

Trial Demonstratives

Christine M. Hammer, CPA

Assignment

Assess Mr. Gokhale's efficiency claims, focusing primarily on six criteria:

- ❖ Cognizability: Has Mr. Gokhale shown his claims are:
 - Verifiable?
 - Merger-specific?
 - Not due to reduction in output/service?

- ❖ Three additional criteria:
 - Shown to reduce variable costs.
 - Duly corrected for divestitures, individual commercial exits.
 - Correctly attributed to challenged product & geographic markets.

Basis for Approach

- ❖ Focus on Mr. Gokhale's reports and the documents he relies on:
 - “Efficiencies are difficult to verify and quantify, in part because much of the information relating to efficiencies is *uniquely in the possession of the merging firms*. Moreover, efficiencies projected reasonably and in good faith by the merging firms may not be realized. Therefore, it is *incumbent upon the merging firms to substantiate efficiency claims*”

Merger Guidelines § 10 (emphasis added)

Basis for Approach

❖ Verification process:

- “The verification process usually includes, among other things, an assessment of the parties’ analytical methods, including the ***accuracy of their data collection and measurement***, an evaluation of the ***reasonableness of assumptions in the analysis***, and scrutiny into how well the parties’ conclusions ***stand up to modifications in any assumptions*** (i.e., the “robustness” of the parties’ analysis).”

Merger Guidelines Commentary p. 52 (emphasis added)

Summary of Opinions

- ❖ Mr. Gokhale has failed to demonstrate that the asserted efficiencies are cognizable.
- ❖ Exception: A \$72.3M FTE synergy in Commercial Group has been shown to be cognizable.
 - Support cited in Mr. Gokhale’s Rebuttal Report
 - No similar support for other FTE synergies
 - “Commercial Group” is outside challenged markets

Summary of Opinions

❖ Mr. Gokhale has failed to consider one-time integration costs of \$1.4 billion.^[1]

- “Cognizable efficiencies are assessed net of costs produced by the merger or incurred in achieving those efficiencies.”

Merger Guidelines § 10

[1] AET-LIT008-0001693301, at -304
(Integration and Transaction Costs)

Summary of Opinions

- ❖ Mr. Gokhale has provided no way to distinguish between fixed and variable costs.
- ❖ Mr. Gokhale has not provided sufficient documentation or analysis for the adjustments made for divestitures and individual commercial exits.
- ❖ Mr. Gokhale has not attributed efficiencies to the challenged markets.

Expert Work

- ❖ “Aetna’s synergy expert will detail the verifiable and merger-specific synergies that arise from the Transaction in a forthcoming report (‘Synergies Report’) to be submitted on October 21, 2016. . . . Aetna also will produce with the Synergies Report any document or data containing the calculations or models used to quantify and attribute each such efficiency, and the associated costs, relied upon by the synergy expert in its analysis.”

PX0347: Aetna’s response to 2nd Set of Interrogatories
(9/28/16)

AETNA/COVENTRY

Mr. Gokhale’s “three primary similarities” between the two transactions.

- ❖ Aetna increased its membership base.
- ❖ Aetna expanded and enhanced its geographic profile.
- ❖ Aetna has used some of the same people, consultants, and “playbooks” to estimate synergies in Aetna/Humana as were used to track synergies following Aetna/Coventry.

Source: Mr. Gokhale’s Rebuttal
Report (DX0577), p.4

Mr. Gokhale's Cognizable Efficiency Claims for 2020

Efficiency Type	Gokhale Cognizable Efficiency Claim ^[1]
Administrative Costs	
Savings from Reductions in Full Time Equivalent Staff:	
FTE - Duplicative Roles (Commercial Group)	\$72.3
FTE - Other Duplicative Roles	\$333.0
FTE - Lift and Load	\$114.5
Savings from Reductions in Purchased Goods & Services:	
IT Amortization	\$122.0
Other Non-FTE Savings	\$277.0
Total Administrative/SG&A Costs	\$918.7
Medical Costs	
Pharmacy (excl. FTEs)	
Pharmacy (Rebate Maximization)	\$202.8
Pharmacy ██████████ Costs-avoided	\$37.5
Pharmacy (Remaining Savings net of \$1.9M Revenue)	\$9.7
Clinical Services	
Concurrent Review	\$160.0
Reimbursement/Clinical Claim Review	\$61.1
Network & Specialty	\$275.4
Medical cost side of RRA for In-home assessment prioritization (\$18.6 + \$7.7)	\$26.3
Total Medical Costs	\$772.9
Total Cost Savings Claimed	\$1,691.6
Revenue	
Pharmacy Revenues-increase AET MA Mail Order & Specialty Utilization ^[2]	\$90.6
Star Ratings Bonus Increase	\$95.0
Insource HUM's Medicaid to Aetna's In-House Operations	\$73.8
Insource AET's Record ID to HUM Team to incr Risk Adj. Revenue	\$95.2
Total Revenue excluding shock loss of \$8.5 billion (2018)^[3]	\$354.6
Cost Savings Claimed plus Incremental Revenue Claimed	\$2,046.2

[1] Mr. Gokhale does not provide estimates for 2017, 2018, and 2019.

[2] Pharmacy Revenues also include \$22.3 million incremental Network Processing Fee Revenue and \$1.9 million Pretax opportunity by fulfilling Aetna's Medicare OTC benefit via Humana Pharmacy versus retail.

[3] Source: PX0324 (Vision 2020: Building a Healthier World), at 144.

Overview Observations

- ❖ Mr. Gokhale has failed to properly assess the assumptions of the underlying methodologies.
- ❖ Mr. Gokhale has failed to verify the data.

Overview Observations

Assumptions

- ❖ Haircuts
- ❖ Best of the two contracts (“BOTC”) approach

Overview Observations

Implicit Assumptions in Mr. Gokhale's BOTC Approach

- ❖ Post-merger, the combined volume can be purchased under the terms of the more favorable contract.
- ❖ All suppliers are interchangeable.
- ❖ Price differentials at the “baseline” time would have remained in place in perpetuity.
- ❖ Price differentials are always due to unique differences in negotiating skill or scale.

Pharmacy (Rebate Maximization)



Pharmacy (Rebate Maximization)

Drug: [REDACTED] (Medicare [REDACTED])

❖ Required Action:

- Humana to use all Aetna contracts for [REDACTED] drugs, including [REDACTED].

❖ Assumption:

- Single point rebate differential (Q4 2015) is representative of future rebate differentials, in perpetuity.

❖ Result:

- PSG calculated recurring synergies of \$3.2 million, based on rebate rate differentials observed in Q4 2015.

Pharmacy (Rebate Maximization)

❖ [REDACTED] and [REDACTED] expected future rebate rates for [REDACTED]. (Stand-alone basis.)

[REDACTED]					
	PSG	Rebate Data From Each Company			
	2015 Rebate %	2016 Rebate %		2017 Rebate %	
Company	Q4	Q1	Projected Exit	Contracted	Projected Exit
[REDACTED]	40%	40%	40%	40%	40%
[REDACTED]	28%	55%	66%	55%	69%
Rebate Differential	12%	(15%)	(26%)	(15%)	(29%)

Source: PX0183, AET-PSGLIT-0000000065, AET-PSGLIT-0000000002

Pharmacy (Rebate Maximization)

Drug: [REDACTED]

❖ Required Action:

- [REDACTED] to use [REDACTED] contract with [REDACTED] for the drug [REDACTED].

❖ Result:

- PSG calculated synergies of \$42.9 million.

[REDACTED]

Company	PSG		Rebate Data From Each Company			
	2015 Rebate %		2016 Rebate %		2017 Rebate %	
	Q4	Q1	Projected Exit	Contracted	Projected Exit	
[REDACTED]	33%	40%	40%	Not Covered	0%	
[REDACTED]	16%	15-17%	18-20%	65%	65%	
Rebate Differential	17%	23-25%	20-22%	(65%)	(65%)	

Pharmacy (Rebate Maximization)

FW: Thoughts on Synergies

From:
"Kost, Brian J" <kostb@aetna.com>
To:
"Crowley, Howard K" <crowleyh@aetna.com>
Date:
Fri, 12 Aug 2016 18:57:33 +0000

If we do anything it should be part of a broader initiative for all areas, not just RX, since all areas are impacted by these delays.

Also both companies are reducing their IVL footprint materially which impacts the baseline significantly.

From: Raymond Pryor [mailto:rpryor2@humana.com]
Sent: Friday, August 12, 2016 2:39 PM
To: Mark Morse; Crowley, Howard K
Cc: Mark McCullough; Kost, Brian J; Tim Nordstrom
Subject: Thoughts on Synergies

Good Afternoon All -

Given the recent announcement of the Aetna/Humana trial date (December 5th) I wanted to throw some thoughts out on our synergy estimates.

Our current synergy submission, considering divestitures, estimates \$290M - \$729.2M in net synergies to the new organization. However, given the postponement of the potential close, I believe we will need to re-evaluate the Network Discount Maximization (Medicare and Commercial) and Rebate Optimization (Medicare and Commercial) synergies closer to the trial date.

My thought is that the synergy value on these areas does not simply move from one year to the next because the baseline opportunity may change:

- As our respective network contracting and rebate teams negotiate better network rates and rebates independently of one another, the 2017 synergy estimates may erode instead of being deferred until 2018.
- The baseline for the synergy estimates was 2015 data; while each entity submitted estimated improvements to Deloitte, we never received the output of their "longitudinal" analysis to my knowledge. Many synergy estimates are sensitive to increases in membership and utilization, but rebates and pharmacy network are unique in that they are also sensitive to the day-to-day work of our supply chain teams, to changes in utilization mix of members, drug pipeline, generic launches, and drug inflation (brand, generic, and specialty).

I am not proposing that we go through another clean room process, but I think that everyone on this note should discuss how we should adjust our approach on evaluating synergies that may be significantly impacted by a postponement in the close date (subsequent to 12/31/2016).

If all agree, I will set up a call and we can determine what next steps we should take.

Thanks,

Raymond Pryor
Strategic Consultant, Humana Pharmacy

- "As our respective network contracting and rebate teams negotiate better network rates and rebates independently of one another, the 2017 synergy estimates may erode instead of being deferred until 2018."

PX0137: Email chain from Brian J. Kost (Exec. Dir., CFO Pharmacy, Aetna) to Howard K. Crowley (Aetna's leader of the Pharmacy functional team), "FW: Thoughts on Synergies," 08/12/16

Concurrent Review

- ❖ Concurrent Review: “Real-time” review of a physician’s recommendation regarding:
 - Admission to acute-care hospital
 - Admission to post-acute setting (rehab., etc.)
- ❖ Issues:
 - Snapshot in time of denial rates
 - Many BOTC issues apply
 - Haircuts: 40%-plus

Concurrent Review

- ❖ Impact on Quality: Efficiency claims are calculated by
 - Increasing denials of care
 - Downgrading to a lower level of care, e.g., “observation”

Concurrent Review

“I understand that *in conducting the analysis supporting the Concurrent Review savings*, the PWC and Aetna-Humana teams reviewed data on outcomes using each company’s Concurrent Review policies *and selected policies that maintained or improved outcomes.*”

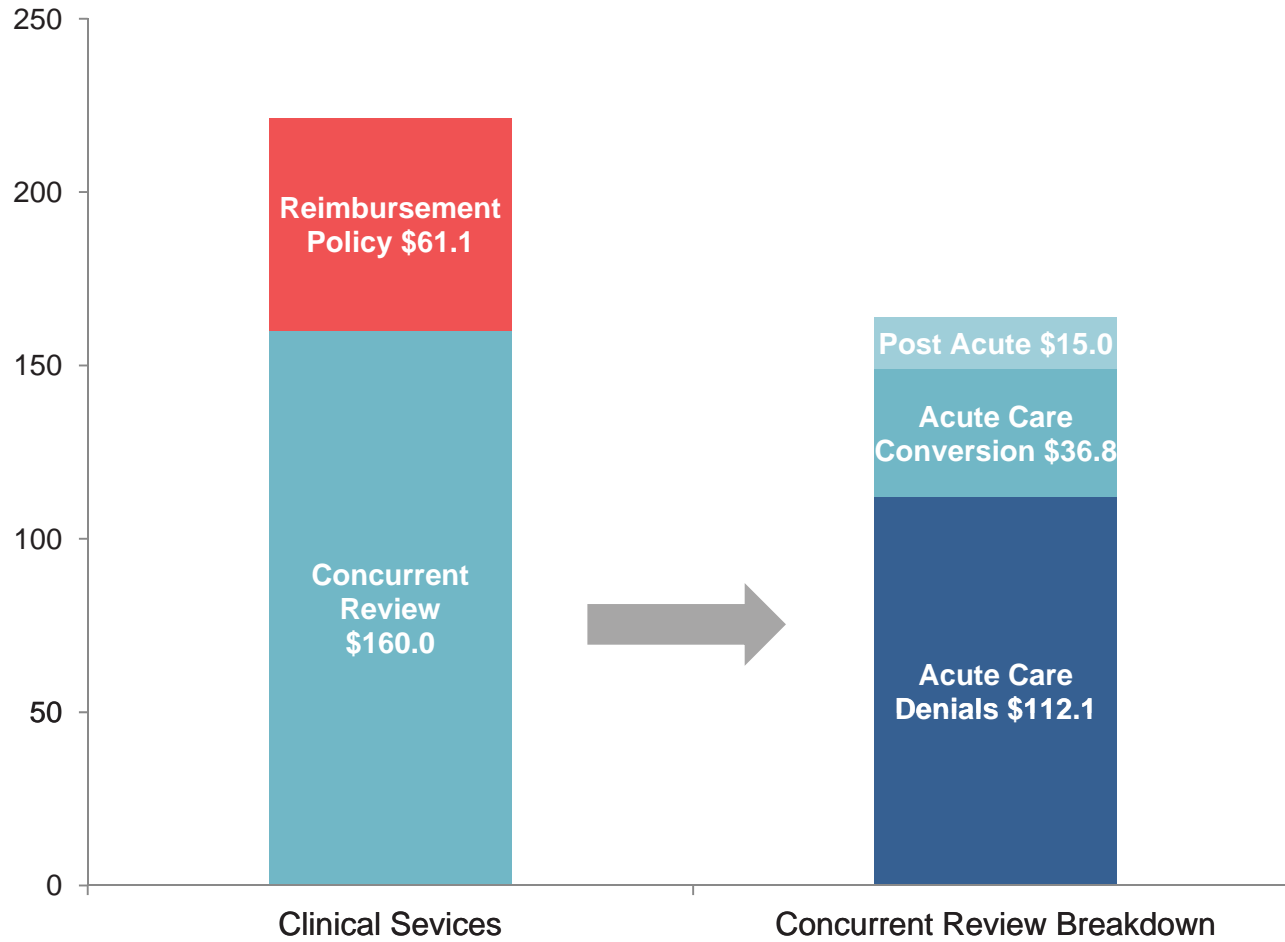
DX0420: Gokhale Report ¶ 188 (emphasis added)

“I think this was an understanding I had at the time of the report that the analysis was isolated to or somehow strongly influenced by looking at certain policies. But as my understanding improved . . . in fact, I think what they did was based more on the metrics on a head-to-head comparison, not solely on a subset of policies.”

Gokhale Dep. 92:13-23

Concurrent Review

(\$ In Millions)



Concurrent Review

Implementation Challenges

- “To facilitate synergy realization, existing provider exemptions need to be resolved; nearly one-third of [REDACTED] providers (**9 out of Top 10**) currently **have some concurrent review exemptions.**”

DX0209, at -003 (emphasis added)

Network

- ❖ BOTC approach at provider level
- ❖ Implementation challenges

Network

PWC Interviews with Aetna and Humana Managers

- “I would be surprised if the hospitals don’t initiate a terminate notice with us now that they’ve been through this process before. . . .”

PX0192, at 4

- “[REDACTED] has been especially difficult. [REDACTED] have made it clear that Humana rates are much better and they said they would terminate our contracts if we try to apply our rates to the Aetna book of business”

- “I think it’s going to be *extremely difficult* – I’ve talked to many hospital systems. Hospitals have said that they *haven’t merged Aetna-Coventry because of differences in rates*”

PX0141, at 2 (emphasis added)

Mr. Gokhale's Cognizable Efficiency Claims for 2020

Efficiency Type	Gokhale Cognizable Efficiency Claim ^[1]
Administrative Costs	
Savings from Reductions in Full Time Equivalent Staff:	
FTE - Duplicative Roles (Commercial Group)	\$72.3
FTE - Other Duplicative Roles	\$333.0
FTE - Lift and Load	\$114.5
Savings from Reductions in Purchased Goods & Services:	
IT Amortization	\$122.0
Other Non-FTE Savings	\$277.0
Total Administrative/SG&A Costs	\$918.7
Medical Costs	
Pharmacy (excl. FTEs)	
Pharmacy (Rebate Maximization)	\$202.8
Pharmacy ██████ Costs-avoided ██████	\$37.5
Pharmacy (Remaining Savings net of \$1.9M Revenue)	\$9.7
Clinical Services	
Concurrent Review	\$160.0
Reimbursement/Clinical Claim Review	\$61.1
Network & Specialty	\$275.4
Medical cost side of RRA for In-home assessment prioritization (\$18.6 + \$7.7)	\$26.3
Total Medical Costs	\$772.9
Total Cost Savings Claimed	\$1,691.6
Revenue	
Pharmacy Revenues increase AET MA Mail Order & Specialty Utilization ^[2]	\$90.6
Star Ratings Bonus Increase	\$95.0
Insource HUM's ██████ Medicaid to Aetna's In-House Operations	\$73.8
Insource AET's Record ID to HUM Team to incr Risk Adj. Revenue	\$95.2
Total Revenue excluding shock loss of \$8.5 billion (2018)^[3]	\$354.6
Cost Savings Claimed plus Incremental Revenue Claimed	\$2,046.2

[1] Mr. Gokhale does not provide estimates for 2017, 2018, and 2019.

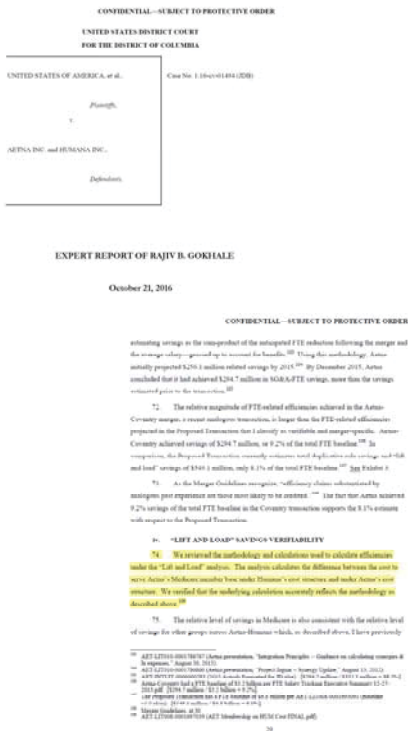
[2] Pharmacy Revenues also include \$22.3 million incremental Network Processing Fee Revenue and \$1.9 million Pretax opportunity by fulfilling Aetna's Medicare OTC benefit via Humana Pharmacy versus retail.

[3] Source: PX0324 (Vision 2020: Building a Healthier World), at 144.

SG&A – FTE - Lift and Load

“The **[Lift & Load] analysis** calculates the difference the cost to serve Aetna’s Medicare member base under between Humana’s cost structure and under Aetna’s cost structure. **We verified that the underlying calculation accurately reflects the methodology as described above.**”

DX0420: Gokhale Report, ¶ 74 (emphasis added)



SG&A – FTE - Lift and Load

Hard-Coded Numbers Are Not Verifiable

AET-LIT008-0001697289 (Medicare Integration - Levels and Layers Analysis) - Microsoft Excel

File Home Insert Page Layout Formulas Data Review View Acrobat iCom Tools

L40 =134000000-K40

	A	B	C	D	E	F	G	H	I	J	K	L	M	
1								Savings						
2	Org Level	Start Date	Variance (Current - End State)	Avg. Salary	Benefits	Total		2017	2018	2019	2020			
3	Layer 4	3/1/2017	2	\$250,000	\$75,000	\$325,000		\$541,667	\$650,000	\$650,000	\$650,000			
4	Layer 5													
5		4/1/2017	6	\$200,000	\$60,000	\$260,000		\$1,072,500	\$1,430,000	\$1,430,000	\$1,430,000			
6		5/1/2017	6	\$200,000	\$60,000	\$260,000		\$953,333	\$1,430,000	\$1,430,000	\$1,430,000			
7	Layer 6													
8		4/1/2017	21	\$125,000	\$37,500	\$162,500		\$2,559,375	\$3,412,500	\$3,412,500	\$3,412,500			
9		5/1/2017	21	\$125,000	\$37,500	\$162,500		\$2,275,000	\$3,412,500	\$3,412,500	\$3,412,500			
40								\$7,401,875	\$10,335,000	\$10,335,000	\$10,335,000	\$123,665,000	1717	
41														
42														
43	Layers 7-12	5/1/2017	54	\$55,415	\$16,625	\$72,040		\$2,576,354	\$3,864,531	\$3,864,531	\$3,864,531			
44		6/1/2017	54					\$2,254,310	\$3,864,531	\$3,864,531	\$3,864,531			
45		7/1/2017	54					\$1,932,266	\$3,864,531	\$3,864,531	\$3,864,531			
46		8/1/2017	54					\$1,610,221	\$3,864,531	\$3,864,531	\$3,864,531			
47		9/1/2017	54					\$1,288,177	\$3,864,531	\$3,864,531	\$3,864,531			
48		10/1/2017	54					\$966,133	\$3,864,531	\$3,864,531	\$3,864,531			
49		11/1/2017	54					\$644,089	\$3,864,531	\$3,864,531	\$3,864,531			
50		12/1/2017	54					\$322,044	\$3,864,531	\$3,864,531	\$3,864,531			
51		7/1/2018	644						\$23,187,188	\$46,374,375	\$46,374,375			
52		7/1/2019	644							\$23,187,188	\$46,374,375			
53			1,717		0.3			\$11,593,594	\$54,103,438	\$100,477,813	\$123,665,000			
54														
55			1,772			\$75,637		\$18,995,469	\$64,438,438	\$110,812,813	\$134,000,000			
56														
57														

SG&A – IT Amortization

What is a valid synergy?

What is a Valid Synergy Hypothesis

- Reduction in SG&A overhead due to simplification or rationalization of processes
- Better utilization of existing spend to expand best practices or lower unit costs – Medical and SG&A
- Reduced spend on overlapping services or programs
- Leveling of performance disparities to capture benefits from “raising the bar” of the lower performing organization
- Elimination of redundant capital investment spending
- Consolidation of applications (or technology)
- Consolidation of operations to reduce lease expense, use/occupancy/real estate taxes and utilities
- Reduction in expense (SG&A or Medical) from contract rationalization
- Cross-sell opportunities

What is NOT a Valid Synergy Hypothesis

- Savings that would occur regardless of the merger
 - **Avoided yet unbudgeted costs**
 - Savings for costs redistributed to other parts of the combined organization to another (e.g., moving FTEs from one cost center to another without valid growth assumptions)
 - Double counting synergies (e.g., procurement team negotiates 20% rate discount and impacted functional team claims these same savings)
 - **Savings in non-cash items (e.g., depreciation or amortization)**
 - Savings for functional area that aren't savings for the organization (e.g., reduce footprint/vacate space with no sublease identified)
- In addition, a synergy is only valid when teams have:**
- **Captured direct cause-effect measurement of the saving**
 - Captured the costs to achieve them

No Claimed In-Market Efficiencies

1

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

-----X

UNITED STATES OF AMERICA,
et al.,

Plaintiffs,

V. Civil Action
1:16-cv-1494
(JSD)

ARTNA INC. and HINGOJA INC.,
Defendants.

-----X

VIDEOTAPED DEPOSITION OF
RAJIV GOKHALE
Washington, D.C.
November 21, 2016
9:04 a.m.

Reported by:
Karen Brynson, RMR, CSR, FARR
Job No. 47418

267

1 So in a particular county if one
2 or the other were to leave, whatever
3 effect that has on the -- on the
4 post-merger firm would be embedded, I
5 assume, in this 121.

6 Put differently, the 121 assumes
7 they will divest as they have announced
8 they will divest.

9 Q. Okay. And I understand that
10 that's gone. But is there any way to tell
11 what they will retain in those markets?

12 A. I have to go back and look. It
13 is not something I have done the math for
14 or analyzed this for yet.

15 Q. Is it -- do you have a sense of
16 how we would, how you'd go about doing
17 that?

Conclusion

- ❖ Mr. Gokhale has not shown that his claimed efficiencies are cognizable, with the exception of \$72.3M in SG&A-FTE Commercial Group efficiencies, which are outside the challenged markets.
- ❖ Mr. Gokhale has not attempted to calculate the efficiencies specific to the challenged markets.

See Expert Reports for Complete Opinions

- ❖ PX0562: Supplemental and Rebuttal Report of Christine M. Hammer (11/11/16)
- ❖ PX0561: Expert Report of Christine M. Hammer (10/21/16)