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UPMC

Office of Senior Vice President & Chief Legal Officer

FAX COVER SHEET

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Insurance Department

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Subject: **Highmark's proposed affiliation with West Penn Allegheny Health System**

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UPMC LIFE CHANGING MEDICINE

April 19, 2013

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Re: Highmark's proposed affiliation with West Penn Allegheny Health System

Dear Mr. Brackbill:

On January 18, 2013, Highmark submitted its Second Amended Form A, which set out its proposal to acquire West Penn Allegheny Health System ("WPAHS") and build its integrated delivery network ("IDN"). Included in that submission were projections made on a set of assumptions that Blackstone has labeled Highmark's "Base Case" for the acquisition. Among those assumptions were:

- "[T]he contract between UPMC and Highmark will expire on December 31, 2014;"[1]
- "As a result, Highmark members will no longer have in-network access to UPMC facilities and UPMC-employed physicians from January 2015 onward, leading to an increase in WPAHS utilization";[2] and
- Highmark will be able to move 90 percent of the patient volume—both commercial and Medicare and both inpatient and outpatient—away from UPMC and into Highmark's new IDN.[3]

Shortly after presenting the Pennsylvania Insurance Department ("PID") with its Base Case projections, Highmark began a public campaign to secure a new contract with UPMC after the current contract expires at the end of 2014. According to Highmark officials, the length of time it takes to return WPAHS to profitability is "irrelevant"; what really matters to them is "maintaining Highmark's financial strength." Chief Legal Officer Thomas VanKirk made Highmark's priorities crystal clear: "It is the enterprise financial viability that we're interested in."[4]

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[1] Blackstone, p. 62.
[2] Blackstone, p. 62.
[3] Compass Lexecon, pp.101-02.
[4] Pittsburgh Tribune-Review, Feb. 26, 2013, Highmark: We Need Contract With UPMC, http://triblive.com/business/headlines/3550806-74/highmark-upmc-penn#axzz2Q7Ba8iYD.

Confronted with these seemingly contradictory positions—relying heavily on the absence of a contract with UPMC to drive volume to WPAHS while publicly pursuing such a contract—the PID asked for an explanation. More specifically, on February 22, 2013, it wrote to Highmark requesting projections for the "financial implications, enrollment/discharge implications and projected IDN savings for the alternative scenario that the Highmark/UPMC contract is extended beyond December 31, 2014." Highmark responded on March 8, 2013, with an alternative scenario based on a radically altered contract with UPMC, one that would explicitly allow Highmark to "tier and steer" tens of thousands of admissions away from UPMC and into WPAHS each year after 2014.[5]

In its draft report of April 8, 2013, Compass Lexecon soundly rejected Highmark's case for a new contract with UPMC, calling the underlying assumptions "unreasonable" and the resulting projections "not . . . credible."[6] Were Highmark to renew its contract with UPMC, moreover, any rescue of WPAHS would be made more difficult, if not impossible, because Highmark would "have fewer means available to incentivize customers to receive care at [WPAHS]."[7]

Indeed, close review of Blackstone's analysis reveals that, if Highmark is permitted to acquire WPAHS, no one except Highmark would gain from a new UPMC contract. According to Highmark's own projections:

- A new UPMC contract would cost Highmark's policyholders more than $1 billion;[8]
- A new UPMC contract would cost WPAHS nearly $600 million;[9] while
- A new UPMC contract would lavish an incremental $2.8 billion in revenue and more than $300 million in additional net operating income upon Highmark.[10]

One other feature of any new contract between Highmark and UPMC merits attention: The combination of Highmark acquiring WPAHS with Highmark and UPMC entering into a new contract would be toxic to competition in both the insurance market and the provider market. Blackstone and Compass Lexecon both caution that Highmark's acquisition of WPAHS, by itself, would create a "reasonable likelihood of

[5] See Addendum No. 4, p. 2; See also Compass Lexecon, pp. 88, 156-57.
[6] Compass Lexecon, pp. 157-58.
[7] Blackstone, p. 90.
[8] Blackstone, pp. 85, 95.
[9] Blackstone, p. 68.
[10] Blackstone, pp. 49, 72.

anticompetitive effects," and call for conditions to "mitigate" those effects.[11] Neither Blackstone nor Compass Lexecon examines, however, the anticompetitive threats posed by adding a new UPMC contract to that mix.

Note that according to the draft reports, Highmark controls approximately 65 percent of the relevant health insurance market,[12] WPAHS controls approximately 16 percent of the relevant provider market,[13] and UPMC controls 47 percent of the provider market and 8 percent of the insurance market.[14] Simple arithmetic demonstrates that if Highmark acquires WPAHS and then enters into a contract with UPMC, that combination will control at least 73 percent of the insurance market and 63 percent of the provider market.[15] The anticompetitive potential (and temptations) for this health care duopoly, with both vertical and horizontal dimensions, are simply staggering—particularly when the next largest competitor in either market commands a market share of only 7 percent. A new contract between a self-interested Highmark/WPAHS and a self-interested UPMC would easily extinguish any remaining or the future prospect of competition in health care in Western Pennsylvania, and for that reason alone is a very bad idea.

Against this backdrop, UPMC recommends that several conditions be applied to any approval of the proposed Base Case acquisition:

A.

Compass Lexecon described "the many uncertainties and specific circumstances required for [Highmark's] IDN to yield benefits,"[16] and recommended as a condition "Dynamic Oversight and Reporting" on Highmark's "accomplishment of specific objectives or adherence to conditions, or that would provide notification of certain triggering events (e.g., additional transactions . . .)."[17] Similarly, Blackstone recommended:

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[11] Blackstone, p. 117; Compass Lexecon, p. 15.
[12] Compass Lexecon, p. 28.
[13] Compass Lexecon, p. 43.
[14] Compass Lexecon, pp. 43, 28.
[15] Even these extraordinary concentrations may understate the dominance of a Highmark/WPAHS/UPMC combination in certain markets. According to data presented by Compass Lexecon, for example, Highmark and the UPMC Health Plan would control more than 84 percent of the market for Medicare Advantage in Allegheny County. See Compass Lexecon, App. II[3a].
[16] Compass Lexecon, p. 196.
[17] Compass Lexecon, pp. 195-96.

- "Conditions requiring a remediation plan for WPAHS if the hospital's financial performance is not turned around by a specific date"; and

- "Conditions limiting the amount of capital that Highmark may commit in the context of an acquisition, affiliation, asset purchase, or other business alliance to entities . . . which would not be structured as a subsidiary to Highmark without providing the PID with consent and/or notification subject to specified standards of review."[18]

UPMC concurs in these observations and recommendations.

B.

As reflected in the Compass Lexecon report, "several commenters recommended that the PID preclude Highmark from renewing its contract with UPMC in the future."[19] Despite being presented with projections demonstrating that any new contract between Highmark and UPMC would imperil (and perhaps foreclose) the recovery of WPAHS, would cost Highmark's policyholders an incremental $1 billion as compared to Highmark's Base Case, and would lavish billions of dollars of revenue and hundreds of millions of dollars of net operating income on Highmark, the author of the report, Margaret E. Guerin-Calvert, did not endorse that recommendation. According to Ms. Guerin-Calvert,

> ***Having assessed all of the factors, I draw the conclusion as an economist that it is better to permit Highmark to attempt to respond to market demand, which appears to include consumer demand for a Highmark-UPMC product and to develop strategies for successful re-vitalization of WPAHS, than to artificially restrict Highmark's options, and to rely on competition from rivals.***[20]

In fact, Ms. Guerin-Calvert did not assess all the relevant factors in evaluating the recommendation. More specifically, she overlooked three factors that make the current situation in Western Pennsylvania unique and that require a condition restricting Highmark's ability to enter into a new contract with UPMC.

First, Ms. Guerin-Calvert overlooks the profound and unavoidable anti-competitive impact of a contract aligning Highmark/WPAHS and UPMC. As noted above, were Highmark to acquire WPAHS it would control at least 65 percent of the health

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[18] Blackstone, p. 76.
[19] Compass Lexecon, p. 195.
[20] Compass Lexecon, p. 195.

insurance market and 16 percent of the provider market. Meanwhile UPMC (according to Compass Lexecon) is responsible for at least 8 percent of the insurance market and at least 47 percent of the provider market. If joined under a contractual umbrella, the resulting combination would control a staggering 73 percent of the insurance market and 63 percent of the provider market. The power of this duopoly is even more foreboding where the next largest competitor in either market controls no more than 7 percent.

UPMC and Highmark have already endured a four-year investigation by the United States Department of Justice into whether their 2002 contract represented an illegal restraint of trade,[21] and are currently defending against a class-action lawsuit claiming that it was.[22] Adding into that mix control over the second largest provider in the region would discourage, perhaps permanently, competitors from entering the insurance market in particular and would invite endless litigation.

Second, Ms. Guerin-Calvert overlooks the time and effort that will be required for patients, subscribers, physicians, health systems, competing insurers, government officials and other interested parties to prepare for the massive transformation and disruption that will be caused by Highmark's Base Case. Under that scenario a mere 20 months from now 3.1 million Highmark subscribers in Western Pennsylvania[23] will find themselves, per Highmark's proposal, without in-network access to UPMC. This includes nearly 250,000 senior citizens currently subscribing to Highmark's Medicare Advantage product.[24] Unless the PID and Highmark acknowledge and begin preparing for that reality now, those subscribers will not be prepared for, or perhaps even aware of, the momentous choices that will be thrust upon them in the cause of saving WPAHS.

Unfortunately, as noted by Blackstone,[25] Highmark "plans to continue seeking a contract extension with UPMC beyond 2014[,]" a delusion pointedly identified by Blackstone as a "vulnerability" in Highmark's plans for WPAHS. As this region approaches what could be the largest transformation and disruption of a health care marketplace in the United States, patients, subscribers, physicians, health systems, competing insurers, and government officials all deserve immediate clarity on what they will be confronting come December 31, 2014.

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[21] See Tribune Review, "Justice Department ends probe of UPMC, Highmark," September 2, 2011, http://triblive.com/x/pittsburghtrib/news/s_754723.html#axzz2QjXBh69h.
[22] See Royal Mile Co., Inc. v. UPMC and Highmark, Inc., No. 2:10:cv-01609 (W.D.Pa.)
[23] Blackstone, p. 7.
[24] Compass Lexecon, App. II [3].
[25] Blackstone, p. 64.

Third, Ms. Guerin-Calvert overlooks entirely the existence and purpose of the Mediated Agreement negotiated under the guidance of the Governor in the spring of 2012 and executed by Highmark and UPMC on July 1, 2012. That agreement, which extended the existing contracts between UPMC and Highmark until December 31, 2014, was explicitly intended to "provide for sufficient and definite time for patients to make appropriate arrangements for their care and to eliminate the need for any possible government intervention under Act 94 [providing for a PID-imposed extension under certain circumstances]."[26] The Mediated Agreement also identified the specific UPMC services that Highmark will retain in its network after December 31, 2014.

To allow Highmark to pursue a new contract with UPMC once Highmark has acquired WPAHS would not only confuse subscribers and deter competitors, but would also defeat one of the central purposes of the Mediated Agreement: to provide Western Pennsylvania with two-and-one-half years of notice about the newly competitive markets that will come to fruition on December 31, 2014.

> ***For these reasons, UPMC urges the PID to include as a condition of any approval that Highmark be precluded from renewing or seeking to renew its contracts with UPMC and the existing contracts be allowed to expire, as contemplated in the Mediated Agreement, on December 31, 2014.***

Whether or not this condition is adopted, UPMC will not consummate a contract with Highmark which is about to commit $2.4 Billion and initiate the largest disruption and dislocation of patients ever contemplated in a single region solely for the purposes of competing with UPMC. It would be pointedly counter-productive and profoundly harmful to the community for UPMC to agree to a contract. Instead, UPMC will provide the desired competition in both the insurance market and the provider market.

C.

In order to protect the insurance-buying public from hazard and prejudice, to provide much needed clarity to subscribers, patients, physicians, health systems, competing insurers, government officials, and other interested parties and to provide adequate time to prepare for what bodes to be a massive transformation of health care in Western Pennsylvania,

> ***UPMC urges the PID to require Highmark, within 30 days of consummating its affiliation with WPAHS, to notify each subscriber to any plan that currently offers in-network access to UPMC, and shall provide***

[26] May 2012 Mediated Agreement between Highmark and UPMC.

> ***reasonable public notice via mass media, that effective December 31, 2014, no UPMC facilities and services beyond those specified in the Mediated Agreement of July 1, 2012 (Children's Hospital of Pittsburgh of UPMC, Western Psychiatric Institute & Clinic, UPMC Northwest Hospital, UPMC Bedford Memorial Hospital, and certain defined oncology services) will be available in-network under any Highmark plan.***

D.

Finally, in light of the complexity and sensitivity inherent in Highmark requiring its subscribers to choose between their relationship with Highmark and their relationship with UPMC,

> ***UPMC urges the PID to require Highmark, within 30 days of consummating its affiliation with WPAHS, to provide the PID and the Pennsylvania Department of Health reasonable plans for the transition of subscribers who, effective December 31, 2014, elect to change their health plans rather than change their providers and for the transition of subscribers who, effective on that date, elect to change their providers rather than change their health plan.***

Very truly yours,

W. Thomas McGough, Jr.