for care exceeding market rates
- Large increases in executive salaries following statewide merger
- Multiple false statements on federal filings
- Failure to abide by governing documents
- Apparent violation of California non-profit law

**Background:** Sutter Coast Hospital was incorporated in Del Norte County in 1985. Today, Sutter Coast Hospital remains a locally owned and governed corporation. Sutter Health is the “corporate member” of Sutter Coast Hospital, and controls the appointment of the majority of the hospital Board. In 1985, when Sutter Coast Hospital was granted a charitable tax exemption, it controlled its own cash reserves. In 1996, Sutter Health changed Sutter Coast’s Articles of Incorporation, mandating Sutter Coast contribute to the “financial strength of Sutter Health.” In 1997, Sutter Health wrote a new bylaws provision for Sutter Coast, granting Sutter Health the authority to transfer “excess cash” (cash in excess of two weeks operating expenses) from Sutter Coast Hospital to Sutter Health. Sutter Coast Hospital has been profitable every year since 1985, except for years 2011 to 2013, when Sutter Coast was operating without a Chief Financial Officer, in violation of hospital bylaws and California law.

Sutter Coast Hospital and Sutter Health are classified as tax exempt public benefit charities. The tax code requires Sutter Health and Sutter Coast Hospital to operate *exclusively* for charitable purposes.<sup>1</sup>

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<sup>1</sup> [http://oag.ca.gov/sites/all/files/agweb/pdfs/charities/publications/guide\\_for\\_charities.pdf](http://oag.ca.gov/sites/all/files/agweb/pdfs/charities/publications/guide_for_charities.pdf):  
"Under the federal tax law definition and to qualify for tax-exempt charitable status, the organization must be organized and operated exclusively for an “exempt” purpose. Exempt purposes are religious, charitable, . . . " "In addition to these requirements, federal tax law also requires that there must be no "private" inurement or improper private benefit to anyone in a position of control over the charitable organization, . . . " (p. 1)

## **Impact of Sutter Coast Hospital's and Sutter Health's tax exemptions on revenues:**

Tax exemptions for Sutter Coast Hospital and Sutter Health equate to billions of dollars in uncollected revenue. In 2014, Sutter Coast's audited value was \$37.8 million, and net income was \$10.8 million.<sup>2</sup> Sutter Health's 2014 assets exceeded \$14 billion, with cash and short term investments exceeding \$4 billion.<sup>3</sup> In 2012, Sutter Health's annual profits were \$735 million, with total yearly income of \$791 million.<sup>4</sup>

## **Evidence that Sutter Coast Hospital is not operating exclusively for charitable purposes:**

(1) The Del Norte County Board of Supervisors has formally requested Sutter Coast Hospital's financial records and meeting minutes, in order to help resolve community concern over hospital operations. The Sutter Coast Hospital Board of Directors, which includes two Sutter Health executives, refused these official record requests.

(2) Multiple false statements by Sutter Health executives regarding the operations of Sutter Coast Hospital, including the following examples:

Former Sutter Coast Hospital CEO Linda Horn claimed that downsizing the hospital to Critical Access status, thereby raising prices on Medicare patients, was a financial necessity.<sup>5</sup> Ms. Horn, and Sutter Coast's self-funded "independent" study both claimed that without Critical Access, the hospital would lose millions of dollars a year.<sup>6</sup> After claiming that without Critical Access, Sutter Coast would be "operating at a loss,"<sup>7</sup> the hospital reported \$14 million in profits for combined years 2014 and 2015, *without* Critical Access designation. Ms. Horn also provided false information on hospital census numbers, erroneously claiming the beds which would be closed under Critical Access designation "have sat empty for years."<sup>8</sup>

(3) At the May 2016 meeting of the Del Norte Healthcare District, a Sutter executive confirmed there were two versions of the Sutter Coast Hospital Strategic Options Study—the "public" version and Sutter's "private" version. The Del Norte Healthcare District requested the private version, in order to further its mission of addressing unmet health care needs. Sutter Coast CEO Mitch Hanna refuses to release the "private" version, even though Sutter Coast funded the study with tax exempt money. Sutter did release a

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<sup>2</sup> [http://www.suttercoast.org/about/2014\\_financials.pdf](http://www.suttercoast.org/about/2014_financials.pdf) (p. 7)

<sup>3</sup> <http://www.sutterhealth.org/about/financials/Sutter-Health-Financials-2014.pdf> (p. 2)

<sup>4</sup> <http://www.sutterhealth.org/about/financials/Sutter-Health-Financials-2013.pdf> (p. 3)

<sup>5</sup> Sutter Health/Sutter Coast Hospital "NewsPlus" by Linda Horn, vol. 7, 12/6/13 (p. 1)

<sup>6</sup> Strategic Options Study for Sutter Coast Hospital, public version, 11/5/13 (p. 1)

<sup>7</sup> Sutter Health/Sutter Coast Hospital "NewsPlus" by Linda Horn, vol. 7, 12/6/13 (p. 1)

<sup>8</sup> *Ibid.*, volume 8, 1/17/14 (p. 3)

"public" version of the study, the findings of which were discredited in a unanimous resolution by ten local elected officials.<sup>9</sup>

(4) Former Sutter Coast CEO Linda Horn claimed 2008 was the last year Sutter Coast was profitable.<sup>10</sup> IRS filings show otherwise--Sutter Coast reported profits exceeding \$7 million in combined years 2009 and 2010.<sup>11</sup>

(5) Sutter Coast Hospital has retaliated against local physicians who voiced concern over hospital practices harmful to patient care.<sup>12</sup> Two of three physicians subject to Sutter Coast's retaliatory conduct have left Del Norte County, worsening the region's chronic physician shortage. Retaliation against health care whistleblowers is not a charitable purpose, and is specifically prohibited under California Health and Safety Code 1278.5.

(6) Sutter Health's statewide prices for healthcare are well above market rates.<sup>13</sup> CVT, California's largest self-funded public schools trust, reported charges for care at Sutter facilities were 60% above statewide averages, adding that Sutter hospitals represent seven of the ten most expensive hospitals in California.<sup>14</sup> Carpenter's Health and Welfare Trust determined that use of Sutter facilities in California wasted \$5,000,000 per year in trust funds.<sup>15</sup> Sutter's above market charges for care are harming government, businesses, unions, and individuals throughout California.

According to Stanford University's Alain Enthoven, "*Sutter put themselves in a monopoly position by building a network with "must have" hospitals and then using that market power to drive higher prices everywhere. The high prices for Sutter damage all of us by raising the general level of prices, taking competitive pressure off of other providers.*"<sup>16</sup> Sutter's use of hospitals which operate in monopoly markets (such as Sutter Coast Hospital) to raise healthcare prices statewide is not a charitable purpose.

(7) Following its statewide hospital merger, whereby community owned hospitals were merged into multi-hospital corporations, Sutter Health's top executives more than doubled their own salaries. Between 2007 (pre-merger) and 2012 (post-merger), Sutter Health CEO Pat Fry's compensation increased from \$2.3 million to \$6.4 million per year.<sup>17</sup> In

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<sup>9</sup> Resolution 2015-055, Del Norte County Board of Supervisors and City Council of Crescent City

<sup>10</sup> Sutter Health/Sutter Coast Hospital "NewsPlus" by Linda Horn, volume 7, p. 1 (12/6/13)

<sup>11</sup> IRS Form 990 for Sutter Coast Hospital, tax years 2009 and 2010, available at [guidestar.org](http://guidestar.org)

<sup>12</sup> Letters to California Attorney General and Del Norte County District Attorney, from three physicians with practices in Del Norte County, available on request

<sup>13</sup> <http://www.latimes.com/business/hiltzik/la-fi-hiltzik-california-hospitals-20160613-snap-story.html>

<sup>14</sup> California Value Trust letter to members, Dec. 2013

<sup>15</sup> Carpenter's Health and Welfare Trust Fund for California, Board of Trustees, 12/2/13

<sup>16</sup> Personal communication with Professor A. Enthoven, May 27, 2014, used with permission

<sup>17</sup> IRS Form 990 for Sutter Health, tax years 2007 and 2012, from [Guidestar.org](http://guidestar.org)

2012, compensation to Sutter Health Board members and key employees totaled \$47,937,117. Under California law, a public benefit corporation may not be organized for the private gain of any person.<sup>18</sup>

(8) Sutter Coast's IRS Forms 990 contains numerous false statements, including misrepresentations that the hospital was operating with a CFO (when it was not), that the hospital Board of Directors had reviewed the 990 prior to filing (which it had not), that no changes were made to governing documents (when over 1,300 changes to hospital bylaws had been made), and that no Director had a business relationship with another Director (when an employer-employee relationship existed between two Directors). Sutter Coast's Form 990 also represents that the hospital documented its meetings, when in fact the SCH Board carried out official business during executive session, when no record was kept.

Sutter Health provided false information on Medicare applications, including misrepresentation of hospital ownership, the lack of a CFO, and the number of interested Directors. For example, Sutter Health claimed in a November 2013 Medicare application that John Gates had been CFO of Sutter Coast Hospital since 1/1/12.<sup>19</sup> Numerous hospital documents contradict that statement, including Board meeting minutes from 2012, in which hospital Directors voiced concern that a CFO should be hired.

(9) Sutter Health and the Board of Directors of Sutter Coast Hospital have violated hospital governing documents. Examples include implementation of patient care policies without physician input (for which Sutter Coast was cited by the Joint Commission<sup>20</sup>), operating without a Chief Financial Officer, and refusal to allow a hospital Director unrestricted access to hospital financial records. California law provides every non-profit Director with the absolute right to inspect and copy all books, records, and financial documents of the corporation.<sup>21</sup>

(10) From July 2011 until December 5, 2013, Sutter Coast Hospital operated without its own CFO, in violation of hospital bylaws and California Corporations Code 5213, which require Sutter Coast Hospital to employ its own CFO.<sup>22</sup>

Sutter Coast Hospital operates a closed Board room, refuses official record requests, retaliates against dissension, violates governing documents,

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<sup>18</sup> [http://oag.ca.gov/sites/all/files/agweb/pdfs/charities/publications/guide\\_for\\_charities.pdf](http://oag.ca.gov/sites/all/files/agweb/pdfs/charities/publications/guide_for_charities.pdf), p. 2

<sup>19</sup> Sutter Coast Hospital Medicare Revalidation Application, signed by John Gates 11/8/13

<sup>20</sup> Joint Commission report on Sutter Coast Hospital, survey June, 2013, p. 8

<sup>21</sup> California Corporations Code 6334: "Every director shall have the absolute right at any reasonable time to inspect and copy all books, records and documents of every kind and to inspect the physical properties of the corporation of which such person is a director."

<sup>22</sup> Source: <http://www.leginfo.ca.gov/cgi-bin/displaycode?section=corp&group=05001-06000&file=5210-5215>

falsifies federal forms, charges patients above market rates, and appears to have violated state and federal law.

Sutter Coast Hospital and Sutter Health are public benefit charities. Both corporations were granted the privilege of a tax exemption, which confers specific obligations. Yet both corporations withhold data needed to improve public health and refuse to honor record requests from elected officials. Such refusals prevent verification of compliance with applicable law.

The tax code prohibits non-profit corporations from operating for the benefit of any individual with control over the corporation. Following Sutter Health's statewide merger, top executive compensation nearly tripled.<sup>23</sup>

Review of Sutter Health's and Sutter Coast Hospital's tax exemptions will require **inspection of internal corporate documents** and the collaboration of elected leaders and oversight agencies.

Please contact me with questions or requests for references to this document. As a former Director and current Chief of Surgery of Sutter Coast Hospital, I have personal knowledge and additional documents to support this review.

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<sup>23</sup> Sutter Health IRS Form 990 for 2007 and 2012. CEO compensation rose from \$2.3 million to \$6.4 million per year during the five year period before and after Sutter's statewide merger