Brackbill, Robert

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Sent:

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To: Cc: Brackbill, Robert Tamburri, Mark

Subject:

Testimony to be provided on 4/17

Attachments:

417testimonyFinal.docx

Mr. Brackbill,

The testimony I will present on April 17 at the West Penn/Highmark hearing is attached. I preregistered and indicated that I would present comments. I am speaking as a result of my engagement with UPMC. Henry Miller



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HENRY MILLER TESTIMONY TO THE PENNSYLVANIA INSURANCE DEPARTMENT APRIL 17, 2012

Thank you for this opportunity to speak to you today. My name is Henry Miller. I am a Director in the Health Analytics Practice of the Berkeley Research Group. I have a doctorate in Economics and Accounting and 40 years of experience as a healthcare consultant and researcher. I have testified as an expert in several settings, including the Pennsylvania Insurance Department, the U.S. Congress, State legislatures and in Federal, State and local courts.

I have worked on hospital contracting and other issues in Western Pennsylvania for many years, starting with assistance on hospital contracting that I provided to Blue Cross of Western Pennsylvania in the early 1980s. Since that time, I have provided additional assistance to both Highmark and UPMC. I am currently completing assignments for UPMC.

Today, I will address three issues that need to be considered as the Highmark acquisition of the West Penn Allegheny Health System is reviewed:

- Inaccurate statements that describe the Pittsburgh hospital environment have been made and need to be corrected,
- The Highmark acquisition of West Penn Allegheny Health System is likely to create a competitive environment that would bring substantial benefits to the Western Pennsylvania healthcare system, and
- Highmark's financial support of the West Penn Allegheny Health System will require substantially more funding than has been proposed.

Because of our limited time, my remarks are summarized. I have considerably more data than I will cite and I will be pleased to share that data with you.

Shortly after Highmark announced that it intended to acquire the West Penn Allegheny Health System, local newspapers began publishing inaccurate statements about the Pittsburgh hospital environment. The articles claimed that Pittsburgh had the highest hospital costs in the U.S. and that UPMC's costs were exceptionally high. These statements are not true.

Medicare data were used to support the contention that Pittsburgh had the highest per capita hospital costs in the U.S. Medicare's expenditures for hospital services provided to Pittsburgh beneficiaries are high, but not because Pittsburgh's hospitals are inefficient. Pittsburgh hospitals serve Allegheny County which has one of the highest proportions of "old elderly" in the U.S. The 2010 census reported that for the U.S. as a whole, 6 percent of the population is over age 75. Most cities have less than 6 percent of their population over age 75, but Allegheny County has 50 percent more (9 percent). According to the National Center for Health Statistics, people over age 75 are admitted to hospitals at a 43 percent higher rate than people aged 65-74. When Medicare data are adjusted for differences in age, Pittsburgh's hospital costs are far from the highest. This finding is further supported by a 2010 study completed by Milliman, a leading healthcare actuarial firm, for the National Business Group on Health. Milliman found that Pittsburgh was one of only thirteen U.S. cities that provided high hospital value for both Medicare and commercially insured patients.

The claims that Pittsburgh has high hospital costs are not true. The claims that UPMC Presbyterian-Shadyside is a high cost hospital are also not true. Measuring hospital costs requires consideration of the relative severity of patients' illnesses. The correct way to compare hospital costs is to standardize them by applying a case-mix index, which measures patient severity. UPMC Presbyterian Shadyside has an exceptionally high case-mix index which means that its patients are more severely ill than patients in other hospitals. In fact, its case-mix index is higher than most of the top hospitals in the U.S., including Johns Hopkins, Massachusetts General and the Mayo Clinic. When UPMC Presbyterian Shadyside's costs are adjusted for case-mix, its costs are actually lower than the majority of Western Pennsylvania hospitals.

Western Pennsylvania's healthcare system needs competition. Highmark, as the area's dominant insurer, needs to provide incentives to innovate, to tie payment to quality of care, to encourage management of the population's health and to improve healthcare outcomes. Although other insurers, such as UPMC Health Plan, have been innovative, Highmark's dominant role has led to Western Pennsylvania lagging behind most of the U.S. in implementing changes that reduce healthcare costs and improve quality. It even lags in moving services from inpatient to outpatient settings, a change that most U.S. regions experienced ten or more years ago.

Change in Western Pennsylvania has been slow because there are few financial incentives to innovate. Highmark's approach to controlling healthcare costs has been to pay the lowest possible unit prices for care – a strategy that has failed because, as Highmark itself has admitted, it has been "ineffective" at controlling utilization. Indeed, given its extremely large market share, Highmark has had little incentive to control utilization or to otherwise develop new, more efficient models of care.

Western Pennsylvania now has a unique opportunity to improve its healthcare system for the benefit of all of its residents. It is on the cusp of creating competitive Integrated Delivery and Financing Systems that will seek to outdo each other in finding new ways to improve the health of the population, to enhance the patient experience of care (including quality, access and reliability) and to reduce, or at least control, the per capita cost of care – the Triple Aim that has drawn national attention. Instead of waiting ten or more years to adopt the changes that the rest of the U.S. is working on now, Western Pennsylvania could leverage the unique attributes of its healthcare system and serve as a model for 21st century American healthcare.

Competition will create the changes that are needed if Highmark follows through on its vision of creating an Integrated Delivery and Financing System, which includes the acquisition of the West Penn Allegheny Health System and if UPMC maintains its independence by not contracting with its competitor.

Approval of the Highmark acquisition of West Penn Allegheny Health System is, therefore, the right thing to do, but only if Highmark is candid with the Insurance Department about the investment needed to assure West Penn Allegheny's success. It has indicated that its current plan is to invest \$450,000,000 – the amount it assumed was needed to prevent West Penn Allegheny from defaulting on its debt. Considerably more money will be needed to make West Penn Allegheny competitive.

Audit reports indicate that West Penn Allegheny had operating losses of more than \$300,000,000 over the past five years. It had a negative total margin of 4.2 percent during this period when the national median total margin for hospitals was a positive 3.4 percent. In 2011, its liabilities exceeded its assets

¹ Testimony of Dr. Kenneth Melani, Chief Executive Officer of Highmark, before the Pennsylvania House Committee on Insurance, August 25, 2011, at p. 3.

by 35 percent and it had an unfunded pension liability of almost \$200,000,000. It had long-term debt of almost \$800,000,000 which resulted in a debt to equity ratio of 114 percent. The national hospital median debt to equity ratio is 26.2 percent.

West Penn Allegheny's extraordinary debt and its need to fund its pension liabilities require far more cash than it can generate itself. In 2011, its audited financial statements indicated that it was able to generate a little more than \$100,000,000 in cash but needed almost \$300,000,000 to meet capital expenditure, debt service and other non-operating requirements. Most importantly, West Penn Allegheny's auditors took the unusual step of raising the question of whether the system could continue to be a going concern considering its losses, negative equity and debt requirements even after the amount of Highmark's investment was known.

West Penn Allegheny Health System not only needs far more cash than Highmark has promised, it needs major operational changes. Since 2000, its acute care admissions have declined by 25 percent. In 2011, its inpatient occupancy rate was 64 percent, far below an efficient level. Over the last decade, it hired at least three hospital turnaround consulting firms at great cost and its losses accelerated. It is not clear that West Penn Allegheny has been willing to make the hard decisions that can make it successful. Highmark will need to make those decisions and it will need to provide the funding to support them.

One final point – although the Insurance Department has asked Highmark targeted questions regarding the sufficiency of its planned funding of West Penn Allegheny – and specifically whether West Penn Allegheny can avoid defaulting on its bond obligations even with Highmark's grants and loans -- Highmark has yet to respond to any of these questions. Without these answers, it will be impossible to assess the viability of Highmark's plan.

Thank you.