Boston's Steward Health Care System has a business model for the Obamacare era. Is it a bold vision or a private equity investment gone wrong?

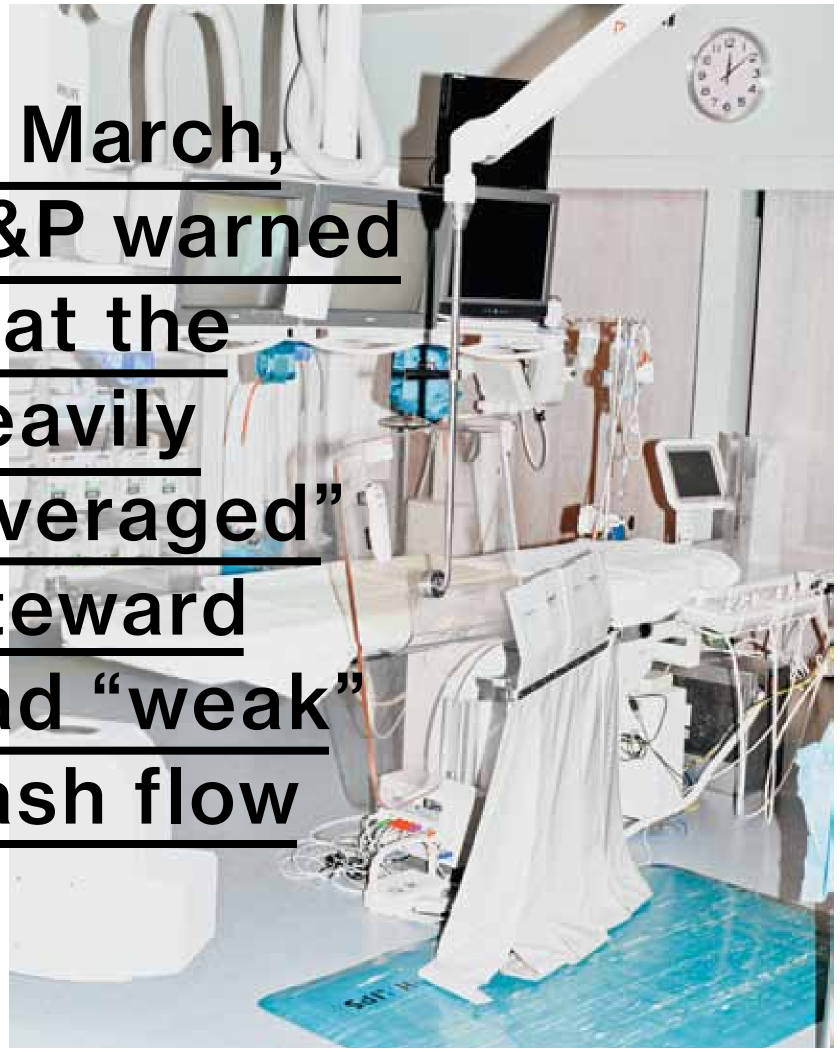
Wall Street's Prescription For Hospitals

By Devin Leonard
Photographs by Harry Gould Harvey IV

A nurse monitors several ERs at Steward's EICU

Ralph de la Torre is dressed in a gray pinstripe suit, white shirt, and orange tie. His graying hair has been carefully trimmed. He looks like a Wall Street guy, and talks like one, too. "I know the numbers like the back of my hand—the quality scores, the heart failure scores," says de la Torre, chairman and chief executive officer of Steward Health Care System, the Boston-based hospital chain owned by Cerberus Capital Management. "I know the financials. I feel compelled to know this business as well as anybody."

De la Torre says he's created the ultimate business model for the age of Obamacare: a national chain of no-frills hospitals. He unveiled his plan in January 2011 at the JPMorgan Healthcare Conference in San Francisco, vowing that Steward would compete aggressively on price with the large university-affiliated teaching hospitals that dominate most metropolitan areas. "In a world of Neiman Marcuses, we're OK with being Filene's," he said. De la Torre said that Steward would deliver low-cost, state-of-the-art care through the use of advanced electronic medical records systems, new preventive medicine approaches, and the standardizing of everything throughout the chain, from billing to emergency room procedures. He joked about publicly humiliating employees who fell short of his safety standards. "It works," he quipped.



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Steward has invested in outpatient surgical centers like this one at Good Samaritan Hospital

De la Torre's experiment began in 2008, when the Archdiocese of Boston hired him to rescue the six money-losing hospitals in its Caritas Christi Health Care system. Two years later, de la Torre orchestrated the sale of the facilities in a deal valued at $895 million to Cerberus, a New York private equity firm and hedge fund best known for buying a majority stake in Chrysler on the eve of the financial crisis and losing its car manufacturing business in bankruptcy. Bloomberg News reported that it recouped most of its losses when it sold Chrysler's financing unit in 2010. Cerberus also has investments in hotels, movies, and guns. It transformed Caritas into a for-profit venture and kept de la Torre in charge of the newly created Steward.

Armed with Cerberus's cash, de la Torre bought more hospitals and lured doctors away from Steward's competitors. "He made a huge splash in the marketplace," says Ellen Bender, a health-care consultant in the Boston area. "He's really been the person to watch in the last few years."

Under the Affordable Care Act, the White House is encouraging the formation of large groups of hospitals and doctors that can manage lots of patients, as insurance companies move from simply reimbursing providers for tests and procedures to paying them to keep people healthy. The Obama administration refers to these groups as accountable care organizations, or ACOs. It's one of the White House's chief strategies for lowering health-care costs. "We created the concept of the ACO on paper in '08," de la Torre says. "Our business plan is an ACO on steroids."

What could be more reassuring than a hospital chief who says he can carry out health-care reform while turning a profit? "If de la Torre keeps it up, he's going to find himself in charge of Obamacare," *Boston* magazine gushed last year when it featured him in its list of the city's 50 most powerful people.

These days, however, Steward looks less like an exemplary experiment in health-care reform and more like a troubled private equity buyout. Steward is a force in Massachusetts, where it owns 11 hospitals and had revenue of $2 billion last year. But the acquisitions de la Torre tried to do in other states either fell apart or never got off the ground. In March, Standard & Poor's warned that the "heavily leveraged" company had "weak" cash flow. "I don't think they have any secret sauce," says Paul Levy, the former CEO of Beth Israel Deaconess Medical Center in Boston who now blogs prolifically about health-care matters.

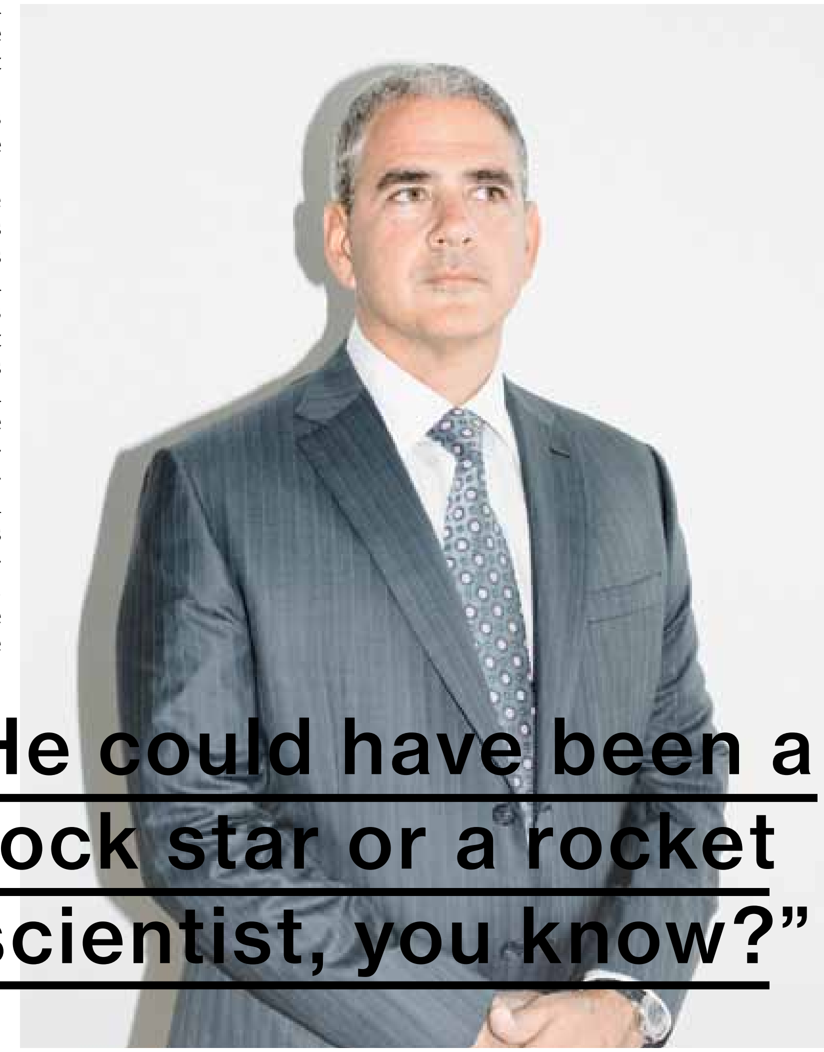
There have been few private equity buyouts of hospital companies. Hospitals are heavily regulated. Those that accept Medicare must provide emergency services to patients regardless of their ability to pay. That alone would make it something of a feat for Cerberus to turn a profit. That's one reason, says Kevin Schulman, a professor of medicine and business administration at Duke University, "everybody's watching this one."

De la Torre, 47, grew up in Florida. His father, the late Angel de la Torre, was an internist from Cuba who immigrated to America in 1960 with so little money that he had to borrow change to call someone to pick him up from the airport. He went back to medical school and eventually became director of cardiology at St. Vincent's Medical Center in Jacksonville, Fla. As a boy, Ralph de la Torre worked as an orderly, passing out catheters to doctors to open up blocked heart valves.

In 1992, de la Torre earned a joint degree in medicine and technology from Harvard Medical School and Massachusetts Institute of Technology. He did his residency at Massachusetts General Hospital and in 1999 took a job at Beth Israel Deaconess Medical Center. "We were looking for a technically gifted surgeon, and he fit the bill," says Frank Sellke, former chief of cardiothoracic surgery at the hospital.

Cardiac surgery is highly competitive. So was de la Torre. Several times a month he flew to a Memphis lab where he practiced on cadavers. He created a minimally invasive "keyhole" surgery technique, repairing heart valves without slicing through patients' breastbones. De la Torre brought the same enthusiasm to his leisure pursuits. He downed energy-boosting protein shakes and power-lifted weights; he traveled by helicopter to remote mountainous areas to test his snowboarding skills.

Some of de la Torre's ex-colleagues describe him as Machiavellian. After a few years, Sellke says, he heard rumors that his colleague was angling for his job behind his back. "I thought it was a joke," Sellke says. "It turned out the joke was on me." In 2006, de la Torre became chief of the cardiothoracic surgery department. Sellke departed for Brown Medical School, where he holds the same title. "I definitely felt betrayed," he says. Steward says de la Torre had nothing to do with the appointment.



"He could have been a rock star or a rocket scientist, you know?"

De la Torre, in his office in Boston, has worked in health care since childhood

De la Torre felt increasingly attracted to the administrative side of the hospital, which he found as challenging as the operating room. "The stuff I didn't learn [in school] is the stuff that fascinates me," he says. "I dive into finances. I dive into legal. I dive into managed-care constructs."

He also ingratiated himself with the city's most influential figures, such as Jack Connors, co-founder of the advertising agency Hill Holliday. In 2008, Connors, who has close ties to the Archdiocese of Boston, told de la Torre that the Archdiocese was conducting a search for a new CEO at Caritas, which was on the brink of insolvency. "The guy is very bright," Connors says of de la Torre. "I mean, he could have been a rock star or a rocket scientist, you know?"

De la Torre says that some in Boston thought he was crazy for taking a job at a hospital system that he describes as "highly distressed." He figured that the moment was right. Two years earlier, then-Massachusetts Governor Mitt Romney had signed a law making insurance available to all the state's citizens, much as Obamacare is intended to do now throughout the country. De la Torre was determined to get out in front of the reform movement. He wasn't the only one trying his hand at health-care reform. Most of the state's big hospitals were tossing around new ideas. De la Torre did it more loudly. "We can't tweak elements of the system while leaving the rest intact," he wrote in January 2009 in an open letter to President Obama published in this magazine. "It's time to overhaul the entire model."

It was around this time de la Torre says he drew up his ACO plan. To begin the transformation, he had to upgrade the company's electronic medical records system so that Caritas doctors could share patient information. De la Torre invested $35 million in the project, almost all the organization's cash. He also spent money on billboards outside hospitals with digital clocks that showed the short wait times in the ER.

He hoped to raise more money by selling bonds, but borrowing costs became prohibitively expensive once the financial crisis set in. He attempted to sell Caritas to Vanguard Health Systems, a for-profit hospital chain in Nashville. Vanguard was one of the few hospital companies controlled by a private equity investor. In this case, it was Blackstone Group. But Vanguard was spooked by Caritas's financial condition. De la Torre says his only alternative was to find another private equity investor with an appetite for risk. It turned out to be Cerberus. "When we began our diligence four years ago, Steward's business plan and model was clearly ahead of its time," Brett Ingersoll, head of global private equity for Cerberus, wrote in an e-mail.

Massachusetts Attorney General Martha Coakley, a Democrat whom de la Torre had raised funds for in the past, embraced the plan. Her office regulates charitable institutions, including Caritas. With her blessing, Cerberus in November 2010 announced it would acquire Caritas and rebrand it as Steward. The company promised to pay off Caritas's outstanding debt, assume responsibility for its pension plan, and invest $400 million in fixing up its ailing hospitals. There were strings attached: Coakley prohibited Cerberus from selling the company or loading it up with debt to fund a special dividend payment for three years.

Four Cerberus executives joined Steward's board. De la Torre says he consults with them—but only up to a point. "I mean, they're smart people," he says. "But I'm the health-care expert."

The Boston health-care market has long been dominated by some of the best hospitals in the country, such as Massachusetts General, where the singer Adele went for throat surgery, and New England Baptist Hospital, where the Boston Celtics go for knee repair. Most people with high-priced insurance gravitate to these large teaching hospitals with big reputations. The region's smaller community hospitals fight over the scraps.

Steward's hospitals were at the bottom of the food chain, and de la Torre needed to change that. With Cerberus's capital behind him, Steward launched an ad campaign with a Super Bowl spot in February 2011 in which actors playing patients spoke glowingly about the arrival of a new kind of health care.

The marketing push was accompanied by a flurry of purchases. By the end of 2011, Steward had bought four more hospitals; one of them, Quincy Medical Center, included an abandoned building occupied by squatters. Steward decided to tear the building down rather than fix it up. De la Torre argued that he could quickly render those hospitals ACO-worthy.

Steward also boosted the number of physicians affiliated with the hospital to increase its patient flow. The company lured 300 primary doctors away from Partners HealthCare, owner of top-rated Massachusetts General, and Beth Israel Deaconesses, de la Torre's former employer. Part of Steward's recruiting pitch was that the doctors would be affiliating with the region's most progressive hospital company. In two cases, Steward sweetened the deal with $36 million to purchase the assets of physician practices, including their real estate.

Steward partnered with two local insurers to provide coverage for small businesses and doubled the size of its home health-care operation. "If you take a managed-care system, an insurance company, a physician company, and a hospital company and you put them in a blender, that's us," de la Torre says. In December 2011, the Centers for Medicare and Medicaid Services bestowed its imprimatur on Steward when it selected the company as one of 32 participants in the Pioneer ACO program, an initiative to explore ways to lower Medicare costs through the very model that de la Torre champions.

De la Torre continued to push Steward to become a reform laboratory. The company has a team of nurses who spend their days calling discharged patients from all of their hospitals to check in. Not everyone appreciates the calls. "Sometimes they say, 'I'm not talking to you. I don't want Steward calling me anymore. I'm tired of you people,'" laughs Jeanne Hill, a thick-skinned Steward nurse. She says she has saved lives by hounding patients who are reluctant to call an ambulance after their conditions worsen.

"This isn't McDonald's. It's not Starbucks. This industry doesn't work that way"

In 2008, de la Torre became head of St. Elizabeth's and five other hospitals near insolvency

Steward patients in more serious shape receive home visits. In July, Colleen Prinzivalli, a pharmacist care manager, dropped by to see Mildred Mackie, a 77-year-old who had recently had a heart stent replaced at Steward's St. Elizabeth's Medical Center in Boston. After she was discharged, Mackie found herself getting easily exhausted while sweeping the kitchen floor. Determined to prevent another hospital visit, Prinzivalli sat down with Mackie in her living room, combing though through roughly 15 different bottles of pills. She discovered that Mackie was on two different drugs that slowed her heart rate when she needed only one.

A week later, Prinzivalli returned. "Do you mind looking through your medications one more time?" she asked. Mackie was taken aback. "You want the whole thing?" she asked. "Yeah," Prinzivalli said. The two women reviewed each bottle again. When it was time for Prinzivalli to leave, she told Mackie not to be a stranger. "We're not a 911 service," she said, "but you can call us if you have any questions about the meds." Mackie says she spoke to Prinzivalli on the telephone in August, but she hasn't needed any further visits. "She doesn't have to come by anymore," says Mackie. "I'm fine."

Steward has gotten some good publicity about its reform efforts—Atul Gawande, a surgeon at Brigham and Women's Hospital and *New Yorker* writer, recently highlighted the company in that magazine—yet some of its self-proclaimed innovations are becoming the industry standard. Paul Ginsburg, president of the Center for Studying Health System Change in Washington, says all of Steward's competitors have set up ACOs and are doing similar things to control costs and prevent hospital readmissions. "You could call it the norm in Boston," he says. Steward says it's several years ahead of its rivals.

Meanwhile, the national chain that de la Torre has talked about hasn't materialized. He looked at hospitals in New York, Florida, Rhode Island, and Maine, to no avail. "Maybe it didn't work, but at least he was out trying to buy some more hospitals," his friend Connors says. "I think that's the part that he loves the most."

It's difficult to see how being on the rugged edge of health-care reform is helping Steward's bottom line. The company had revenue of $1.6 billion in 2011 and lost $50 million. Last year its revenue climbed to $2 billion, and losses narrowed to $33 million. De la Torre insists the company will be profitable this year. (Steward made a similar projection last year to Rhode Island when it was trying to buy a hospital there, and still ended up in the red.)

In March, Steward did a $250 million junk bond offering. Standard & Poor's cautioned that Steward's debt, including lease and pension obligations, was five times its cash flow and said the company was setting off additional alarm bells by loaning money to its top executives as part of its management retention plan instead of paying them in cash. "It's something we don't see a heck of a lot of," says John Babcock, an S&P credit analyst. Even so, Steward says it had more than enough buyers for its bonds.

De la Torre dismisses concerns about Steward's debt levels. He says the company's results will improve as more insurers embrace the ACO model. But it's not clear how effective ACOs will be at containing costs. In July, the Centers for Medicare and Medicaid released the result of the first year of the Pioneer ACO project. The results were widely considered a disappointment: Together the 32 participants saved $88 million, and nine of the participants left the program. Steward's four Boston-based competitors who remained in the Pioneer program made their results public. De la Torre says he's proud of Steward's results, but the company won't release them. Steward says it wants to share the information with its doctors first.

De la Torre's other problem is that some of his hospitals have major troubles. According to the Massachusetts Center for Health Information and Analysis, seven of Steward's hospitals lost money last year. In May, a team of inspectors from the state Department of Mental Health paid a surprise visit to the psychiatric ward for the elderly at Quincy Medical Center and found disarray. According to a state report, "One patient was found sitting in her bed covered with feces. … She stated the staff would not answer the bell."

The local media decried the negligence at Quincy Medical. In July, Daniel Knell, the hospital's president, tendered his resignation, citing "several incidents [that] have ignited public debate." A spokesman for Steward says the company is proceeding with its plan to upgrade Quincy Medical. But such incidents reveal how difficult creating an integrated hospital chain can be. Jeff Goldsmith, a health-care analyst in Charlottesville, Va., says people often fail to understand that each hospital is its own ecosystem. "This isn't McDonald's," he says. "It's not Starbucks. This industry doesn't work that way."

"I don't want Steward calling me anymore. I'm tired of you people"

Steward nurses follow up with patients from all hospitals from a call center

"We're a startup," de la Torre says. "We've only been in existence for two and a half years." He says the transformation of Steward is still in the early stages. It's unclear how much longer de la Torre has to realize his ambitions. Market conditions suggest that Cerberus will try to unload Steward after the no-sell agreement expires in November. Several large for-profit hospital companies have been on the prowl for acquisitions. One is Tenet Healthcare, which announced a plan in June to purchase Vanguard for $1.8 billion. Another is Community Health Systems, which is in the throes of a $3.9 billion merger with Health Management Associates. Either one might be eager to devour Steward when they are done with their current expansions. "They have their hands full now, but that might be different in six months to a year," says David Cyganowski, managing director of Kaufman Hall & Associates, an Illinois health-care consulting firm. Tenet and Community Health Systems had no comment about a possible deal with Steward.

Many people in Boston are fairly certain that Steward is for sale. "Would I be willing to bet that it'll belong to somebody else within the next three years?" says Connors. "Absolutely. I'd bet on that tomorrow."

De la Torre downplays the possibility of Cerberus selling his company. "They believe in the model," he says. "They believe in what we're achieving, and they believe in the long-term strategy. When they sell is up to them, but I can honestly tell you it wouldn't affect the operations of the company."

Cerberus had no comment on a possible sale. In an e-mail, Ingersoll wrote: "The team has kept its entrepreneurial spirit and drive, and we are extremely pleased at their performance as well as the market's validation of Steward's innovative model."

De la Torre might welcome an opportunity to cash out. No one ever said it was easy to transform the health-care business. And perhaps de la Torre will get a chance to try again. "This is just one man's opinion," says Connors. "But I think whatever happens, Ralph will keep finding a larger microphone and a larger platform to do just that." B