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Anne K. Bingaman
Assistant Attorney General
Antitrust Division
United States Department of Justice
10th & Constitution Avenue, N.W.
Washington, D.C. 20530

Re: Request for Business Review Letter -- "Wisconsin Subacute Preferred Provider Network"

Dear Ms. Bingaman:

Pursuant to the business review procedure set forth in 28 C.F.R. § 50.6, The Hillhaven Corporation ("Hillhaven") hereby requests that the Department of Justice Antitrust Division review and state its enforcement intentions with respect to the proposed formation and operation of the "Wisconsin Subacute Preferred Provider Network" by Hillhaven. Hillhaven proposes to create and operate this Network on a cooperative basis with a limited number of other providers of certain long term health care services to enhance cost-effective competition in the developing area of "subacute" care.

Hillhaven is the nation's second-largest provider of long term health care services, including skilled nursing, rehabilitation, convalescent, retirement housing, pharmacy, and associated services. Hillhaven owns, leases or manages more than 300 nursing facilities in 34 states, 22 retirement housing centers in 17 states, and a pharmacy subsidiary operating in 25 states.

A. OVERVIEW OF THE PROPOSED SUBACUTE PREFERRED PROVIDER NETWORK

Hillhaven is at the forefront in developing cost effective "subacute" medical and rehabilitation services in nursing facilities. In general -- there is no common regulatory definition -- subacute care is designed to provide comprehensive medical and rehabilitative services to individuals who do not require, or are unable to sustain, the intensity of acute care, but who require more intensive nursing, rehabilitation, or technically complex care than typically is provided in a nursing facility. Nursing

facilities almost always provide subacute services in beds certified for "skilled nursing" reimbursement by the Medicare Program. "Routine" skilled nursing care typically involves 2.5 to 3.0 hours of direct nursing care per patient per day; "subacute" care may involve as much as 5 to 7 hours of direct nursing care per day, plus intensive physical, occupational, and other therapies. Hillhaven has defined three levels of subacute care, including "Level One," which involves intensive nursing observation, assessment, monitoring and intervention; "Level Two," which involves more complex medical assessment, monitoring and intervention; and "Level Three," which addresses the crucial medical needs of patients on mechanical ventilators, complex intravenous infusion therapy, medical management for post surgical patients, wound and decubitus ulcer care, brain and spinal cord injury rehabilitation, and similar services.

Nursing facilities typically recruit and train additional qualified staff, develop new clinical, quality assurance and utilization review programs, and establish new relationships with suppliers of medical specialty and rehabilitation services in order to provide subacute services. These functions are not necessarily costly, but they require access to specialized expertise. Wisconsin does not require special licensure or certificate of need approval to convert existing nursing beds to subacute care, and nearly any nursing facility can qualify for Medicare "skilled nursing" certification by recruiting appropriate staff and offering the necessary array of services.

Nursing facilities typically offer subacute services to insurance companies and other third party payors as an alternative to costly acute care hospital stays for appropriate patients. Subacute services are becoming increasingly popular with "managed care" plans as part of their efforts to reduce utilization of acute care services. In addition, the federal Medicare Program generally favors the use of subacute services as a cost-effective alternative to acute care in appropriate cases. Medicare reimbursement for nursing care remains essentially cost-based (subject to various caps and limits, which, in turn, are subject to certain "exceptions"), so it is relatively attractive to nursing facilities, and most subacute units have a high percentage of Medicare patients. Some states also are beginning to experiment with special enhanced Medicaid rates for subacute care, but Wisconsin does not yet have such a program.

Hillhaven's subacute programs are particularly popular with managed care payors because of Hillhaven's significant clinical and operational experience, its well established Subacute Quality Assurance Program, and operational features such as a central "800" telephone referral line.

Hillhaven currently operates fourteen nursing facilities in Wisconsin, all of which operate subacute programs. All of the Hillhaven facilities are located in the Eastern part of the State. In the course of discussions with various private managed care payors in Wisconsin, some payors have urged Hillhaven to create a statewide network of affiliated subacute providers to assure consistent quality and availability of subacute services for their subscribers throughout the State. These payors are particularly eager to use Hillhaven's existing central subacute "800" referral line to be able to locate a subacute bed anywhere in the State. As is described in further detail below, it is unusual for a prospective long term care resident to travel far from home, even for unusual or specialized services, so Hillhaven's facilities alone would not provide statewide coverage.

Hillhaven therefore proposes to create a statewide "preferred provider network" of Subacute Medical and Rehabilitation Programs ("The Network"). The proposed Network would not be a new legal entity, but would be created and operated by Hillhaven through contracts with selected non-Hillhaven Members in areas of the State where Hillhaven has no facilities. The Network initially would include all fourteen Hillhaven facilities in the Eastern part of the State and approximately four non-Hillhaven facilities in other areas of the State that would agree to offer subacute services that meet Hillhaven's clinical and operational standards. As is described in greater detail, a significant part of the Network -- from the perspective of both Hillhaven and the payors -- would be access by such non-Hillhaven facilities to the Hillhaven Subacute Quality Assurance Program, and to the central "800" referral number. It is unlikely that the non-Hillhaven Members, acting alone, could create a similar uniform quality assurance process or central referral process.

As is set forth in detail below, the non-Hillhaven Members would enter into a "Network Agreement," a model of which is attached hereto. Hillhaven will sell, and the non-Hillhaven Members will buy, training, quality assurance, referral and other administrative programs, including access to the "800" referral process, for a flat daily payment for each Network patient. Hillhaven proposes to negotiate non-exclusive contracts with third party payors on behalf of the Network which would include a price for which Hillhaven would serve Network patients, but each of the non-Hillhaven Members would be responsible independently to negotiate its own price for each such contract. Each non-Hillhaven Member would continue to provide services other than subacute care outside the Network, and each would be permitted to provide subacute services to non-Network patients and payors. Additional safeguards described more fully below would be included in the Network Agreement to prevent anticompetitive conduct.

Hillhaven believes that the proposed Network will enhance competition by offering payors and consumers greater availability of, and efficient referral to, high quality, cost-effective subacute medical and rehabilitation programs throughout the State. Hillhaven also believes that the Network would be able to achieve certain economies of scale -- especially with respect to clinical development, training, quality assurance and administrative matters -- and thereby will be able to offer subacute care services at more competitive prices.

B. THE WISCONSIN SUBACUTE CARE MARKET

Wisconsin has more than 400 nursing facilities, containing approximately 48,500 licensed beds. Approximately 20,000 of these beds are certified as "skilled" beds and potentially could be used to provide subacute services. There has been a general moratorium (with limited exceptions) on the approval of additional nursing home beds in Wisconsin for more than ten years, but there is no certificate of need or other restriction on conversion of existing nursing facility beds to subacute services. During the past few years, many nursing facilities have developed a variety of "special care" units, including subacute units.

As noted, there is no common definition of "subacute" nursing services, nor is there a specific regulatory category for that service in Wisconsin. Existing "subacute" programs range from traditional skilled nursing services to a variety of complex, high-tech medical and rehabilitation services. Hillhaven has been unable to determine exactly how many "subacute" programs exist in Wisconsin -- even the state and national nursing home trade associations do not know -- but any number would have little or no meaning in any event because there is no common definition for the term. However, Hillhaven believes that by any reasonable definition, the proposed Network would control only a small fraction of the actual and potential market for subacute services, and would not cause any adverse impact on competition in any relevant product or geographic market. In addition, as noted, subacute services are a substitute for certain acute care services. The American Health Care Association ("AHCA") estimates that as many as 30% to 40% of acute care patient days could be served in subacute beds in nursing facilities. AHCA currently is engaged in an effort to quantify these days by hospital Diagnostic Related Group ("DRG"), acuity, length of stay, etc., but it seems clear that there is a substantial degree of overlap between some acute care services and subacute nursing facility services.

Competition among Wisconsin nursing facilities tends to be limited. In many areas, most nursing facilities maintain very high occupancy -- 95%+ is not unusual -- and prospective residents

frequently accept placement in the first available bed without respect to the usual competitive considerations. Approximately 50% of all nursing facility residents are paid for by the Medicaid Program, which places residents in the first available bed without regard to price. In general, each nursing facility draws the vast majority of residents from the immediately surrounding community (or residents have family members nearby). Hillhaven facilities in urban and suburban areas typically draw the majority of their residents from immediately contiguous zip codes, and rural facilities rarely draw from beyond contiguous counties. There is no concept in long term care similar to that of the "tertiary care" hospital, i.e., a facility that attracts specialty cases from distant areas. A nursing facility that offer special services, e.g., a dementia care unit, subacute services, etc., or that has a good reputation, a convenient location, attractive premises, etc., might have some competitive advantages with respect to nearby facilities, especially for "private pay" patients, but it is very unusual for any potential resident to seek out a distant facility unless all closer facilities are full.

Hillhaven's fourteen facilities have a total of approximately 2800 licensed beds, of which approximately 360 beds are certified for skilled nursing care and could be devoted to subacute services. The four initial non-Hillhaven Members have a total of 558 licensed beds, of which approximately 56 beds would be devoted to subacute services. Hillhaven's intention is that at least one of the Network Participants would be reasonably convenient to every part of the State, although most probably would have to attract Network patients from beyond their customary service areas. Hillhaven is not sure at this time whether the Network will be able successfully to do so with the number and location of beds initially contemplated for membership. The Network Agreement permits Hillhaven, at its sole discretion, to select additional Network Members if necessary to assure adequate coverage and availability of beds.

It is extremely unlikely that the Network would control a substantial percentage of the subacute referrals or patient days either Statewide, or in any Member's local submarket. Again, precise estimates are not possible, but Hillhaven expects that for the foreseeable future, at least half of the residents of any subacute unit will be Medicare beneficiaries, and therefore not even potentially subject to the Network, which will involve only private managed care contracts. The private managed care market is unconcentrated and competitive, with additional insurance companies, health maintenance organizations, etc. offering new managed care plans to employers, unions, consumers, etc. continually. These plans also vary considerably regarding the amount and terms of coverage for long term care services.

Hillhaven believes that the largest managed care plan, Blue Cross/Blue Shield, has less than 15% of the non-governmental market. Hillhaven projects that 10% to 15% of the admissions to the Network's subacute beds will be referred through the Network.

It also is extremely unlikely that the Network could enter into contracts with every private managed care payor in the State. However, even in the unlikely event that the Network could do so, competition would not be foreclosed for several reasons. First, as is discussed below, the payor contracts will not be exclusive, even as to Network Members. Second, new payors are entering the market continually. Third, the Network will not control a substantial percentage of beds either Statewide, or in any local submarket. Fourth, only 10% to 15% of the admissions to the Network's subacute beds are projected to be referred through the Network. And fifth, there are no regulatory or significant economic barriers to conversion of existing beds to subacute services by additional competitors.

C. STRUCTURE AND OPERATION OF THE PROPOSED WISCONSIN SUBACUTE PREFERRED PROVIDER NETWORK

Hillhaven seeks to establish the Wisconsin Subacute Preferred Provider Network as a means to assure consistent quality of services and an efficient referral process in order to compete more effectively in the marketplace for managed care referrals.

1. The Product

Each prospective Member of the Network currently operates a duly licensed, Medicare and Medicaid certified nursing facility, and each will agree to continue to do so in substantial compliance with all applicable laws and regulations. Each Network Member will agree to operate a subacute nursing program in accordance with Hillhaven's "Twelve Minimum Critical Elements" that are outlined in the Network Agreement. Hillhaven will develop and maintain, with appropriate input from all Network Members and other appropriate sources, extensive clinical and administrative policies and procedures to effectuate these "Critical Elements." These policies and procedures, and the ongoing training, clinical support and quality assurance activities are at the heart of the services Hillhaven will provide to non-Hillhaven Members, and are important features to prospective payor-customers of the Network. In addition, Hillhaven will provide all Network Members with recruitment and staffing assistance, program development support, and marketing support for the Network.

Hillhaven also will include all Network Members in the Hillhaven Managed Care Referral Process that includes referral

intake through an "800" National Referral Telephone Line. The National Referral Process will maintain information regarding the location of available beds, and payors will call the Referral Line for referral to the closest available bed for their patients. This referral service will operate on a nondiscriminatory basis.

Hillhaven also may negotiate with payors the use of uniform administrative services such as uniform admission protocols, billing forms and procedures, utilization review procedures, and other non-price terms necessary efficiently to deliver a quality service.

Non-Hillhaven Members will pay Hillhaven a flat daily fee per Network patient, which the parties have determined is a fair market value for the support and referral services Hillhaven will provide.

2. **Selection and Termination of Members**

Hillhaven will have complete discretion to invite non-Hillhaven facilities to participate in the Network; to evaluate the compliance of non-Hillhaven Members with the Network Agreement; to terminate non-Hillhaven Members; and to add new Members to meet payor or service needs.

The Network Agreement will permit Hillhaven to invite additional facilities to become Members of the Network if Hillhaven has determined that additional subacute beds are needed to serve patients generated by Network referral sources in a particular geographic area, and existing Members are unwilling or unable to meet such demand to the satisfaction of Hillhaven or one or more referral sources. Hillhaven could consult with existing non-Hillhaven Members regarding the need for additional Members, but the Network Agreement will make clear that the final decision is in Hillhaven's sole discretion, and neither existing nor prospective members will be permitted to appeal or challenge such a decision under the Network Agreement. Because Hillhaven would add new Members only where existing Members were unwilling or unable to satisfy market demand, addition of new Members will not have an anticompetitive effect in the market. It is unlikely that Hillhaven would choose to add new Members in areas served by Hillhaven facilities, but the Network Agreement would permit Hillhaven to do so if demand so required.

Hillhaven likewise will have the sole discretion to terminate any Member from the network. The Network Agreement will set forth the grounds for termination. In no event will Hillhaven terminate a non-Hillhaven Member for failure to adhere to price terms negotiated by Hillhaven. Finally, the Network Agreement will

permit any non-Hillhaven Member to withdraw from the Network on 90 days written notice.

3. Competitive Safeguards

The Network Agreement will contain two significant provisions to prevent anticompetitive conduct. First, each non-Hillhaven Member independently will negotiate its own prices with each payor, and all Network members will be prohibited from exchanging cost or price information.

Second, the Network will be completely non-exclusive. Both Hillhaven and non-Hillhaven Members will be free, if they so choose, to enter into managed care contracts outside the Network, and to develop and market subacute and other services to any payor, including Network payors.

a. Pricing Issues

Hillhaven anticipates that it will take the lead to negotiate Network contracts with managed care payors, and that Hillhaven will negotiate prices for the Network services it provides as part of these contracts. This "Hillhaven price" will be established solely on the basis of Hillhaven's own costs, desired profit margin, and other factors affecting desirable rates, none of which would be shared with any non-Hillhaven Member.

Each "Payor Agreement" will provide that each non-Hillhaven Member must negotiate its own prices for such services. Hillhaven currently has a "standard price list" for various subacute services, and anticipates that it would make this list available to all potential payors and non-Hillhaven Members -- in fact, Hillhaven believes that this list already is common knowledge in the industry[1] -- but Hillhaven will not share with non-Hillhaven Members the actual prices Hillhaven agrees to with payors, which may well differ from the "standard price list." Hillhaven will not negotiate prices on behalf of non-Hillhaven Members, and will neither encourage nor discourage either payors or non-Hillhaven Members to use the "standard price list" in their own negotiations.

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[1] Virtually all long term care providers file publicly available government "cost reports" that set forth their cost data in great detail, and all daily room rates, prices for special services, etc. must be made available to the public under federal and state regulations. Nevertheless, the Network Agreement will prohibit members from exchanging among themselves any cost or price information.

Hillhaven anticipates that some payors will attempt to negotiate the same price with every member of the Network. Hillhaven will neither encourage nor discourage payors or non-Hillhaven Members from doing so, but, as noted, Hillhaven will not share its negotiated prices with non-Hillhaven Members. The Network Agreement will obligate non-Hillhaven members to negotiate in good faith to attempt to reach agreement with each payor with whom Hillhaven enters into a contract on behalf of the Network, but Hillhaven anticipates that it is possible that a non-Hillhaven Member may be unable to agree to terms with a payor. Hillhaven does not intend to "police" participation as such, but will need to know which Members have agreed to terms with which payors to facilitate operation of the central referral process.

The Network Agreement would permit any Member to agree to serve any Network payor's referrals outside of the Network should both parties so choose. Again, Hillhaven will not police that process, except to assure that adequate beds are available for Network referrals. As noted, should one or more Network Members fail or refuse to provide adequate availability of beds for Network referrals, Hillhaven could recruit additional Members.

Finally, the Network Agreement will provide that each Member is completely free to establish and price clinical programs outside the Network, and to apply their own admission, discharge or other procedures to services and patients outside the Network. Thus, each Network Member would continue to provide other services, and could compete with one another for all non-Network patients and services, including non-Network subacute patients.

b. <u>Non-exclusivity</u>

The Network Agreement will provide that any Network Member may enter into any agreement to provide routine skilled nursing or subacute services with or through any other network or payor (subject only to confidentiality restrictions on certain business and patient information). As noted above, any Network Member may choose to provide services to any Network payor outside the Network, and there will be no restrictions against serving referrals from Network payors after a Member withdraws from the Network.

Referrals to the Network will be based solely on the clinical needs and best interests of each patient. Each patient and referral source will be offered a free choice of providers (subject only to the provisions of applicable contracts between patients and their insurance companies or payors). No Member will be required to refer any patient to the Network or to any other Network Member for services.

CONCLUSION

The proposed network will provide the potential to increase the quality of services offered to patients, reduce the costs of subacute care by encouraging competition, and provide transactional efficiencies with little potential for anticompetitive effects.

I will be pleased to provide further information about the proposed preferred provider network for which Hillhaven seeks a statement of the Division's intentions. Hillhaven has not undertaken this activity, and does not intend to do so prior to an expression of the Division's intentions.

Sincerely,

Joseph L. Bianculli
Counsel to The Hillhaven Corporation

cc: Geralyn A. Kidera, Esq.
Bill Kirsch