

Payer-Provider Integration for Accountable Care: A Case Study

HIGHMARK



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Industry Consolidation



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Trends in Industry Consolidation: Are We Next?



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Why Do Industries Consolidate?

- Buyers and suppliers start to exert greater power
- Excess capacity no longer subsidized by artificially inflated prices
- Capital becomes scarce and expensive
- Regulatory reform changes the playing field
- Intensified competition leads to failure of weaker players
- Economies of scale becomes an essential competitive advantage



Emergence of Giants Resets the Competitive Base

- Extreme value becomes a buyer expectation
- No room for waste or duplication
- Economies of scale now a requirement to play the game
- Tipping point is reached--no longer viable to remain a standalone
 - Capital
 - Efficiencies
 - Collaboration



Who Are the Health Care Consolidators?

For-Profit



Not For-Profit



Driving Forces for Payer-Provider Integration



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Driving Force 1: Reform Impacting Payers

- Medical Loss Ratio (MLR) limits, except for actions that...
 - Improve health outcomes
 - Prevent hospital readmissions
 - Improve patient safety
 - Increase wellness
 - Enhance the use of healthcare data to improve quality, transparency and outcomes
 - HIT costs related to the above



According to Peter Kongstvedt:

- “MLR limits will create steady pressure to capitate or otherwise pay large groups or IPAs for both medical care and UIM and Network development and management”
- “Health insurance is really becoming health financing, which will further erode margins”



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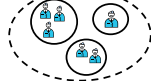
Driving Force 2: Providers Form the Core of ACO's

Who can be an ACO?

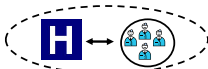
1. Physician Group Practice



2. Network of Individual practices



3. Hospital-Provider Joint Venture



4. Hospital that Employs Physicians



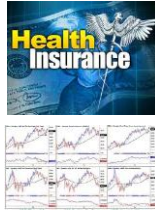
5. Others as determined by HHS



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Driving Force 3: Payers Have Key ACO Competencies

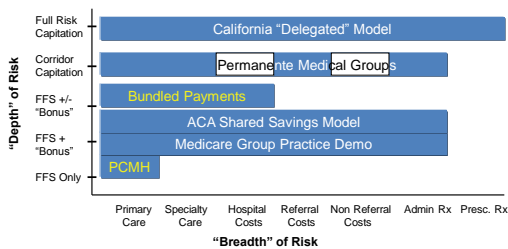
- Data registries
- Actuarial analysis
- Claims management and payment disbursements
- Utilization management
- Readmissions reduction
- Disease management
- Quality
 - Monitoring
 - Reporting
 - Incentives/rewards
- Member enrollment and marketing



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Driving Force 4: Providers Are Assuming Greater Population Risk

Schematic of ACO Risk Assumption



Source: Francis Crossin, MD, Kaiser Permanente



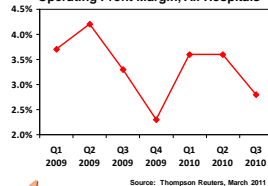
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Driving Force 5: Significant ACO Start-Up Capital and Operating Costs in Era of Flat/Declining Hospital Margins

ACO Start-Up/Annual Activities

- Network Development and Management**
 - 1 ACO management and staff
 - 2 Leveraging system's management
 - 3 Legal and consulting
 - 4 Financial IT support systems
 - 5 Primary care acquisition
 - 6 Specialist relationship building
 - 7 Post acute care network management
 - 8 Contracting capabilities
 - 9 Physician leader compensation
- Care Coordination, Quality and Utilization**
 - 10 Disease registries
 - 11 Care coordination and discharge follow-up
 - 12 Specialty-specific disease management
 - 13 Hospitalists
 - 14 Integration of inpatient/outpatient services
 - 15 Patient education and support
 - 16 Medication management
 - 17 PCMH designation
- Clinical Information Systems**
 - 18 Electronic health record
 - 19 Interoperability
 - 20 Health information exchange
- Data Analytics**
 - 21 Analysis of care patterns
 - 22 Quality reporting costs
 - 23 Other activities and costs

Operating Profit Margin, All Hospitals



Source: Thompson Reuters, March 2011

Total Costs:
Start-Up: \$5M-\$12M
Annual: \$6M-\$14M



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The Upshot: Accountable Care is Challenging the Conventional Roles of Payer and Provider



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The Implications of Accountable Care

- Providers are reevaluating the viability of their business model and assessing the ACO option
 - Pressures on existing service lines
 - Demands for economies of scale
 - Drive to eliminate duplication
- Larger payers are jumping into ACO's able to offer administrative services
- Questions remain...
 - Who will do what?
 - What is the business model?

GEISINGER

GroupHealth

Kaiser Permanente

UPMC

Intermountain HealthCare

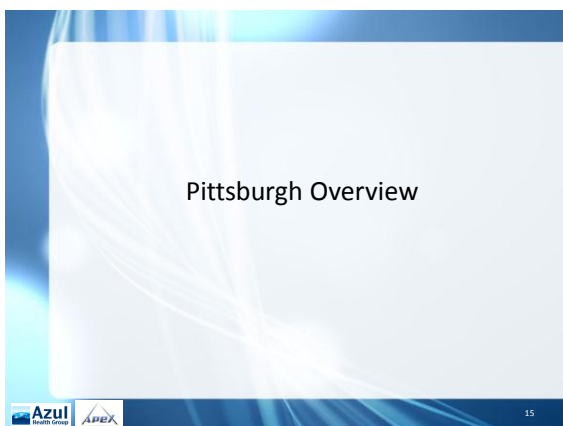
Lovelace Health System

Integrated Payer-Provider Systems Are Best Positioned for Accountable Care
Obvious answer: We need each other!!



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Pittsburgh Overview



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Western Pennsylvania's Cast of Characters



- Largest NFP bankruptcy in history
- 5 hospitals, \$1.5B revenues, 700 employed physicians, 12,000 FTE's
- 10-year history of struggle
- \$750B bond issue in 2007



- Huge international system
 - 20+ hospitals
 - \$9 Billion in revenues
 - 2,900 employed physicians
 - Facilities in Ireland, Cyprus, China, Italy
- UPMC Health Plan aggressively growing and impacting Highmark
- Publicly-stated mission: "Bury" WPAHS



- Dominant commercial payer in Western PA
 - 3,000,000 members
 - 65% commercial market
- Excellent reputation across BCBS
- Branching out into new business lines
 - Vision & Dental
 - Delaware, West Virginia, et al
- Recently failed merger with Independence Blue Cross
- Nearing end of 10-year UPMC contract



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State of the Local Community Circa 2010

- Pittsburgh insurance premiums among the highest in the country
- UPMC and Highmark embattled over upcoming contract talks
 - UPMC seeking 40% rate increase
 - Highmark reacts to potential premium increases
- UPMC attacking key Highmark strongholds
 - Erie/Hamot
 - Eastern suburbs - Monroeville
- WPAHS lawsuit with UPMC and Highmark claiming collusion from 2001 deal
- WPAHS pursuing turnaround but in need of capital



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Evolution of the Strategy



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Precipitating Events for Highmark

- Rate negotiations with UPMC rapidly deteriorating
- Prospect of repeating this exercise every 5-10 years
- UPMC health plan growing market share
- Health reform on its way
 - Payer limitations
 - ACO's
 - Exchanges
- Continuing premium hikes stifling local business and harming Highmark reputation



Precipitating Events for WPAHS

- Turnaround/downsizing plan in play
- Capital constraints preventing growth plans
- Success in becoming low-cost, high quality provider
- Aggressive moves by UPMC in key markets
- Losing war of attrition
- Running out of time—seeking capital partner



Converging/Complementary Strategies



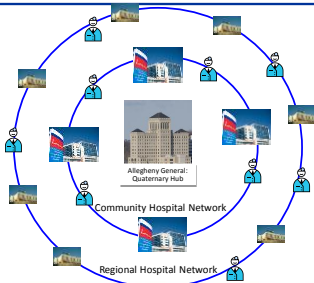
- Declare war on UPMC
- Ensure competition through survival of WPAHS
- Slow UPMC Health Plan market share growth in key regions (east, north)
- Transform business model by morphing into a provider
- Develop competitive provider network
 - Tertiary medical center
 - Community hospitals
 - Physicians



- Obtain a capital partner
- Preserve community-based/local healthcare
- Ensure competition by serving as a counterpoint to UPMC
- Leverage low-cost high quality market position
- Provide a physician-led alternative to UPMC
- Establish medical school to train the next generation of western PA physicians



Highmark's Key Strategy: Build Local Provider Network to Preserve Market Competition



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As the Strategy Matures, the Temperature Rises

- December 2010 – WPAHS-Highmark talks initiated at CEO level
- Highmark-UPMC rhetoric boils over
- Both organizations start to recalibrate strategy
 - Highmark: Transform business model
 - WPAHS: Execute recapitalization transaction
- Active negotiations between WPAHS and Highmark
- UPMC reacts by shutting off contract talks with Highmark
 - "How can we contract with a competitor?"

Pittsburgh Post-Gazette
UPMC, Highmark
prepping for battle

**PITTSBURGH
TRIBUNE-REVIEW**
UPMC, Highmark embroiled
in classic bad splitup

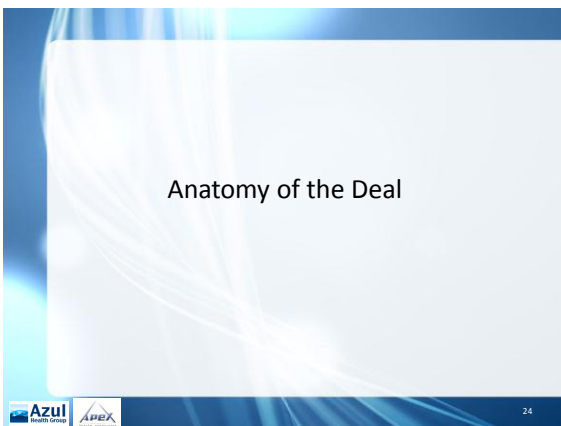
BUSINESS TIMES
Highmark, UPMC end
negotiations as Aetna steps in

Modern Healthcare
Highmark goes to court to
fight UPMC ad campaign



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Anatomy of the Deal



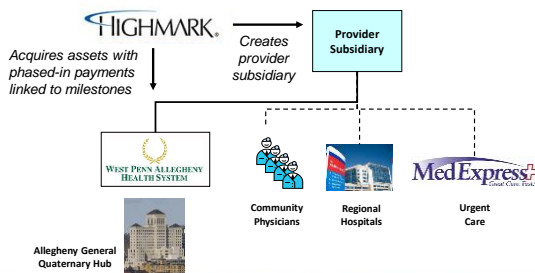
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Key Decision Points Crystallized the Deal

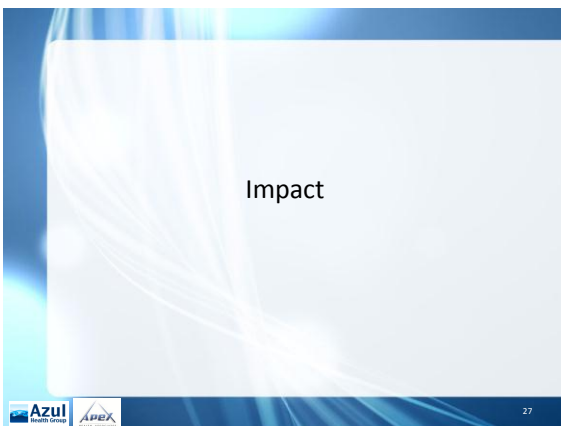
- Highmark would move down the road to total acquisition
- WPAHS would be infused with capital upon completion of certain milestones
- Highmark would have input on how funds were spent
- Transition plan for senior management



Highmark Pursues Strategy to Become a Payer-Provider Through Acquisition



Impact



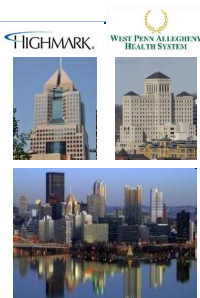
Immediate Impact at WPAHS

- Balance sheet strengthening
 - Cash on hand increases 20 days
 - Rating agencies shift from “negative” to “developing”
- Pension obligation guaranteed
- Access to capital for strategic growth initiatives
 - West Penn revitalization
 - Forbes competitive position
- Morale boost



Long-Term Impact

- One of the largest integrated delivery system by revenue (\$18B)
- Accenture-Highmark joint venture for extending EMR to community physicians
- Commitment to containing the cost of health care in Pittsburgh
- Poised to compete long term with UPMC



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