

MARKET IMPACT REVIEW

Partners HealthCare's proposed acquisition of
the Care New England Health System

FINAL REPORT

bailit
health

February 4, 2018

I. Purpose and Scope

On April 4, 2017, Care New England Health System (CNE) and Partners HealthCare (Partners) announced that they had signed a Letter of Intent and agreed to negotiate the terms by which CNE would join Partners.¹ Health Insurance Commissioner Marie Ganim requested that Bailit Health Purchasing, LLC perform a Market Impact Review to assess how the proposed transaction could affect the affordability of commercial health insurance in Rhode Island.

There are several potential policy implications of Partners acquiring CNE, including but not limited to CNE's financial health, the impact on its workforce, and potential changes to graduate medical education arrangements. With OHIC's agreement, this report focuses more narrowly on the potential impact on health insurance premiums, considering (1) the potential impact on commercial spending for care delivered to Rhode Island residents, and (2) the opportunity for the potential merged entity to achieve cost savings, and the extent to which any savings will accrue to Rhode Island residents via lower premiums.

In performing this analysis, we have considered possible motivations for Partners to acquire CNE, and the multiple actions Partners might take after acquiring CNE.

II. Methods

To inform this Market Impact Review, we performed insurer interviews, reviewed literature evaluating the impact of health care consolidation, and considered available data relevant to the transaction. We also discussed the history of Partners' market behavior in Massachusetts with a member of the Massachusetts Health Policy Commission and separately with Commission staff. Finally, we consulted with Martin Gaynor, PhD., an economist who serves on the faculty of the Carnegie Mellon University and is a former Director of the Bureau of Economics at the Federal Trade Commission.

A. Interviews

We conducted seven interviews with health insurers in Rhode Island, Massachusetts, and New Hampshire. We included Massachusetts and New Hampshire insurers because Partners has acquired hospitals in both states over the past several years. We employed a structured interview guide with open-ended questions in order to organize the conversations and allow the participants to share their thoughts freely. Participants were promised that their participation would be confidential and that responses would not be attributed. A sample

¹ Partners HealthCare. 2017. "Care New England and Partners HealthCare agree to explore affiliation". www.partners.org/Newsroom/Press-Releases/Care-New-England-Affiliation.aspx. Accessed January 18, 2018.

interview guide, containing questions used with Rhode Island and Massachusetts insurers, is attached as **Appendix 1**.²

B. Literature Review

We performed a literature review based on the recommendations of Dr. Gaynor and the Massachusetts Health Policy Commission interviewees. Much of the literature focused on within-state provider consolidation, but there are a number of observations and considerations relevant to the cross-state proposed Partners-CNE transaction. Where appropriate, these findings are included in the discussion below. We also reviewed two recent Federal Trade Commission enforcement actions related to hospital acquisitions. A bibliography is attached as **Appendix 2**.

C. Available Data

The Massachusetts Health Policy Commission (HPC) and the Massachusetts Center for Health Information and Analysis offer a wealth of publicly available data on the Massachusetts health care market, including the Partners system, and individual Partners Massachusetts hospitals. The HPC has also published three “Cost and Market Impact Review” (CMIR) reports on four proposed Partners transactions; these reports contain detailed quantitative and qualitative analyses of Partners. We concluded, however, that none of the Partners CMIR reports is directly relevant to the proposed CNE acquisition; in these cases the existing Partners network shared a significant service area overlap with the hospitals and physicians targeted for acquisition, and nearly all Massachusetts insurers contracted with both Partners and the entities it sought to acquire.³ By contrast, only some Rhode Island insurers contract with Partners hospitals, and Rhode Island interviewees report relatively little patient migration to Partners facilities.

² New Hampshire interviewees were asked a slightly different set of questions pertaining to the local market experience.

³ The HPC’s first Partners CMIR report (2013) examined the proposed acquisitions of South Shore Hospital (SSH) and Harbor Medical Associates, a related physician group. The Health Policy Commission found that in SSH’s primary service area, Partners had nearly the same market share for inpatient services as South Shore, each capturing about a quarter of commercial discharges; the HPC also found that Partners had a dominant share of the statewide physician market. In its CMIR of Partners’ proposed acquisition of Hallmark Health System (Hallmark) (2014), the HPC found that Partners already established contracts on behalf of Hallmark hospitals and physicians with most of the large Massachusetts commercial payers, and that other Partners hospitals and physicians had strong commercial inpatient and primary care market share in Hallmark’s primary service areas for these services. The most recent HPC CMIR (2018) considered Partners’ acquisition of Massachusetts Eye and Ear Infirmary (MEEI). While the *service area* overlap of the entities was significant (MEEI is located next door to Partners’ Massachusetts General Hospital), they had relatively little *service* overlap. However, because MEEI is a single geographically proximate specialty hospital, we did not find the analysis to be directly relevant to the proposed CNE transaction.

III. Care New England and the Current Rhode Island Market

A. System Composition

CNE comprises four hospitals: Women and Infants Hospital (W&I), Kent Hospital, Memorial Hospital, and Butler Hospital. CNE also owns a large outpatient mental health and addiction services center and a home health agency.

CNE also employs physicians, although its employed group is not large. It reported just over \$100 million in revenues in the first eight months of 2017, although these revenues reflect a heavy internal subsidy from the hospitals (approximately \$41 million over the same period).⁴

CNE operates an ACO, Integra Community Care Network, in partnership with Rhode Island Primary Care Physicians Corporation (an independent practice association) and South County Health.

CNE is in the process of closing Memorial Hospital, but CNE will still represent about 25% of licensed hospital beds in the state after the closure (see **Appendix 3**). Each of the three remaining hospitals has a distinct profile (i.e., a large specialty hospital (W&I), a mid-sized community hospital (Kent), and a psychiatric hospital (Butler)) and they offer services that are largely complementary to one another. Women & Infants hospital is a teaching hospital for Brown University Medical School.

CNE does not have a general tertiary / quaternary medical center. Most interviewees believed the bulk of tertiary / quaternary care for Rhode Island residents is delivered at Lifespan's Rhode Island Hospital, although some is performed at the community hospitals, and some is performed at Boston academic medical centers (including, but not limited to Partners hospitals). Care New England currently has a clinical affiliation with Partners' Brigham and Women's Hospital in cardiology, and in vascular, thoracic and colorectal surgery.

Within Rhode Island, Women & Infants competes with general acute hospitals for maternity care, but has a dominant market position, and delivers a significant majority of babies in Rhode Island. Kent Hospital, located in Warwick, competes with Providence general acute care hospitals; Rhode Island Hospital is only ten miles away. Butler Hospital competes with other Rhode Island hospitals that have a psychiatric unit, such as Rhode Island Hospital and Fatima Hospital, and, to a limited extent, with Lifespan's Bradley Hospital, a pediatric psychiatric hospital.

⁴ Care New England Combined Statement of Unrestricted Activities (Unaudited), filed November 2017.

B. Commercial Insurance Payment Rates

In 2012 OHIC and the Rhode Island Executive Office of Health and Human Services funded a comparative study of multi-payer hospital payment rates in the state.⁵ Selected report findings are displayed in **Appendix 4**. The report found that that Kent enjoyed higher commercial insurer rates than most other Rhode Island hospitals for inpatient care, but lower rates for outpatient care. Women & Infants received the highest payments in the state for both inpatient and outpatient care, likely due to a combination of its specialty services and its dominant market position. While this analysis used data that are now several years old, Rhode Island insurers generally confirmed that CNE continues to enjoy high rates relative to the rest of the Rhode Island hospital market.

C. Financial Status

Despite higher commercial insurer rates, CNE has been struggling financially for some time. According to its annual report, it has experienced worsening financial operations since FY15, losing \$2M on operations in FY15 and \$68M in FY16.⁶ In addition, it reported a \$40 million operating loss in the first half of FY2017⁷. Perhaps for this reason CNE has been actively seeking to be acquired.

When announcing major staff reductions in April 2017, CNE attributed its ongoing challenges to, “reduced volumes due to changing demographics, reduced inpatient neonatal care, a declining birth rate, and a decrease in reimbursements.”⁸

The closure of Memorial Hospital is projected to improve CNE’s financial outlook, but some interviewees felt that CNE had been experiencing operating losses at each of its hospitals, such that additional steps would need to be taken to improve CNE’s margin over the long term. Recent financial results for the CNE hospitals are included in **Appendix 5**.

⁵ “Variation for Payment in Hospital Care in Rhode Island” (2012). Prepared for the Rhode Island Office of the Health Insurance Commissioner and the Rhode Island Executive Office of Health and Human Services by Xerox.

⁶ Care New England 2016 Annual Report. See http://issuu.com/carenewengland/docs/ar_final?e=23096185/54000728. Accessed January 18, 2018.

⁷ Bartlett, Jessica. “Partners exec. Care New England acquisition depends on bottom line” *Boston Business Journal*, May 14, 2017.

⁸ “Care New England Begins Major Staff Reductions – Many at Women & Infants Hospital.” *GoLocalProv.com*, April 26, 2017. Available at www.golocalprov.com/health/care-new-england-says-majority-of-staff-reductions-took-place-at-women-infa. Accessed January 22, 2018.

IV. Partners Healthcare

A. System Composition

Partners Healthcare is the largest health system in New England. It is comprised of 13 hospitals, six physician groups (which contract as a single entity, Partners Community Physicians Organization), an insurance company (Neighborhood Health Plan) and a number of other health care entities. Partners owns two large academic medical centers in Boston, Massachusetts General Hospital (MGH) and Brigham & Women's (B&W) Hospital. The system has 74,000 employees⁹ as compared to approximately 8,000 CNE employees.¹⁰

B. Commercial Insurance Payment Rates

Partners hospitals and medical groups tend to have the highest relative prices among Massachusetts providers. In particular, MGH and B&W are among the highest priced general acute care hospitals in the state,¹¹ and interviewees reported that the Partners physician organizations are up to 50% more expensive than the typical Rhode Island commercial physician fee schedule.

C. Financial Status

For FY17 Partners reported \$13.4 billion in operating revenues and an operating margin of \$53M after experiencing a prior year loss.¹² In general, the Partners hospitals tend to be financially strong with consistent positive operating margins. Recent losses for the health system have been attributed to the performance of its insurance company, Neighborhood Health Plan. Partners' six physician groups are a significant source of system revenue - nearly \$2.2 billion in FY16 operating revenue. Interviewees described Partners as having a consistent strategy of expanding its physician groups to consolidate referral patterns and to use its negotiating leverage to seek higher physician rates.

D. Treatment of Rhode Island Residents at Partners Hospitals

Interviewees reported that relatively few Rhode Island residents seek care from Partners hospitals. However, when they do seek out care from a Partners hospital that care is costly, as the care is often tertiary or quaternary care. Interviewees cited oncology, cardiology, orthopedics, and transplants as the most common services delivered to RI residents at Partners hospitals. Interviewees felt that some of this care could be delivered at Rhode Island Hospital,

⁹ <https://innovation.partners.org/about/about-partners-healthcare>. Accessed January 18, 2018.

¹⁰ www.carenewengland.org/about/upload/CNEProfileFY15.pdf. Accessed January 18, 2018.

¹¹ The Center for Health Information and Analysis publishes relative price data for Massachusetts hospitals. MGH and B&W were more expensive than 92% of Massachusetts hospitals in Blue Cross Blue Shield's network on a blended (inpatient plus outpatient) basis, with prices 46% above the median. Data from United indicated that B&W prices were 70% above the median for inpatient care, but 32% below the median for outpatient care.

¹² www.partners.org/Newsroom/Press-Releases/2017-Financial-Results.aspx. Accessed January 18, 2018.

but little at CNE facilities. While there was some variation by insurer (and none had performed specific analysis of the question), general insurer sentiment was, in the words of one RI insurer, “not enough business goes to Boston to draw our attention.”

E. Partners’ Expansion in Recent Years

Hospital

Partners has acquired two community hospitals in recent years: Cooley Dickinson Hospital in western Massachusetts in 2013 and Wentworth-Douglass Hospital in southern New Hampshire in 2017. Partners attempted to acquire two larger hospital systems in Massachusetts in recent years, but the transactions were withdrawn after intervention by the Massachusetts Health Policy Commission and the Attorney General.¹³ Interviewees reported little change in relationships with Cooley Dickinson or Wentworth-Douglass since being acquired by Partners. However, they noted that the Massachusetts Attorney General required that Cooley Dickinson negotiate separately from other Partners hospitals for five years following the acquisition, and the Wentworth Douglass acquisition is relatively recent.

The Massachusetts Health Policy Commission reported reviewing Cooley Dickinson’s experience since 2013. While they found that the hospital’s “Community-Appropriate Discharges” decreased faster than the statewide trend after being acquired, it appeared that local patients were not traveling to Partners’ Boston hospitals, but rather were traveling to geographically closer Partners competitor hospitals in western Massachusetts.

Following its aborted effort to acquire South Shore Hospital in Massachusetts, Partners said that it would look for regional, national and international growth opportunities, based on the belief that it must grow to remain competitive and successful.¹⁴

Partners has recently moved to acquire the Massachusetts Eye and Ear Infirmary, a specialty hospital in Boston (MEEI) and its physician group (MEEA). The Health Policy Commission has reviewed the transaction, finding,

“After the transaction, Partners could likely obtain Partners physician rates for MEEA physicians across all commercial payers and would likely seek significant hospital rate increases for MEEI. ... The parties concede that they expect MEEI and MEEA to receive higher prices ... These rate increases would ultimately be borne by consumers and businesses through higher commercial premiums, including for tiered and limited

¹³ Weisman, Robert. “Partners ends bid to acquire South Shore Hospital” *Boston Globe*, February 17, 2015 and McCluskey, Priyanka. “In face of opposition, Partners unlikely to expand further in Mass.” *Boston Globe*, December 18, 2015. Partners did acquire Harbor Medical Associates in 2014 after a CMIR of that transaction by the HPC. It also acquired Pentucket Medical Associates, a multispecialty physician practice, in 2015 after review by the HPC. Partners’ proposed acquisition of MEEI is still under review by the Massachusetts Department of Public Health.

¹⁴ McCluskey, Priyanka. “Partners to acquire RI’s Care New England.” *Boston Globe*, April 19, 2017.

network products that include MEE, and may also impact other providers' spending against risk budgets to the extent that their patients use MEE. ...

While the parties have claimed that the transaction will result in operational efficiencies and improvements in the quality of patient care and access to services, they have declined to offer an unequivocal and measurable commitment to limit the price increases that would increase spending for payers and consumers, and have not provided evidence that a corporate merger is either necessary or sufficient to achieve quality or access improvements. The parties also have not offered commitments regarding MEE's commercial payer network participation that would protect against any impaired access to MEE's specialty services subsequent to the transaction."

The Health Policy Commission shared its findings with the Department of Public Health's Determination of Need staff, and formally referred the transaction to the Massachusetts Attorney General's office, where it is currently under review.

Unlike past acquisitions, but like a potential CNE acquisition, MEEI has stated that its proposed acquisition is motivated in part by financial difficulties.¹⁵

Physician Network

Partners owns six physician groups which contract as a single entity, Partners Community Physicians Organization (PCPO). As a single entity, they comprise Massachusetts' largest physician group, with nearly \$2.2 billion in operating revenue. Our interviewees described the growth of the physician network as an integral part of Partners' business strategy. Because PCPO commands high payment rates, Partners can acquire practices and increase their revenue by including them under the PCPO contract. This allows them to increase physician salaries while also consolidating referral patterns, increasing volume to Partners hospitals.

V. Partners' Proposed Acquisition of Care New England

Partners and Care New England signed a letter of intent and agreed to negotiate exclusively in April 2017. The agreement did not include CNE's Memorial Hospital, which CNE initially planned to sell but now, with State approval, is in the processing of closing.

In announcing the agreement, Partners noted that CNE has had a clinical affiliation with Brigham and Women's Hospital in cardiology and in vascular, thoracic and colorectal surgery since 2009, and has had "a longstanding collaborative and collegial relationship" between

¹⁵ McCluskey, Priyanka. "Partners defends deal with Mass. Eye and Ear", *Boston Globe*, November 11, 2017.

Partners' McLean Hospital and CNE's Butler Hospital around behavioral health care.¹⁶ This echoes the pattern seen in New Hampshire, where a clinical affiliation preceded the acquisition of Wentworth-Douglass Hospital.

As noted above, Partners' past acquisitions have not been distressed hospitals, and Partners has stated publicly that it will only finalize the CNE transaction if CNE can become profitable.¹⁷ While CNE's actions to close Memorial Hospital will improve its financial performance, one interviewee stated that Partners goal is to have hospitals run a 1-2% margin, and expressed skepticism that CNE could get to that point prior to the acquisition. When asked, interviewees identified a variety of reasons why Partners would be interested in acquiring CNE:

1. Expansion. As stated above, Partners has stated publicly that it needs to grow to be successful. Because Partners' ability to expand further in Massachusetts is limited by state regulators, the system is looking to nearby markets in other New England states and even abroad.
2. Overhead costs. The Partners system has significant fixed overhead costs that can be spread over a larger group of hospitals.
3. Higher referral volume for high-margin services. Partners may see an opportunity to direct more Rhode Island care to its Massachusetts facilities.
4. Building market share within Rhode Island. Previously Partners has pursued growth through practice acquisition and developing new outpatient facilities, such as the one opened in 2017 in Foxboro, MA.
5. Adding margin. Some believe that by increasing revenues at CNE Partners may believe it can make CNE profitable, with revenue increases coming from a combination of higher hospital and physician payment rates and increased utilization. Partners may also see an opportunity to lower CNE operating costs.
6. Value-based contracting. In Massachusetts Partners has sophisticated value-based contracts with multiple payers and has built systems to manage total cost of care. Partners may believe it can be financially successful taking the same approach in Rhode Island.

These potential motivations for the transaction are considered in greater detail in the next sections.

Although CNE has a significant market share in Rhode Island, it is about one-fourth the size of Partners existing network. The total acute care beds at CNE's two general acute care hospitals are less than the licensed beds at just one of Partners' medical centers in Boston. CNE is even

¹⁶ Partners HealthCare. "Care New England and Partners HealthCare agree to explore affiliation" 2017. Accessed at www.partners.org/Newsroom/Press-Releases/Care-New-England-Affiliation.aspx on January 18, 2018.

¹⁷ Bartlett, Jessica. "Partners exec. Care New England acquisition depends on bottom line", *Boston Business Journal*, May 14, 2017.

smaller in comparison to Partners overall organization, which includes the physician organization, insurance company, and other entities.

Partners HealthCare has not filed an official notice of the CNE transaction with the Department of Health, but based on news coverage, OHIC anticipates a filing soon.

VI. Potential Partners Post-Acquisition Actions and Their Impact on Affordability

A. Rate Increases

Many interviewees indicated that they believed that Partners would seek higher rates for CNE hospitals, based on their understanding of Partners' past behavior in Massachusetts. One interviewee said, "Our experience with Partners tells us they like to solve problems with revenue solutions. They will say, 'hit this price point or we are out of your network - including the whole Massachusetts network.'" Another interviewee, however, observed that over the past few years Partners had "been on good behavior" and was agreeing to rate increases that were in line with the market, in contrast to its earlier market behavior. However, it is likely that any such "good behavior" is related to the regulatory oversight and scrutiny provided by the Commonwealth of Massachusetts; it may not reflect Partners' approach in new markets such as Rhode Island.

The fact that CNE has been experiencing significant financial losses, coupled with Partners' indication that it would seek rate increases for MEEI if that acquisition was to occur, makes it more likely in our estimation that Partners would seek rate increases if it acquired CNE.

1. Economic Study of Mergers and Rate Increases

Economic literature suggests that hospital consolidation is often associated with higher rates, because the hospital system can take an 'all-or-nothing' bargaining approach. However, this mechanism is weaker if the acquired hospital is geographically distant from the system hospitals, because it is more difficult to link the bargaining strategy. In order for a system to use its market power as leverage for higher rates, at a minimum, there must be common payers (insurers) and customers (employers or individuals) between the system hospitals and the newly acquired hospitals. State borders provide some protection against this effect, presumably because there are fewer common payers or customers.¹⁸ However, the Partners-CNE transaction may have characteristics that allow for Partners to successfully negotiate higher rates. Two insurance companies have Massachusetts and Rhode Island business (United, Tufts), and BCBSRI has a reciprocity arrangement with BCBSMA that allows members to seek

¹⁸ One recent paper found that 'cross-market' mergers did have a price effect in some cases, but found no such effect when the merger crossed a state border.

care in both states. One Rhode Island insurer interviewee noted that “Partners is *very* significant to our business. Even small [Rhode Island] employers cross borders.”

Our conversations with insurers were consistent with the economic theory; generally, insurers who contracted with both Partners and CNE saw rate increases as a more likely outcome than insurers who were only in one market or the other.

2. Rhode Island Regulatory Limitations on Rate Increases

OHIC Regulation 2 provides significant protection against large price increases for CNE hospitals should Partners acquire CNE. One interviewee stated, “the State has more of a role than we might, because of the rate cap,” and suggested that Partners will lobby the State to modify the cap to help address CNE’s financial situation.

With respect to hospital rates, several interviewees noted that CNE hospitals already are among the highest paid in Rhode Island (for one insurer CNE prices were reported to be *higher* than comparable Partners hospitals in Massachusetts) and suggested that even with increased leverage or negotiating pressure, Partners may not be successful in increasing hospital rates further. Women & Infants, in particular, already has very strong market power in Rhode Island; interviewees did not see a Partners acquisition changing CNE’s ability to negotiate higher rates.

B. Physician Group Growth

Partners has a large physician group presence in Massachusetts, which is in stark contrast to Care New England. Several interviewees noted that Partners may seek to expand CNE’s physician group network by obtaining higher payment rates and offering physicians high salaries to join. While this might lead to increased practice transformation, primary care practice ACO participation and improved care coordination, it could also lead to price increases and drive referrals to Partners’ high-priced Boston hospitals. Generally speaking, research evidence does not support better care or care coordination based on physician market consolidation.

C. Referrals

Several interviewees indicated that Partners would seek to send more high-margin care to Boston hospitals. However, interviewees were not all aligned in whether this strategy would have a meaningful impact on affordability. One interviewee stated that Rhode Islanders believe that Boston-based care is better than Rhode Island-based care, so they will go to Boston hospitals if given an opportunity. Another interviewee stated that Rhode Island residents are reluctant to travel “more than 4 miles” for care. We suspect that the interviewees were separately considering tertiary and non-tertiary care, but cannot confirm that to be so.

If Partners were to redirect tertiary and quaternary care to Boston, it would likely come at the expense of Rhode Island Hospital. The impact on affordability would depend on the differential between RIH and Partners rates (and in theory, Rhode Island Hospital might reduce

its rates to remain competitive). Interviewees suggested anecdotally that Partners rates are higher, but volume is relatively low, and felt that other potential Partners activities would have a larger impact on affordability.

One interviewee reported “anecdotally” that Partners’ new outpatient facility in Foxboro is underutilized. This is another site to which Partners might direct referrals; again, the price differentials are unknown.¹⁹

The Partners brand is seen as very strong; it is possible that by attaching it to CNE properties, there will be increased utilization at the existing sites. Since CNE hospitals are already higher priced than the average Rhode Island facility, this could lead to increased costs and higher premiums.

D. New Facilities

After acquiring Wentworth-Douglass Hospital in New Hampshire, Partners opened a new outpatient facility at the Pease Tradeport in Portsmouth, NH – another community hospital’s service area. It has also opened new outpatient facilities in Foxboro and Danvers, MA. Partners may see an opportunity for such facilities in Rhode Island under the Partners or CNE brand, and would bring new capital to CNE to pursue the idea.

These facilities may be able to bill at hospital outpatient rates even if they are not on the same campus as an acute care hospital. One insurer reported that this strategy is not as highly used in Rhode Island as it is in Massachusetts and may be another opportunity for Partners to obtain higher payment for outpatient services without increasing rates, per se. In fact, absent a regulatory prohibition against doing so, Partners might add a facility fee to its invoices for currently CNE-employed physicians.

E. Value-Based Contracting

Interviewees reported that Partners has a reputation for being more sophisticated and focused with respect to value-based contracting than most Rhode Island ACOs. One insurer noted that CNE had been focused on value-based contracting, but that financial pressures may have trumped its focus. Partners may also help expand value-based care through physician network consolidation and investments (see above). The impact of these possibilities is difficult to anticipate.

F. Cost Reduction

Most insurers were skeptical of Partners’ ability to reduce CNE’s costs. However, one insurer suggested that it might be possible, and another noted that Partners in Massachusetts was “now

¹⁹ It may be possible to use hospital discharge data and/or cost report information – which is collected for both states, to develop a comparison between the institutions. For instance, it would be possible to compare Net Patient Service Revenue and cost per case-mix adjusted discharge. Such analysis is beyond the scope of this report.

focused on managing costs and managing care.” Economic literature provides little support for the idea that cross-market mergers lead to meaningful cost reduction. Partners has not yet offered any description of mechanisms for cost reductions with respect to CNE. In 2013, in its evaluation of Partners’ proposed acquisition of South Shore Hospital, the Health Policy Commission found that “the cost increases anticipated from the proposed transactions far exceed savings achieved from Partners’ accountable care initiatives to date.”

Moreover, even if Partners were to demonstrate that significant operating cost reductions were likely, it would have to further demonstrate that such savings would accrue to health insurance premiums, for instance through a commitment to limit payment rate increases over the relevant period. Cost reductions that accrue only to Partners itself would not improve the affordability of care in Rhode Island.

VII. Analysis

We believe the central question to consider when contemplating Partners acquisition of CNE is “Why would Partners want to acquire CNE?” There are six possible motivations listed in Section V. above that informed our evaluation of potential actions Partners might take.

1. Expansion. We don’t believe that this is simply expansion for expansion’s sake. Partners would not seek to acquire CNE if it didn’t achieve a specific financial goal. Moreover, CNE isn’t large enough to justify this explanation. Fundamentally, it’s not clear why Partners needs to grow to be successful.
2. Overhead Costs. We also do not believe that the opportunity to spread overhead costs is the reason for an acquisition of CNE. There is little evidence that managing a new out-of-state provider network would provide a meaningful opportunity to spread existing overhead costs relative to new overhead obligations, especially given the size of CNE relative to Partners’ total operating expenses.

All of the other plausible reasons relate to an opportunity to grow Partners’ business.

3. Referrals for high-margin services. It seems unlikely that the transaction is designed to secure existing, modest referral volume from CNE to Partners hospitals. We heard mixed analysis of whether there was a meaningful opportunity to direct additional care to high-priced Boston teaching hospitals. On one hand, the power of Partners brand reputation may be sufficient to drive volume north. On the other hand, local insurers tended to believe that Rhode Island residents would be reluctant to travel to Boston if similar care is available locally. On balance, we believe Partners will attempt to increase referral volume to Boston, but must see other opportunities; the referral profits alone are unlikely to be sufficient to motivate the transaction.

4. Building market share within Rhode Island. Observers believe that Partners' strong brand – a reputation for high quality care – results in greater market power than would be implied by its size alone. Partners is likely to promote this brand in Rhode Island, with or without the development of new facilities. If more patients end up at CNE hospitals within Rhode Island, it may increase premiums, as CNE hospitals are already higher priced than other Rhode Island hospitals. Moreover, as discussed above, Partners may be successful in consolidating a physician network in Rhode Island, which may lead to higher spending directly (due to potentially higher rates) and indirectly (due to referrals to high-cost settings). We believe this is a significant part of Partners' motivation.
5. Adding margin. We do not have any specific information about how Partners might seek to reduce CNE operating costs, beyond efforts already underway. Therefore, margin increases would largely be dependent on increased payments from commercial insurers. We believe it is likely that Partners could successfully bargain for higher rates from insurers that currently contract with the Partners' Massachusetts hospitals. We anticipate they would have less opportunity with Rhode-Island-only insurers. As noted below, the State will have significant influence on Partners' ability to obtain such rate increases. Partners could also seek higher rates from Medicaid and its MCOs
6. Value-based contracting. We believe that Partners is likely to achieve more rapid and more successful adoption of value-based contracting strategies than CNE would otherwise, due to its relevant contracting and management experience, as well as the potential for physician network growth. The impact of such changes on premiums is ambiguous, as it depends on the level of total cost of care budgets and their long-term success in achieving care efficiencies.

Whether these efforts would increase health care spending more than alternative future scenarios for CNE, we can only speculate. Partners certainly enjoys regional market clout with commercial insurers that is unmatched. However, even if Partners does not acquire CNE, some action by CNE is inevitable, as its current rate of financial loss is not sustainable.

If only because of CNE's financial distress, we find it likely that if Partners acquired CNE it would take actions to increase revenue to CNE, which, if successful, would adversely impact the affordability of Rhode Island commercial health insurance premiums in the immediate term. The financial realities imply that another acquiring entity would be likely to attempt the same, albeit perhaps with less insurer leverage than Partners.

In the end, it will be the State that has the most influence over the impact that a Partners acquisition of CNE would have on commercial health insurance premiums.

Appendix 1

Example Market Impact Review Interview Guide

Note: Each interview was performed using a guide similar to the following document, although in many cases the open-ended questions led to responses and conversations beyond the format here. As indicated below, the questions for Rhode Island insurers were somewhat different than for insurers from other states.

Thanks for taking time to speak with us today. Bailit Health has been asked by the RI Office of the Health Insurance Commissioner to perform a limited-scope cost and market impact review of Partners HealthCare's proposed acquisition of the Care New England (CNE) health system. The Commissioner is interested in assessing the likely impact of the acquisition on commercial health insurance premiums. Nothing that you share with us today will be attributed to you or your organization in the subsequent report we will produce for the State.

Care New England comprises four hospitals, a large outpatient mental health and addiction services center and a VNA. It also has some owned physician practices and is a member of the Integra ACO. Care New England is in the process of closing a hospital, but will still represent about 25% of licensed hospital beds in the state after the closure. Partners HealthCare has not filed any paperwork regarding the CNE transaction, but based on news coverage, OHIC anticipates a filing soon.

Rhode Island Insurers

- 1) Do you contract with Partners HealthCare in Massachusetts?
 - a. If yes:
 - i. Please describe your contracting experience with Partners.
 - ii. How do Partners contract prices compare to those of RI hospitals and medical groups?
 - b. If no:
 - i. Do your patients seek care at Partners hospitals, and if so, how do you pay the claims?
- 2) Approximately what percentage of your commercial spend goes to Partners hospitals²⁰ and Partners-affiliated physicians? What percentage of your inpatient discharges are from Partners hospitals? Are patients traveling to Partners hospitals for care that could be delivered by CNE hospitals?
- 3) Where do Rhode Island residents seek high acuity hospital care? (At CNE? At other hospitals in or out of state?)

²⁰ Partners HealthCare hospitals include Mass General, Brigham and Women's, Cooley Dickinson, North Shore Medical Center, Newton Wellesley, Faulkner, McLean, Spaulding Rehabilitation and Wentworth-Douglass

- 4) How important is it for you to offer a product that has both Rhode Island and Massachusetts hospitals or physicians in its network?
- 5) Do you have customers who need to provide insurance coverage for employees in multiple states (e.g., Rhode Island, Massachusetts, New Hampshire)? How important are these customers to your business?
- 6) Are there RI employer accounts (or prospective accounts) that have told you that they value access to Partners hospitals?
- 7) Have any RI employer groups conveyed to you their sentiments regarding the proposed acquisition, and if so, what have they told you?
- 8) What impact do you anticipate that Partners' potential acquisition of CNE will have on commercial health insurance premiums in RI? Why? *Please be as specific as possible in identifying the actions that you believe will positively and/or negatively affect premium growth.*

Out-of-State Insurers

- 1) What impact did Partners' acquisition of smaller hospitals have on:
 - a. the prices that you paid to those hospitals and to their affiliated physicians?
 - i. If spending increased, what do you believe was the cause? Higher unit price? Higher volume? Increased coding intensity?
 - b. referrals to other hospitals and their affiliated physicians?
 - i. If referral patterns changed, were the referrals to less or more costly providers on a TCOC and/or price basis relative to previous referral patterns?
- 2) What impact do you anticipate that Partners' potential acquisition of CNE will have on commercial health insurance premiums in RI? Why? *Please be as specific as possible in identifying the actions that you believe will positively and/or negatively affect premium growth.*
- 3) Do you contract with CNE hospitals in Rhode Island?
 - a. If yes:
 - i. Please describe your contracting experience with CNE.
 - ii. How do CNE contract prices compare to those of MA hospitals?
- 4) Approximately what percentage of your commercial spend goes to CNE hospitals²¹ and CNE-affiliated physicians? What percentage of your inpatient discharges are from CNE hospitals? Are patients traveling to CNE hospitals for care that could be delivered by Partners hospitals?
- 5) How important is it for you to offer a product that has both Rhode Island and Massachusetts / New Hampshire hospitals or physicians in its network?
- 6) Do you have customers who need to provide insurance coverage for employees in multiple states (e.g., Rhode Island, Massachusetts, New Hampshire)? How important are these customers to your business?
- 7) Are there employer accounts (or prospective accounts) that have told you that they value access to CNE hospitals?

²¹ Partners HealthCare hospitals include Mass General, Brigham and Women's, Cooley Dickinson, North Shore Medical Center, Newton Wellesley, Faulkner, McLean, Spaulding Rehabilitation and Wentworth-Douglass

8) Have any employer groups conveyed to you their sentiments regarding the proposed acquisition, and if so, what have they told you?

Appendix 2

Selected Research Literature

There is a wide variety of literature on hospital acquisitions and market power in the health care sector. Two recent articles that specifically consider “out-of-market” acquisitions where the acquiring system and the target hospital(s) have relatively little patient overlap were particularly useful for this report:

Dafny, L., Ho, K., and Lee, R. 2016 “The Price Effects of Cross-Market Hospital Mergers.” *NBER Working Paper*, 22106. Available at www.nber.org/papers/w22106.

For a useful commentary on this article, providing additional context, see Cantlupe, J. 2016 “New Scrutiny for Hospital Mergers.” *NEJM Catalyst*. Available at <https://catalyst.nejm.org/scrutiny-hospital-cross-market-mergers/>.

Lewis, M.S., and K.E. Pflum. 2017 “Hospital Systems and Bargaining Power: Evidence from Out-of-market Acquisitions.” *Rand Journal of Economics*, 48: 579-610.

The following is a selection of other articles that evaluate the impact of hospital mergers:

Hwang, W., et al. 2013 “Effects of integrated delivery system on cost and quality.” *Am. J. Manag. Care* 19(5):e175-84.

Schmitt, M. 2017 “Do hospital mergers reduce costs?” *J. Health Econ*, 52: 74-94.

Tsai, T. C., and Jha, A. K. 2014 “Hospital Consolidation, Competition, and Quality” *JAMA*, 312: 29-30.

Vogt, W. B. and Town, R. 2006 “How has hospital consolidation affected the price and quality of hospital care?” *The Robert Wood Johnson Foundation Synthesis Project*. Available at www.rwjf.org/en/library/research/2006/02/how-has-hospital-consolidation-affected-the-price-and-quality-of.html.

Two recent FTC cases include discussion of the impact of consolidation on health care competition:

FTC v. Advocate Health Care Network. Northern District of Illinois (last updated March 22, 2017). Available at www.ftc.gov/enforcement/cases-proceedings/1410231/ftc-v-advocate-health-care-network.

FTC and Commonwealth of Pennsylvania v. Penn State Hershey Medical Center. Middle District of Pennsylvania (last updated October 17, 2016). Available at www.ftc.gov/enforcement/cases-proceedings/141-0191-d09368/penn-state-hershey-medical-center-ftc-commonwealth.

Appendix 3

Licensed Beds for Selected Hospitals

<u>Rhode Island Hospitals</u>			<u>Total Staffed Beds</u>
Rhode Island Hospital	Lifespan		691
Miriam Hospital	Lifespan		245
Newport Hospital	Lifespan		129
Kent County Memorial Hosp.	CNE		343
Women & Infants Hospital	CNE		247
Butler Hospital	CNE	Psychiatric	143
St. Joseph's / Fatima Hosps.	CharterCARE		229
Roger Williams Med. Center	CharterCARE		160
Landmark Medical Center			141
South County Hospital			91
Westerly Hospital			75
 <u>Partners Hospitals</u>			 <u>Total Staffed Beds</u>
Massachusetts General Hosp.	MA		1,078
Brigham & Women's Hospital	MA		859
North Shore Hospital	MA		431
Newton Wellesley Hospital	MA		230
McLean Hospital	MA	Psychiatric	201
Cooley Dickinson Hospital	MA		92
Wentworth-Douglass Hospital	NH		178

Note: Partners owns six smaller or specialty (rehab) hospitals not included here: B&W Faulkner Hospital, Nantucket Cottage Hospital, Martha's Vineyard Hospital, Spaulding Rehab, Spaulding Cambridge, and Spaulding Cape Code.

Sources:

Massachusetts hospitals: Center for Health Information and Analysis FY2016 Hospital Profiles

Rhode Island hospitals: American Hospital Directory analysis of CMS Cost reports

Wentworth-Douglass: *Boston Globe*

Appendix 4
Selected Commercial Market Findings from Variation in Payment for
Hospital Care in Rhode Island (2012)

		Care New England		Lifespan		CharterCARE	Statewide (Commercial)
		Kent	Women & Infants	Rhode Island Hospital	Miriam Hosp.	St. Joseph's / Fatima Hospital	
Beds		359	167	719	247	312	
Average Payment per Inpatient Stay		\$16,666	\$23,367	\$14,416	\$12,889	\$11,205	\$14,975
Relative to the statewide all-payer average	Payment per Inpatient Stay	1.57	2.20	1.36	1.21	1.05	1.41
	Payment per Outpatient Visit	0.89	1.49	1.19	1.09	0.88	1.09

Source: Xerox, "Variation for Payment in Hospital Care in Rhode Island" (2012). Prepared for the Rhode Island Office of the Health Insurance Commissioner and the Rhode Island Executive Office of Health and Human Services. Pages 12, 16.

Appendix 5

Recent Financial Performance at CNE Hospitals

Care New England Financial Performance, June - August 2017 (millions of dollars)

	Butler	Kent	Women & Infants	Other	Total
Total operating expenses	26.1	75.2	117.5	72.2	290.9
Net income (loss) from operations	0.9	(2.3)	4.7	(10.5)	(7.1)
Net nonoperating gains (losses)	0.3	1.4	3.6	-	5.3
Excess (deficiency) of revenues and gains over expenses	1.2	(0.9)	8.3	(10.5)	(1.8)

Note: reported figures are net of a significant internal subsidy (transfer) from the hospitals and other entities to the Care New England Medical Group (\$16.2 million). The "Other" losses include the operations of Memorial Hospital, which account for the majority of the losses (-\$6.2 million).

Source: Combined Statement of Unrestricted Activities (unaudited), filed November, 2017