

This is a translation of the original article “US Firmen in der Zwickmuehle”, which appeared in the *Süddeutsche Zeitung* on March 29, 2016. The original article in German can be found at: <http://www.sueddeutsche.de/wirtschaft/us-firmen-in-der-zwickmuehle-1.2925346>

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## **In a quandary**



Caption: Doctors in the United States have an excellent reputation, but hospitals often engage in fraudulent billing. (Photo: Brendan Smialowski / AFP)

*Fraudulent billing, false documents, accounting scandals: Many companies harm the country and their shareholders. Regulators are often aware of these activities but look the other way.*

*By Claus Hulverscheidt, New York*

The inspectors arrived in the early morning, they wore black polo shirts and beige pants, and quickly found what they were looking for. They secured a large number of files, which showed that the Riverside General Hospital located in the heart of Houston falsified documents for years, and defrauded Medicaid and Medicare for more than \$100 million. Marilyn Tavenner, the former head of the CMS, immediately stopped the disbursement of taxpayers' money to the hospital, only to revise her decision shortly thereafter: Although the scandal expanded even more in the upcoming months, Medicare and Medicaid funds continued to be distributed to the hospital.

How is that possible? Why did the CMS (a division of the Department of Health and Human Services) continue to distribute these funds, instead of prosecuting the fraudulent billing? Two studies by economist Jonas Heese from Harvard Business School, who studies the behavior of regulators, provide answers to these questions. His findings: in many cases regulators such as the CMS or the SEC do prosecute fraudulent billing or accounting fraud rigorously. But because too draconian sanctions would often also affect innocent parties – such as patients or employees – regulators can also be lenient.

### **Because hospitals provide a service to the public, regulators are lenient**

In fact, both companies and their regulators often face a quandary. This becomes especially clear in the U.S. health care system. In particular, non-profit hospitals, who provide about 80 percent of health care, constantly face the problem that one of the 29 million uninsured people might seek medical treatment. If patients cannot pay for the treatment, hospitals have to incur the costs, unless they engage in improper billing to cover such costs.

A popular way to engage in improper billing is "upcoding." Here, the hospital assigns an incorrect billing code to a service provided to claim higher reimbursement from, for instance, Medicare and Medicaid. For example, a patient with a respiratory infection is usually assigned the code DRG 80. In that case, the hospital receives \$4,377.50. By adding a complication such as asthma or hypertension, the hospital can apply the code DRG 79, resulting in a payment of \$8,188.50; an increase by \$3,811. A similar DRG system is also used in Germany.

Although upcoding alone causes billions of dollars in improper payments, regulators often look the other way. "If you look at it purely theoretically, it would of course be desirable that a regulator strictly enforces any form of improper billing," Heese says in an interview with the *Süddeutsche Zeitung*. "In practice, however, such strict enforcement can lead to collateral damage; for instance, hospitals might stop treating uninsured patients. Therefore, strict enforcement is economically and socially not necessarily the best way."

In other words, because hospitals provide a public service, regulators are willing to look the other way. The same applies to hospitals that continue to provide medical education – despite constant budget cuts in recent years – and recoup the costs for such education via improper billing.

The decisions of regulators are often influenced by political pressure. In the case of Riverside General Hospital, Congresswoman Sheila Jackson Lee demanded that Tavenner immediately restores Medicare funding. Jackson Lee argued that the payment stop risks the health of the weakest patients for whom access to Medicare can be literally lifesaving.

In other cases, according to Heese's findings, such external pressure is not needed: "Most regulators have goals, which are often in conflict with each other," he says. The CMS, for instance, aims to promote access to health, while ensuring the lawful use of taxpayers' money at the same time.

Such lenient treatment by regulators is not limited to cases of life and death, as Heese shows in a second study about the Securities and Exchange Commission (SEC). The Securities and Exchange Commission, which oversees most large and medium-sized U.S. firms, has a reputation of pursuing fraud rigorously. Four out of ten companies that have been subject to an SEC enforcement action go bankrupt, either because of the high fines imposed by the SEC or because the market loses trust.

### **In election years regulators are especially lenient**

A particularly strong case is that of the auditing firm Arthur Andersen, which helped to cover up the accounting fraud of Enron: After the scandal was revealed in 2001, the SEC and other regulators pursued Andersen rigorously. As a result the company went bankrupt and 28,000 employees lost their jobs. The vast majority of these employees were not involved in the Enron case.

This case triggered some reflection at the SEC, as Heese shows that firms, whose collapse would affect a large number of employees or regions with high unemployment, can expect lenient treatment by the SEC. As this effect is pronounced during election years, political influence reinforces such regulatory leniency.

The consequences of such lenient treatment can be severe – and difficult to digest: companies that engage in similar behavior are treated differently by regulators. If regulators engage in such lenient enforcement, this might also delay necessary health care reforms. And Heese finds something else: "Companies that realize that they are not as strictly regulated as others, engage in more aggressive behavior." Thus, lax regulation reemphasizes shortcomings and sets wrong incentives.

Notwithstanding, Heese takes a neutral position in the debate on the correct behavior of regulators. From his point of view, the question of what goals the SEC or the CMS should prioritize is a political one. In 2014, SEC chief Mary Jo White already revealed her position: "Some have questioned whether it is appropriate for prosecutors to consider the consequences – direct and collateral – when they make a decision whether to indict a company. Of course they should." Both the SEC and the CMS did not comment on Heese's studies.