COMMONWEALTH OF MASSACHUSETTS

HEALTH POLICY COMMISSION

COST AND MARKET IMPACT REVIEW

PRELIMINARY REPORT RESPONSE

ON BEHALF OF

LAHEY HEALTH SYSTEM & WINCHESTER HEALTHCARE MANAGEMENT, INC.

MAY 1, 2014

EXECUTIVE SUMMARY

Lahey Health System, Inc. ("Lahey") and Winchester Healthcare Management, Inc. ("Winchester") (together, the "Parties") provide this joint response to the Health Policy Commission ("HPC") Preliminary Report ("Preliminary Report") dated April 16, 2014. This response is organized in the following manner:

1. General comments on the findings and conclusions in the Preliminary Report

2. Response to the HPC's concerns regarding (A) whether the Lahey-Winchester system could or will use its increased size over time to leverage higher prices and other favorable contract terms in negotiations with commercial payers, and (B) whether Lahey will add or increase facility fees to Winchester's ancillary services causing total medical spending to increase

3. Lahey and Winchester's support for accountability and transparency

4. Appendix containing factual clarifications to information in the Preliminary Report

1. GENERAL COMMENTS ON FINDINGS AND CONCLUSIONS IN PRELIMINARY REPORT

Lahey and Winchester concur with the HPC's finding that the proposed transaction between Lahey and Winchester may decrease health care spending, while providing high-quality care comparable to the Boston academic medical centers ("AMCs"). As Lahey and Winchester have previously stated, the purpose and plan for this transaction is to improve care delivery in the region north of Boston by keeping more care in-system and out of higher-cost downtown Boston AMCs. The key driver of this plan is Lahey and Winchester's desire to address the perceived value gap in the regional healthcare marketplace characterized by underutilized locally-based, high-quality and lower-cost providers and facilities. Lahey and Winchester's aim is to create a true alternative to high-cost downtown-based Boston AMCs that contribute to the Commonwealth's high level of total medical expenses ("TME"). Lahey and Winchester believe that, consistent with Chapter 224, a business strategy that delivers accessible, lower cost care at comparable levels of quality will be very competitive in a marketplace where consumers have access to accurate and intelligible information to make informed decisions about their healthcare. Because Boston-based health systems have the reputation for excellent quality, Lahey and Winchester's success is conditioned on delivering a product that is lower-cost than these Boston AMCs, while maintaining equal or higher quality.

In addition, Lahey and Winchester agree that they are both strong overall in terms of quality performance, but acknowledge that there are differences between them and that by sharing best practices both entities will improve. Further, the Parties firmly believe that material improvements in quality in the context of a transaction can be achieved, and in the Lahey-Northeast combination are being achieved, even when there are not substantial differences in quality between merging parties. The fact that Massachusetts providers are characterized by high quality does not mean that continued improvements cannot be made. The Lahey shared governance model demonstrates the value that Lahey attributes to representation from both the academic medical center and community hospital affiliates on the Lahey Board. Representation from each of the affiliates facilitates multi-directional sharing of best practices, policies, and procedures that will not merely bring the lower performing entity up to the level of the higher performing entity, but will also drive continuing system-wide improvements that could not be achieved by any individual affiliate on its own. As

a system, Lahey will continue to invest in high quality care and measure and track these improvements in quality as the data becomes available.

2. RESPONSE TO THE HPC'S CONCERNS REGARDING (A) WHETHER A LAHEY-WINCHESTER SYSTEM COULD OR WILL USE ITS INCREASED SIZE TO LEVERAGE HIGHER PRICES AND OTHER FAVORABLE CONTRACT TERMS, AND (B) WHETHER LAHEY WILL ADD OR INCREASE FACILITY FEES TO WINCHESTER'S ANCILLARY SERVICES CAUSING TOTAL MEDICAL SPENDING TO INCREASE

The Preliminary Report identifies two concerns with the transaction that, according to the HPC, could impact the potential to realize cost savings for employers and consumers. These concerns are: first, the merger of two financially strong direct competitors may reinforce the market strength of the resulting system, increasing the system's ability over time to leverage higher prices and other favorable contract terms in negotiations with commercial payers; and second, if Lahey adds or increases facility fees to Winchester's ancillary services, total medical spending will increase.

2.A. THE POTENTIAL FOR HIGHER PRICES OR MORE FAVORABLE CONTRACT TERMS

Lahey and Winchester understand that the HPC may be skeptical of some mergers and predictions about the ability of merging parties to lower costs and refrain from using increased market share to raise rates. However, Lahey believes its precedent transaction with Northeast Health System and, both as noted in the Preliminary Report and as further discussed under the section hereafter regarding facility fees, its business strategy for developing a competitive alternative health system, clearly support the conclusion that such actions are unlikely and would be counterproductive. Moreover, Lahey's continuing fundamental inability to charge higher prices based on competitive constraints in its service area supports the conclusion that the transaction will not lead to higher rates or greater leverage in contract negotiations with commercial payers.

In borrowing in part from the antitrust investigatory toolkit, the Preliminary Report includes calculations of market shares and the increase in market concentration, as well as a diversion analysis. Lahey and Winchester respectfully would take this opportunity to highlight the differences between their analytical approach and that of the HPC.

MARKET SHARE ANALYSIS OF HOSPITALS AND PRIMARY CARE PHYSICIANS

Lahey and Winchester respectfully disagree with certain aspects of the HPC's methodology for calculating market shares and market concentration with respect to hospital services. Specifically, the HPC's analysis of separate 75% hospital service areas for Lahey Hospital & Medical Center, Lahey-Beverly, and Winchester Hospital, significantly understates the breadth of geography over which Winchester and Lahey respectively compete for patients on a regular basis, and does not account for the competitive constraints that the system will face as a whole post-transaction. Relevant precedent from the federal antitrust agencies and the courts indicate a 90% combined Lahey-Winchester hospital service area is the appropriate starting point in antitrust hospital merger analysis.

Although Lahey and Winchester have a different view from the HPC of the appropriate geographic markets used to analyze market shares and concentration levels resulting from the transaction, even in the HPC's defined geographic markets, the market shares and concentration levels do not approach levels that antitrust agencies and courts have found are likely to lead to anticompetitive effects. Specifically, the Lahey

and Winchester combined market share for hospital inpatient services is below 30% in both the Winchester PSA and the Lahey-Peabody PSA.[1] The resulting market concentration in each will not change significantly and will remain only "moderately concentrated" under the *FTC and DOJ Horizontal Merger Guidelines*. Furthermore, the HPC acknowledges that Lahey and Winchester will continue to face strong competition from a number of other hospitals and health systems both within their respective PSAs and from outside their PSA. These indicators all support the conclusion that Lahey and Winchester will not have sufficient additional post-transaction leverage to enable the system to increase prices or gain supracompetitive contract terms from commercial payers.

With respect to the analysis of market shares and market concentration for primary care physicians, the HPC used the claims information from the largest commercial payer based on the All Payers Claims Database ("APCD"). Lahey and Winchester respectfully disagree with the use of a 75% service area for the same reasons indicated above. Lahey and Winchester have not accessed this data in the APCD and therefore have not evaluated the HPC's methodology and calculations with respect to physician market shares and market concentration from the combination of primary care physicians.

DIVERSION ANALYSIS

Although the HPC concludes, based on its diversion analysis, that Lahey and Winchester are each other's "second closest substitute", the diversion ratio results (Lahey diversion to Winchester is <10% and Winchester diversion to Lahey is approximately 16%) are well-below the threshold relied upon in the upward pricing pressure model ("UPP") developed by former lead antitrust economists for the federal antitrust agencies. This means that from an economic standpoint, it would not be profitable for Lahey and Winchester to raise prices at either hospital because in doing so, they are far more likely to lose patients to rival unaffiliated hospitals than to recapture the patients within their own system post-transaction.

COMPETITIVE MARKET LANDSCAPE

The HPC does not address a third factor in the antitrust analysis of competitive effects—evidence from the parties regarding the views of commercial payers and large employers for or against the proposed transaction. As previously indicated, the three largest commercial payers are supportive of an affiliation between Lahey and Winchester. Lahey and Winchester are not aware of any commercial payers or large employers that are opposed to the transaction.

2.B. FACILITY FEES

As previously indicated, Lahey has no plans to convert WPA outpatient physician practices or Winchester freestanding facilities to hospital-based practices post-acquisition, nor has any of Lahey and Winchester's financial, operational or business planning for the combined entities been based on any such conversions. Moreover, Lahey historically has not engaged in this type of conversion with any of its acquired physician practices and only on one occasion, through a terminated joint venture, has Lahey converted to facility

[1] Although the Lahey-Beverly PSA Beverly PSA shares calculated by the HPC are above the "moderately concentrated" level, as the HPC acknowledges, Beverly is the smaller hospital in Lahey's system and system-wide competition will remain strong. Therefore, on net, Lahey will continue to face competitive constraints as a system.

billing for an ancillary service. In May 2013 a MRI joint venture between Lahey and another entity ended. The MRI service continues to operate on the campus of Lahey's hospital licensed facility in Peabody. Further, Lahey has not deployed any such conversions in the context of the original merger of Lahey and Northeast.

Lahey's business strategy of lower cost matched with high quality noted in the Preliminary Report, applies equally to any expanded deployment of facility-based fees. At its meeting of April 16, 2014, in the context of a discussion regarding facility fees, Commissioner Hattis referenced a Boston Globe story from March 2013 regarding the costs for certain procedures at Lahey's hospital-based dermatology service. This service had been decanted from the main campus on Mall Road many years earlier (ergo was not acquired and "flipped" – a national practice that has been widely criticized), signage throughout the facility clearly indicated that it was a hospital based practice, and after considerable investigation the Office of the Attorney General took no action. However, the situation illustrates why any business strategy based on further or expanded deployment of such fees is inconsistent with the realities of the new marketplace, where information will be readily available and considered in consumer decision-making. Consistent with the goals of Chapter 224, the new marketplace will be driven by the availability of data regarding quality and price and will provide significant financial incentives for consumers to choose value over brand. In such a marketplace, fees that cannot easily be translated into value by consumers will be difficult to maintain.

Consistent with this value strategy, Lahey constantly reviews and continues to update and improve its communications with patients over fees and stresses transparency with respect to fees in everyday practice. In fact, Lahey was recently notified that the State has been monitoring health plan and providers' compliance with the new price transparency mandate by having secret shopper calls made by staff at the Office of Consumer Affairs. Lahey was pleased to learn that their calls to Lahey received a perfect score for accuracy, responsiveness and positive consumer experience.

3. LAHEY AND WINCHESTER'S SUPPORT FOR ACCOUNTABILITY AND TRANSPARENCY

The Parties clearly believe the new era of health reform will increasingly encourage consumers to make healthcare decisions based on quality and price.[2] Lahey and Winchester have demonstrated their commitment to accountability and transparency in many ways, including with respect to the HPC's authority and processes under Chapter 224: Lahey has participated or provided testimony at HPC hearings; the Parties' have been fully engaged and open throughout the HPC's CMIR process for the pending transaction; and the Parties' have provided information and data in response to the HPC's requests related to its review of third-party transactions. Lahey and Winchester support the efforts of the HPC to develop greater transparency in the healthcare marketplace as a tool to drive quality, to lower cost, and to spur competition, and believe that Lahey and Winchester will benefit from a more transparent environment. The Parties recognize that (i) these goals may be better served by comparing accomplishments to aspirations; and (ii) there is an eighteen to twenty-four month lag time with respect to much of the data that the HPC and the Center for Healthcare Information and Analysis ("CHIA") must rely upon. To that end,

[2] Lahey and Winchester are proud to be ranked highly for their cost-efficiency and quality (*see, e.g.*, Truven Health Analytics Top 100 Hospitals report available at: http://www.100tophospitals.com/studies_and_winners/100_top_hospitals/ and Rice, C: "Shopping for Surgery: NerdWallent Ranks Most Affordable Mass. Hospitals", available at: http://www.boston.com/lifestyle/health/blogs/white-coat-notes/2014/03/18/besthospitals/50YXR593iWCVVi5eI21riI/blog.html (LHMC, Winchester, and Beverly all make this list)).

without agreeing to a reporting obligation inconsistent with the rest of the marketplace, Lahey and Winchester will continue to cooperate with the HPC with respect to its statutory purpose to "monitor the reform of the health care delivery and payment system in the commonwealth," and to support the HPC's ability to expeditiously evaluate the impact of transactions subject to its review.

4. APPENDIX: FACTUAL CLARIFICATIONS FOR THE PRELIMINARY REPORT

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Note that Lahey has specialists but not PCP's that practice in southern New Hampshire.

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Lahey Days Cash on Hand ratio and Cash Equivalent amounts are low compared to how Lahey calculates the same measures. The primary reason for the discrepancy is the presentation of long-term investments. The HPC figures for Lahey do not include these investments while Lahey (consistent with its bond covenants and rating agency perspective) includes these long-term investments. The table below illustrates the difference in calculation. For comparison, the BIDMC financial statements identify 95+% of their investments as short-term (meaning included in the calculation) with only 5% being long-term investments (excluded from calculation). The Lahey financial statements are the inverse with approximately 5% of investment identified as short-term (included in calculation) and 95% as long-term (not included in calculation).

Financial performance as included in section III of HPC Preliminary Report

		Fiscal 2012		Fiscal 2011	
		Lahey Calculated	HPC Calculated	Lahey Calculated	HPC Calculated
Cash and equivalents		293,801	293,801	234,716	234,716
Short term investments	+	10,953	10,953	10,423	10,423
BD depreciation funds	+	63,579	63,579	59,023	59,023
BD education funds	+	3,058	3,058	3,169	3,169
Current portion of asset whose use is limited	+	-	2,771	-	2,953
Long term investments	+	264,886	-	242,138	-
Total Cash and Equivalents	=	636,277	374,162	549,469	310,284
Operating Expenses (less Depr.)		1,343,497	1,343,497	1,277,829	1,277,829
Calendar days	/	365	365	365	365
Operating Expenses per Day	=	3,681	3,681	3,501	3,501
Total Cash divided by Operating Expense per Day	=	173	102	157	89

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- Winchester FY2011 and FY2012 Days Cash on Hand were 142 and 167, respectively
- Winchester FY2012 Net Assets were $201,166,000

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The HPC and the Parties both projected potential savings from this transaction. However, the sources of those savings were different. HPC estimates an annual decrease in total medical spending of $2.7 million, consisting of both a $1.3 million annual savings in hospital TME from shifting hospital care from Boston AMCs to Lahey and $1.4 million of physician-related contract savings. The Parties did not include in their estimates reduction in TME based on a decrease in spending related to a shift in WPA contracts from NEQCA to Lahey (at NEPHO rates). However, the model did include TME reductions based on shifts in care related both to hospital and physician services, which were not included in the HPC's estimate, resulting in a total estimated annual reduction in TME of $3.3 - $5.0 million, reflecting the Parties' belief that the potential cost savings in this transaction will result primarily from the shift in care to providers with high quality and low TME, as described in Section 1. of this response.