PROPRIETARY AND PSEUDO-VOLUNTARY HOSPITALS

One community facility that is almost universally missing from the areas of rapid suburban expansion is a hospital. Even the so-called "complete" communities that are the American version of new towns have usually failed to include a hospital in their original plans.

The whole problem of planning for, financing, staffing and operating a hospital is complex. ASPO Planning Advisory Service Information Report No. 50 covered zone locations for hospitals, and another report on planning for hospitals is in prospect. In the meantime, however, a recent development in the hospital field should be brought to the attention of planners and public officials. This is the spread of proprietary, profit-making hospitals, especially in suburban areas. (Part of the following information is taken from "Patients for Profit," an article by Alice Lake which appeared in the Saturday Evening Post, September 29, 1962.)

In 1960, the American Hospital Association listed 848 proprietary hospitals as compared with 3,305 voluntary, nonprofit hospitals. However, the real total was probably nearer 1,000, since many of the proprietary hospitals take care not to be listed. In California alone, there were 141 such establishments, mostly concentrated in the southern part of the state. To give an idea of the extent of their over-all development, in the same year more than a million and a half Americans were patients in proprietary hospitals.

Proprietary hospitals, owned by individuals or corporations, are not new in the United States. For many years they were found mainly in rural areas, where they performed a real community service in providing medical care not otherwise available. Many of such buildings nowadays are being erected by real estate promoters for lease to groups of doctors, and 25 per cent returns on investments are not uncommon. This would be beside the point if proprietary hospitals furnished bona fide public health services. Unfortunately, in all too many cases, their purpose is to siphon off the profitable short-term cases, leaving charity, clinical and long-term cases, as well as research, training and other money-losing activities, to the nonprofit voluntary institutions.

Copyright © 1963 by American Society of Planning Officials
Most state licensing regulations cover only physical construction and nonmedical staffing aspects of hospital establishment. Proprietary hospitals often skimp on staff and equipment in an effort to maximize their net revenues. The result is that only 33 per cent of all proprietary hospitals were accredited by the Joint Committee on Accreditation of Hospitals\(^1\) in 1960, as compared with 76 per cent of all voluntary nonprofit hospitals.

In areas of recent residential development, the prospect of a new community hospital being built quickly on taxable land by private funds seems to offer an ideal solution to the problem of financing suitable public health facilities. The alternative of a long drawn-out fund-raising drive, followed by a construction interval and continuing maintenance expenses, with a certainty of supplementary drives to meet foreseeable deficits, is not attractive. Nevertheless, such a program is undoubtedly more in the long-range interests of the community than the acceptance of a quick-profit type of proposal.

* * * * * * * * * * * * * * * * * * * * * * * *

A recent variation on the proprietary hospital is the psuedo-voluntary hospital, which undertakes to disguise some of the more blatant commercial aspects of the proprietary institution. The following is an extract from the Fourth Annual Report, 1961-1962 of the Hospital Planning Council for Metropolitan Chicago, reprinted with permission of the Council’s Executive Director, Dr. Karl S. Klicka:

...This pseudo-voluntary type of hospital organization is so insidious in its operation and has such serious disadvantages for the community that a full disclosure of its dangers is required.

The legal arrangement by which a pseudo-voluntary organization is established is simple enough. A proprietary (profit-seeking) group buys or builds a hospital which it then leases on a long-term basis to a non-profit corporation which it organizes and controls. In this way the proprietary ownership of the hospital is obscured by the non-profit operating group and the institution can pose to the community as a voluntary, non-profit type of operation.

This kind of arrangement is entirely legal and is made possible by the limited requirements of the Illinois Not-for-Profit Corporation Law. Under this law, any three or more people can, upon payment of a $10 fee and submission of a simple application, obtain a charter as a non-profit corporation. The principal qualifying requirement is that no part of the income from the non-profit corporation's operation shall be distributed to its members, directors or officers. Since the profit from a pseudo-voluntary operation comes through the proprietary ownership of the facilities rather than from the hospital's non-profit operation, this requirement poses no obstacle.

Qualifying legally as a charitable institution for purposes of

\(^1\)This committee is sponsored by the American College of Physicians, American College of Surgeons, American Hospital Association, and American Medical Association.
exemption from corporate income taxes and state sales taxes, and for
tax exempt status for donations might be somewhat more difficult,
but it is entirely possible that the non-profit corporation portion
of a pseudo-voluntary institution could so qualify. The principal
requirements for such qualification are that the corporation be or-
ganized for charitable purposes (which the non-profit hospital-oper-
ating corporations could legally claim to be) and that some charity
care be provided (which could easily be arranged).

The fact that a pseudo-voluntary type of organization may legally
qualify as a non-profit operation and as a charitable institution
does not make it desirable, but rather, makes some of its undesirable
possibilities appear even more sinister. A look at some of its possi-
ble consequences and at some of the actual disadvantages already dis-
covered in specific proposals of this type leave no doubt of its un-
derdesirability from the community's point of view. This conclusion
is amply borne out by the following catalog of disadvantages:

1. The fact that the proprietary nature of the organization
is hidden from view can fool the community into thinking that the
primary motivation behind the hospital is community service rather
than personal gain. This could not only lead to undeserved support
from the community-at-large, but could cause many civic-minded in-
dividuals to unwittingly devote time, energy and, perhaps, money
to an institution designed to benefit private promoters.

2. In most profit-seeking ventures, the profit is in the form of
net income (revenue minus expenses) and is regarded as a reward for
risk-taking. In the pseudo-voluntary type of operation, the profit
is taken out first, in the form of a rental, and the risk to the
owners is thereby substantially reduced. Deficits, if any, are the
responsibility of the non-profit corporation, not the ownership group.

3. Because of the possibility of overlapping directorships, or
indirect control through ownership selection of the non-profit cor-
poration directors, the lease agreement between the proprietary own-
ership and the non-profit corporation could provide for an exorbitant
rental, without public knowledge. Actual cases are on record which
call for rentals of up to 25% of the gross revenue [emphasis in ori-
ginal] of the hospital's operation, where the normal taxes, insur-
ance and maintenance costs which are usually ownership expenses were
also to be paid for from the hospital's operating income.

4. If the non-profit hospital-operating corporation were to
run a deficit (after having already paid the proprietary group its
rental) and had legally qualified as a charitable institution, it
could go to the community for donations to make up its deficit --
something that an outright proprietary institution could never do.
This assurance of general community support in a crisis would give
the hospital's private investors even more of a "sure thing."

5. Since the primary motivation behind the pseudo-voluntary
hospital is private gain rather than community service, it can be
expected that the owners will try to minimize their investment and
maximize their return. This leads to skimpy construction that barely
meets the state's minimum construction standards and the elimination of many services and facilities that are usually included quite automatically in a genuine community service institution. Actual plans of proposed pseudo-voluntary institutions show that in this type of proposal provision is rarely made for more than 300-400 square feet per bed, as compared to a desirable gross area per bed of 600-800 square feet. Provision for parking spaces and for auxiliary service space and equipment is also frequently quite inadequate by voluntary hospital standards.

6. The incentive to reduce operating expenses (and thereby insure a substantial rental) leads to proposed staffing patterns that fall far below the levels maintained by voluntary hospitals. Proposed ratios of personnel to patients for pseudo-voluntary institutions have been found to be as low as half of what is regarded as necessary for good quality care.

7. Once a sub-standard, pseudo-voluntary hospital is built in a community, it can become a major obstacle to the development of more adequate hospital facilities for that community. Community support for a new voluntary hospital would be harder to generate and the need for additional facilities would be harder to justify. Also, even though inadequate, the beds of the pseudo-voluntary hospital would be counted as part of the total bed supply and that community's priority for the building of additional beds would be greatly reduced.

8. The erection of a proprietary or pseudo-voluntary hospital in a community deprives that community of the opportunity to obtain federal funds in the form of a Hill-Burton grant of up to $1,000,000 for the construction of a genuine voluntary non-profit hospital. The community not only loses the possibility of a federal grant and sizable corporate donations, but will end up by paying the full amount of the construction costs in the form of hospital charges that include the gradual return of principal to the proprietary investors.

9. The quality of medical care is likely to suffer in a pseudo-voluntary institution. Because of the necessity for keeping the hospital's beds full of paying patients, less attention will be paid to a physician's professional qualifications than to his ability to fill the hospital's beds. Such institutions, therefore, can become a haven for physicians who cannot obtain staff appointments in reputable voluntary hospitals. This danger becomes even more acute when the medical staff leadership of the pseudo-voluntary hospital is itself part of the proprietary ownership group.

10. The pseudo-voluntary hospital is particularly insidious because of its strong superficial appeal to communities who are looking for an easy way to have their own hospital. It appears to be a voluntary, charitable institution which will be built in record time at no apparent cost to the community. It can be made to appeal to a community's pride and pocketbook at the same time, since it will give the community its own hospital and the property will remain on the community's tax rolls. In the absence of any opposing
viewpoints or contrary information, these appeals are frequently too strong for a community to resist.

These ten points should suffice as evidence that the pseudo-voluntary hospital presents potentially serious problems in the development of a fully adequate and efficient hospital system for metropolitan Chicago. The Hospital Planning Council will continue its efforts to protect individual communities against this kind of exploitation by carefully investigating every proposal for a new hospital that comes to its attention and by making the results of its investigations available to the proper community authorities and to the community newspaper.

Community representatives and individual citizens can help by notifying the Council of any effort being made to build a hospital in their community. A pseudo-voluntary hospital proposal can usually be identified not only by its dual profit and non-profit organization structure, but also by the fact that its organizing efforts tend to be shrouded in secrecy. Negotiations are frequently handled by a spokesman who represents an unnamed group of investors. There is great reluctance to identify any of the prospective owners or medical staff members, or to divulge any details of financing or proposed operations. The site has usually been selected and preliminary plans have been drawn (including attractive artists' sketches) without the benefit of advice from the Bureau of Hospitals of the State Department of Public Health, the Hospital Planning Council or a recognized professionally competent hospital consultant. Hospital proposals which exhibit any of these characteristics represent a potential danger to the community for which they are proposed and should be reported immediately to the Hospital Planning Council or to the Illinois State Bureau of Hospitals.

Recently, proprietary hospital promoters have run afoul of the Securities and Exchange Commission. A favorite method to raise the money for a pseudo-voluntary hospital is to issue and sell mortgage bonds. The standard interest rate seems to be 8 per cent, which is judged to be high enough to attract the naive investor, but not so high as to arouse suspicion.

Under a 1933 federal statute, the bonds of charitable institutions are exempt from SEC rules requiring registration of securities offered for sale. However, the SEC has claimed that the pseudo-voluntary hospitals are not charitable. In a suit in Federal District Court in Phoenix, the Court ruled that the SEC had full authority over the securities of the new profit-making hospital ventures. The promoters had claimed that the intent was to operate the hospitals on a nonprofit basis, but the Court ruled that the obvious profit-making motive in building the hospital in the first place brought the whole scheme under the SEC regulations.

Community pride, the desire of citizens to have their "own hospital," makes the new suburb particularly susceptible to the proprietary hospital promoters. Even the physicians in such areas are often persuaded, against their better

---

2This ruling was reported on in the Wall Street Journal, February 7, 1963.
judgment, to support the second-rate facilities offered by such institutions. Establishing a modern hospital is not something quickly done, nor to be done on the basis of a limited service area. Public officials who believe their community needs a hospital should investigate all proposals very carefully. They should particularly look into the possibility of cooperating with a number of other communities to build one good hospital rather than several substandard hospitals. The public officials should also check carefully with their own state health department, the U.S. Public Health Service, and the American Hospital Association before they commit themselves to any kind of a hospital scheme.

COPYRIGHTED
May not be reproduced or quoted without permission.