Testimony of Professor Lawton Robert Burns

DECEMBER 9, 2016

Summary of Opinions

Summary of Opinions

- The proposed divestiture is unlikely to effectively preserve competition
- The divestiture would not provide Molina with the resources necessary to compete
- The ASA does not overcome Molina's weaknesses
- Molina is acquiring the Medicare Advantage lives for a low price
- Molina's prior failure in individual Medicare Advantage confirms the divestiture is risky

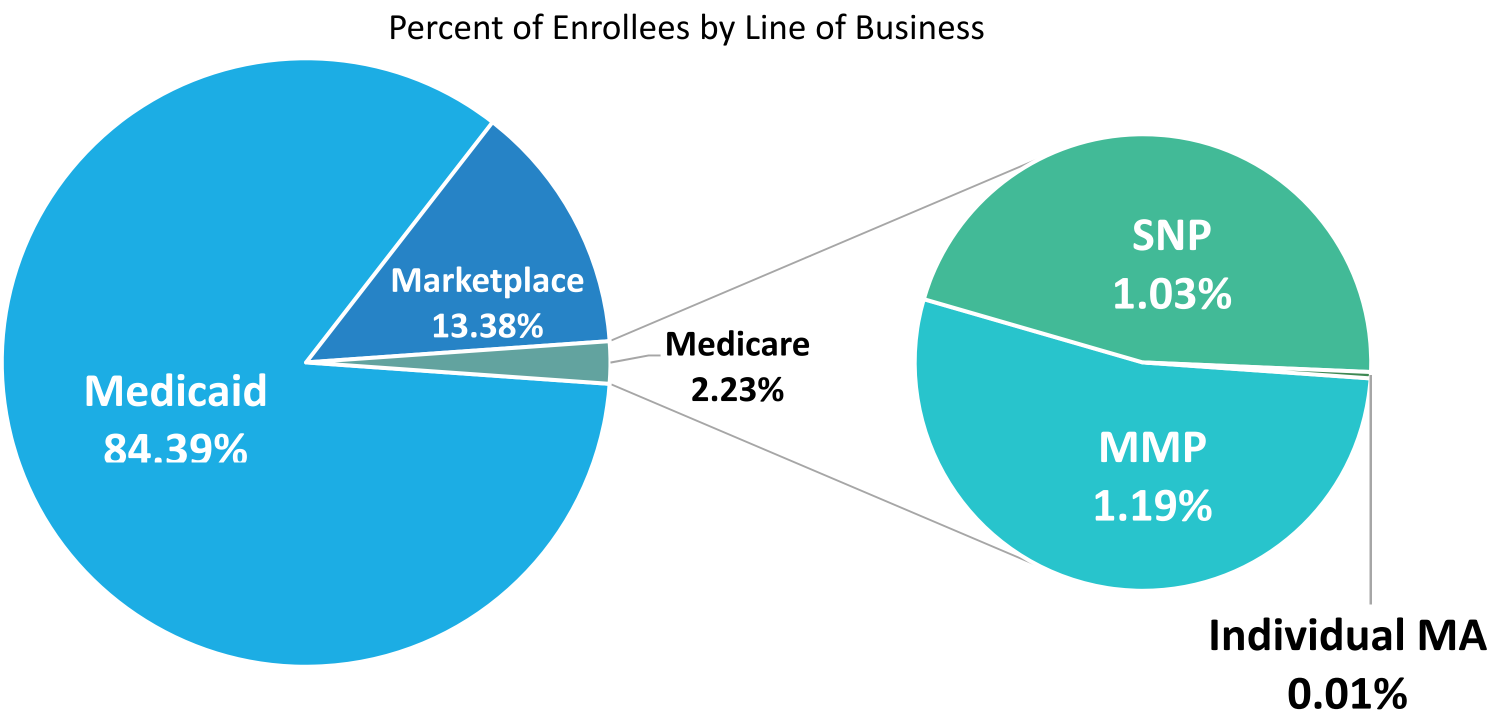
Overview of Molina

Medicaid v. Medicare

	Medicaid	Medicare
Population	Low income families, qualified pregnant women and children, and individuals receiving Supplemental Social Security Income	Individuals 65 years of age or older or those who have certain disabilities or other specific conditions and who generally age in from employer-sponsored plans
Networks	Generally narrow provider networks	Provider networks often broader
Marketing	Substantial membership through auto-enrollment	No auto-enrollment; direct-to-consumer marketing

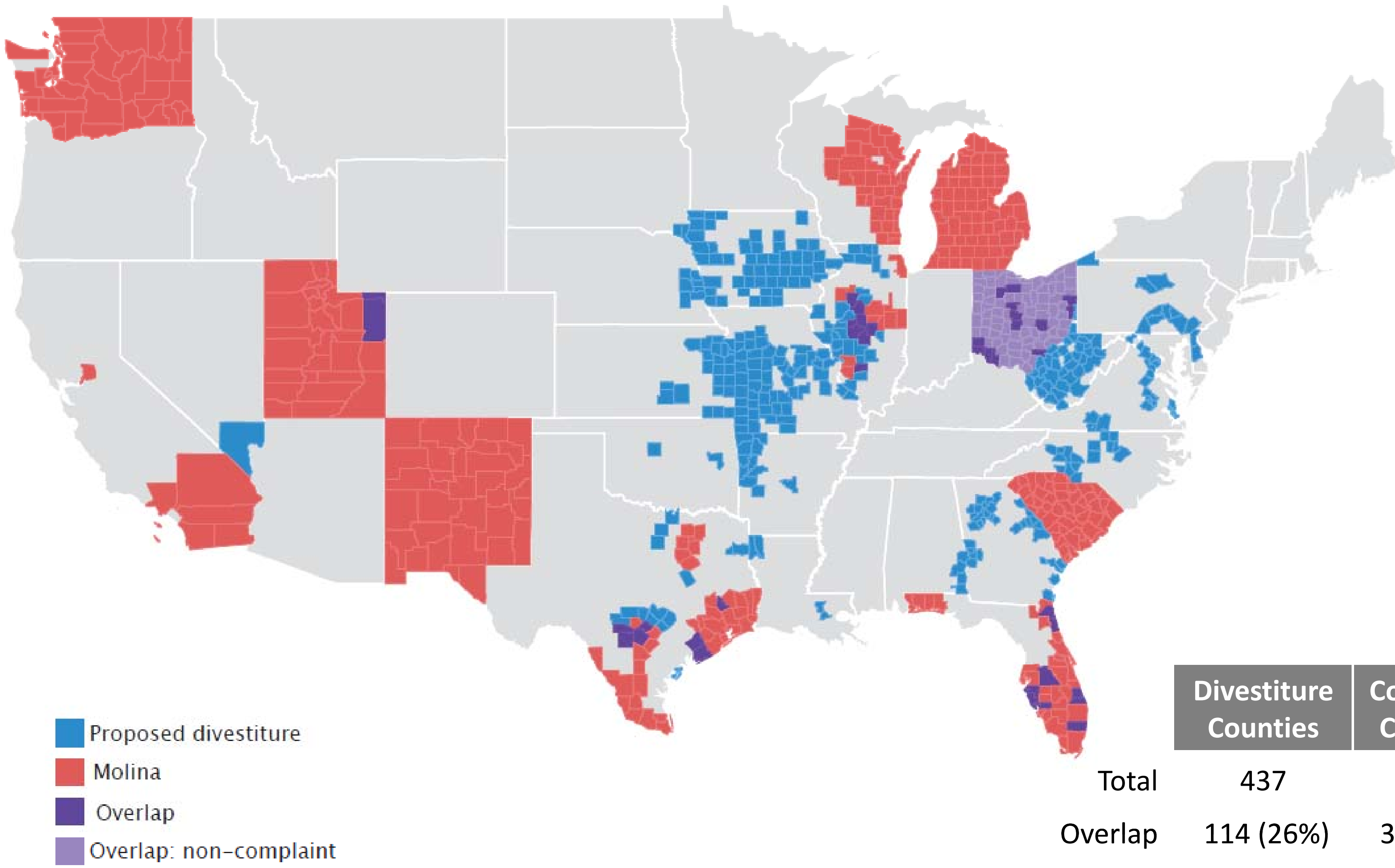
Molina Is a Medicaid Company

- Molina's exchange and D-SNP businesses are in the same states as its Medicaid business and target similar populations



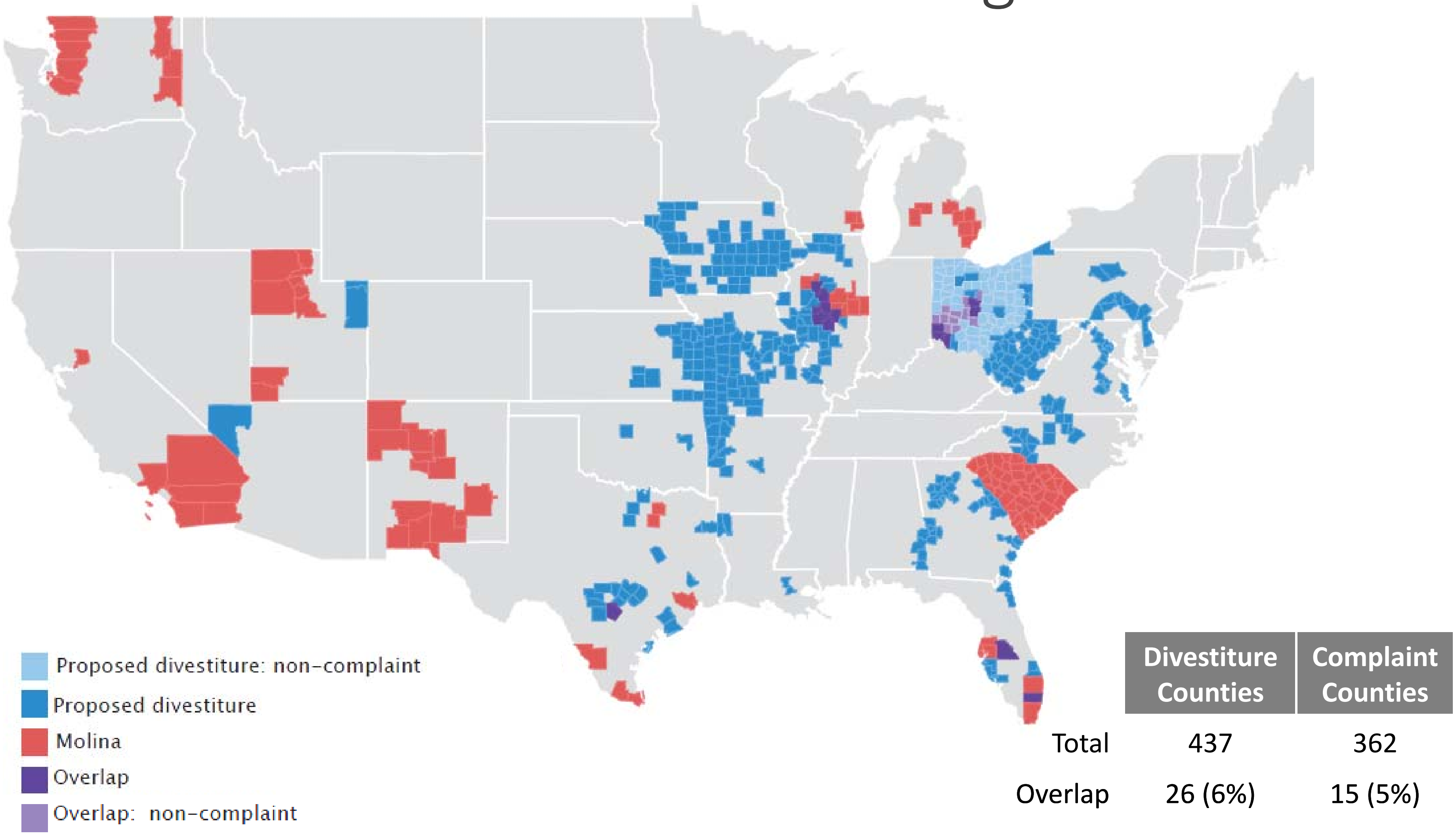
Source: Molina HealthCare, Inc., SEC Form 10-Q for period ended Sept. 30, 2016, at 35.

Molina's Current Footprint: All Plans



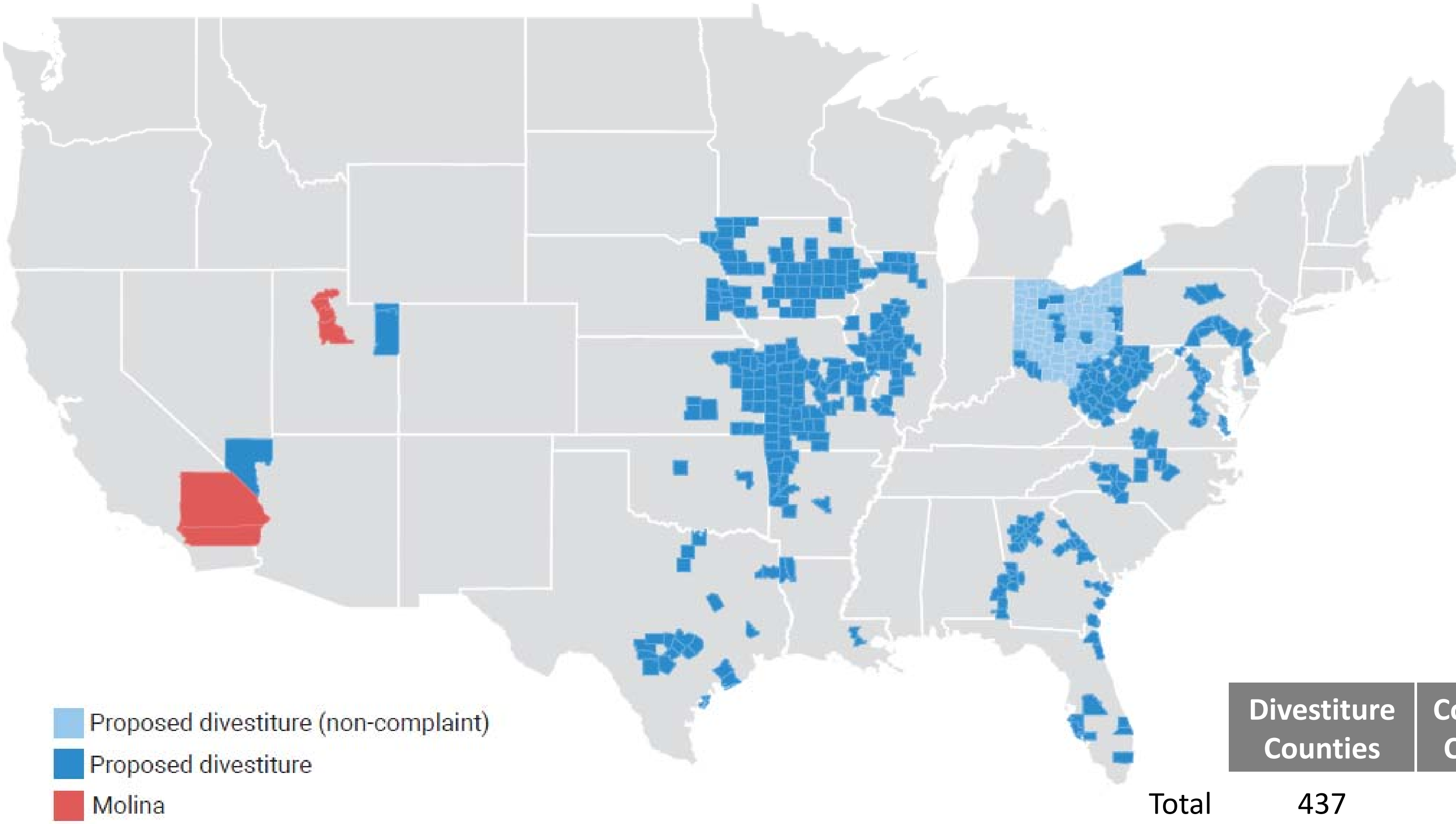
	Divestiture Counties	Complaint Counties
Total	437	362
Overlap	114 (26%)	39 (11%)

Molina's Current Footprint: Medicare Advantage



	Divestiture Counties	Complaint Counties
Total	437	362
Overlap	26 (6%)	15 (5%)

Molina's Current Footprint: Individual Medicare Advantage



	Divestiture Counties	Complaint Counties
Total	437	362
Overlap	0	0

Molina's Finances

- Molina has the highest debt-to-equity ratio in the industry: 52.4%
- Molina's bonds are considered not to be investment grade

Bond Rating	
Molina	BB
Aetna	A-
Humana	A-

A rating BBB- or above is considered investment grade; a rating BB++ or below is considered junk status.

See, e.g., Charles Schwab, Guide to Sub-Investment Grade/High Yield Bonds

The Divestiture Would Not Provide Molina with the Resources Necessary to Compete

Molina Would Not Receive the Resources that are Necessary to Compete

	Sale of an Intact Business	Proposed Divestiture
Provider Contracts	✓	✗
Star Ratings Infrastructure	✓	
Broker Network	✓	
Recognized Individual MA Brand	✓	
Employees and Infrastructure	✓	
Experience with PPO Plans	✓	

Provider Networks Are Important to Individual Medicare Advantage Competition

- Provider networks are a key factor affecting consumer choice
- Provider networks are a key factor affecting profitability and quality of Medicare Advantage plans

Value-Based Contracts Are Important to Medicare Advantage Competition

- Value-based contracts (VBCs) lower costs and make Medicare Advantage plans more competitive
  - Cost metrics
  - Performance metrics
- Aetna's goal: 75% to 80% VBCs by 2020
- Challenges for Molina:
  - Scale
  - Provider relationships
  - Local presence

Scale Is Important for Obtaining Competitive Provider Networks

- Scale is important for obtaining price and non-price terms

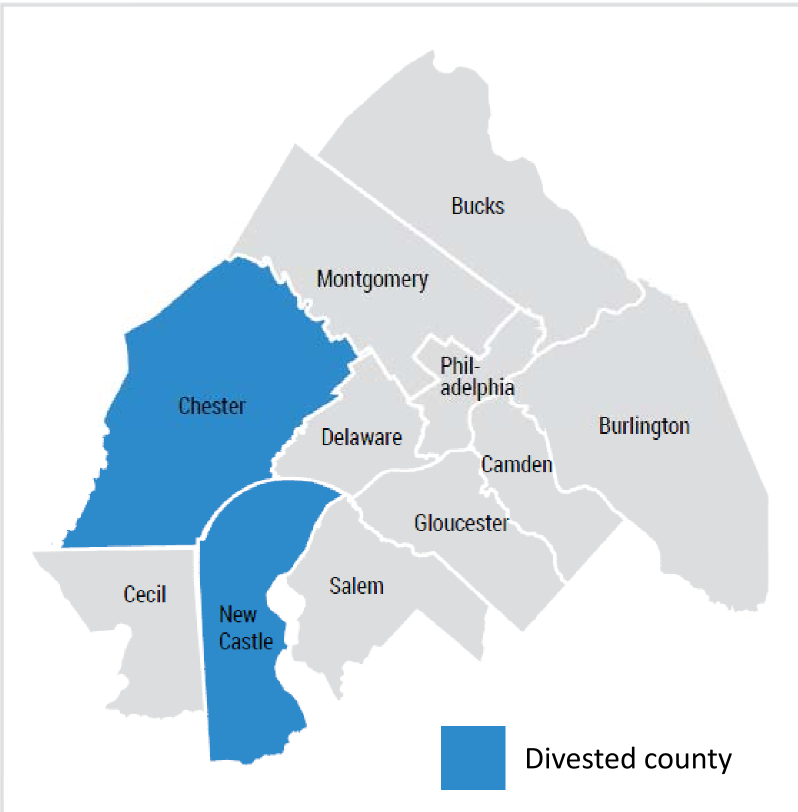
- Examples of important non-price terms include:
  - Collaborations to improve star ratings
  - Participation in value-based contracts

Reasons That Molina Would Lack Scale

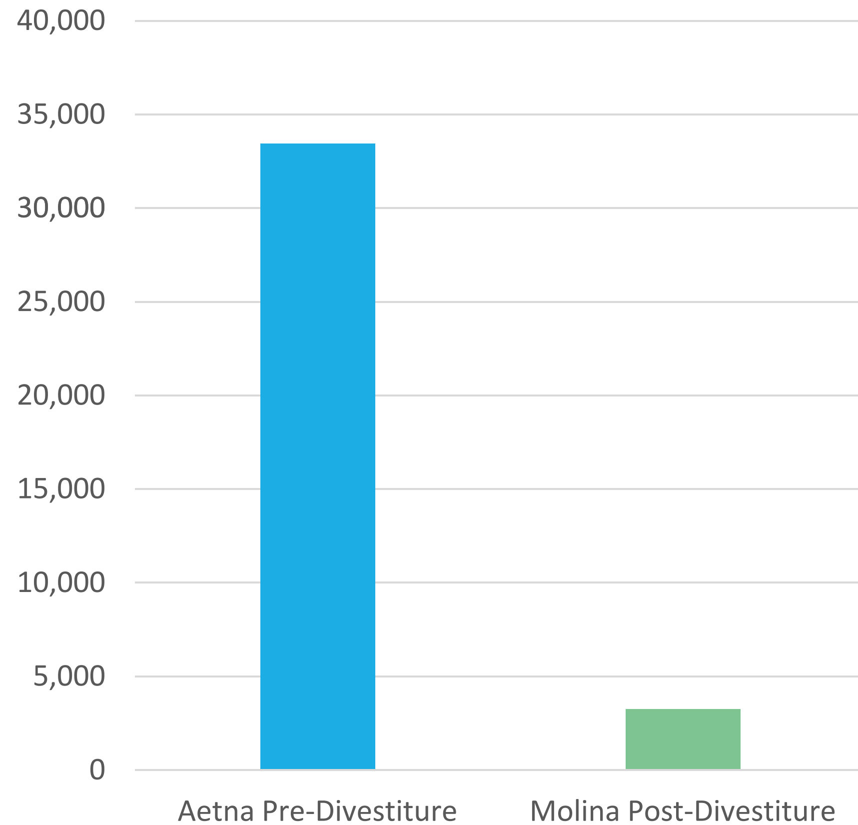
- Partial divestiture of counties in some MSAs
- Contiguous counties not always divested
- No group Medicare Advantage lives
- No Special Needs Plan Medicare Advantage lives

Example of Molina's Disadvantage in Scale: Philadelphia

Proposed Divestiture Counties in Philadelphia MSA

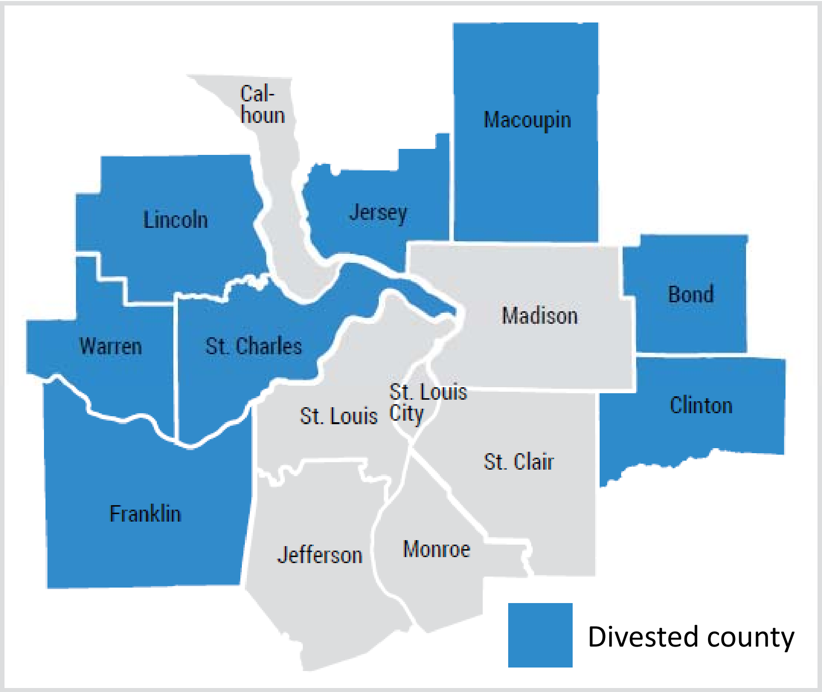


Individual MA Lives for Aetna Pre-Divestiture and Molina Post-Divestiture: Philadelphia MSA

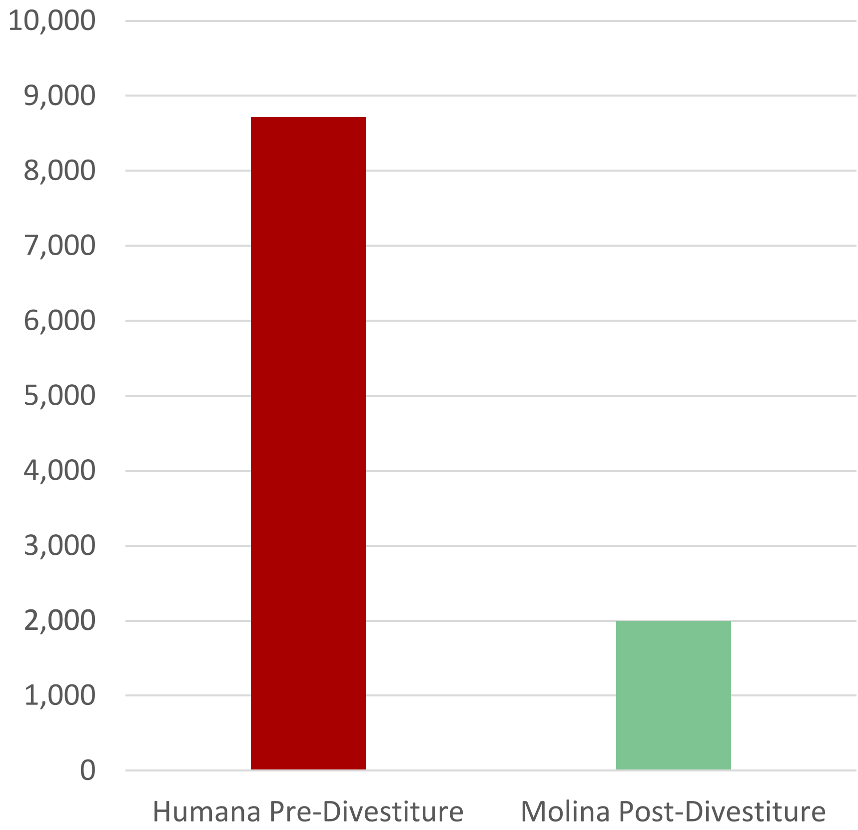


Example of Molina's Disadvantage in Scale: St. Louis

Proposed Divestiture Counties in St. Louis MSA



Individual MA Lives for Aetna Pre-Divestiture and Molina Post-Divestiture: St. Louis MSA



Molina Would Have Difficulty Building a Competitive Provider Network

- Aetna: **38,000** provider contracts used to serve members in divestiture counties
- Negotiating provider contracts – particularly VBCs – can take significant time
  - Aetna entering Georgia: 2 years
- The ASA is unlikely to provide Molina with substantial assistance
  - Aetna's obligations are limited to "facilitating discussions"
  - Contracts may not be assigned to Molina

Molina Would Not Receive the Resources that are Necessary to Compete

	Sale of an Intact Business	Proposed Divestiture
Provider Contracts	✓	✗
Star Ratings Infrastructure	✓	✗
Broker Network	✓	
Recognized Individual MA Brand	✓	
Employees and Infrastructure	✓	
Experience with PPO Plans	✓	

Star Ratings

- A quality rating system that measures thirty two individual metrics
- Star ratings address five criteria:
  - Preventative care
  - Chronic conditions
  - Member experience
  - Member complaints and changes in plan performance
  - Customer service

Star Ratings Are Important to Medicare Advantage Competition

Star Rating	Benchmark	Rebate %
3 Stars or fewer	100%	50%
3.5 Stars	100%	65%
4 Stars	105%	65%
4.5 Stars or above	105%	70%

Star ratings translate directly into greater benefits to consumers

Molina Would Be Challenged to Maintain Competitive Star Ratings

- Molina has never had an individual Medicare Advantage contract rated four stars or higher
  - One D-SNP contract in New Mexico obtained a four-star rating for the first time in 2017
- Molina lacks the stars infrastructure of the divesting parties
- If unsuccessful, Molina may not be able to maintain the divested plans’ benefits

Molina Would Not Receive the Resources that are Necessary to Compete

	Sale of an Intact Business	Proposed Divestiture
Provider Contracts	✓	✗
Star Ratings Infrastructure	✓	✗
Broker Network	✓	✗
Recognized Individual MA Brand	✓	
Employees and Infrastructure	✓	
Experience with PPO Plans	✓	

Brokers Are Important to Medicare Advantage Competition

- Brokers drive consumer choice
- Insurers compete for brokers’ attention
  - Brokers invest time to obtain certification, e.g., annual training course
  - Relationship building is key
  - Brokers want to work with well-known, stable insurers that offer competitive plans

Molina Would Have Difficulty Establishing Competitive Broker Relationships

- Molina does not have a large network of individual Medicare Advantage brokers
- Molina lacks a local presence in the majority of divestiture counties
- Molina lacks a competitive Medicare Advantage brand

Molina Would Not Receive the Resources that are Necessary to Compete

	Sale of an Intact Business	Proposed Divestiture
Provider Contracts	✓	✗
Star Ratings Infrastructure	✓	✗
Broker Network	✓	✗
Recognized Individual MA Brand	✓	✗
Employees and Infrastructure	✓	
Experience with PPO Plans	✓	

Brand is Important to Medicare Advantage Competition

- Seniors use brand to infer an individual Medicare Advantage product's quality
- Brokers consider brand
- Aetna continues to use the Coventry brand

Molina Would Not Have a Competitive Individual Medicare Advantage Brand

- Molina's brand is largely unknown among individual Medicare Advantage customers
- Molina is not acquiring the divesting party's brand
- Building a competitive Medicare Advantage brand requires significant time and investment

Molina Would Not Receive the Resources that are Necessary to Compete

	Sale of an Intact Business	Proposed Divestiture
Provider Contracts	✓	✗
Star Ratings Infrastructure	✓	✗
Broker Network	✓	✗
Recognized Individual MA Brand	✓	✗
Employees and Infrastructure	✓	✗
Experience with PPO Plans	✓	

Molina Is Not Acquiring Other Assets Important to Medicare Advantage Competition

- Molina is not acquiring employees
  - Sales
  - Marketing
  - Actuaries
  - Others
- Molina is not acquiring other valuable infrastructure
  - IT systems/integration
  - Local office locations

Molina Would Not Receive the Resources that are Necessary to Compete

	Sale of an Intact Business	Proposed Divestiture
Provider Contracts	✓	✗
Star Ratings Infrastructure	✓	✗
Broker Network	✓	✗
Recognized Individual MA Brand	✓	✗
Employees and Infrastructure	✓	✗
Experience with PPO Plans	✓	✗

Molina Lacks Experience Managing PPO Plans

- Over 50% of the plans to be divested are PPO plans
- Molina has no experience operating preferred-provider organization (PPO) plans
- Managing a PPO plan involves different challenges from operating an HMO plan
  - Managing out-of-network use and costs
  - No “gatekeeper” to control costs
- Molina’s lack of PPO experience may impact plan costs, out-of-network usage, medical loss ratios, and care management

Molina Is Acquiring the Medicare Advantage Lives for a Low Price

The Purchase Price Is Low

- Molina is acquiring the individual Medicare Advantage lives for $401 per life
- Molina's investment bank: recommended a price of approximately $1,800 per life
- A Molina board member: Lives potentially worth $2,500 to $3,000
- The low purchase price reflects the riskiness of the transaction

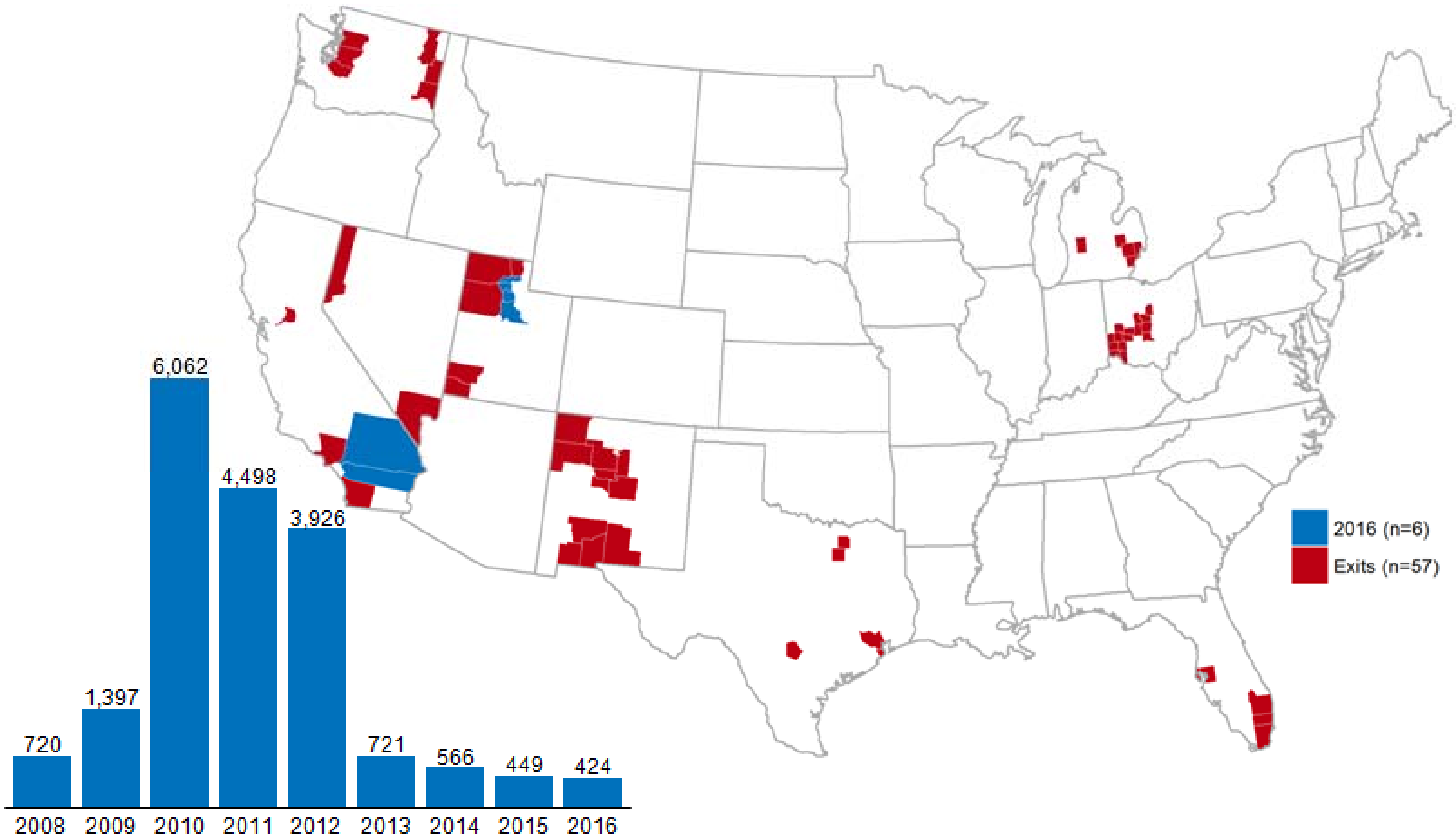
The ASA Does Not Overcome Molina's Weaknesses

The Administrative Services Agreement Would Not Make Molina an Effective Competitor

- The ASA is limited in duration
  - Ends 12/31/2018 at the latest
- Molina would be dependent on administrative services provided by Aetna
- Aetna would have no incentive to do more than the minimum necessary to assist Molina

Molina's Prior
Individual Medicare Advantage Failures

Molina's Failed Attempt at Individual Medicare Advantage



Source: 2008–2016 CMS Enrollment Data by CPSC; 2008–2016 CMS Service Area Data; and 2008–2016 CMS Landscape Data

Note: Counties in which enrollment was between 0–10 individuals show up in the enrollment data as having "*" enrollment. For these counties, an enrollment of 0.58 individuals was assumed, which is the average level of enrollment across all such counties

Reasons for Molina's Previous Failure

- Average or below-average provider networks
- Limited expertise
  - D-SNP and Medicaid expertise not helpful
    - Molina failed where it had an existing D-SNP presence
    - Molina failed where it had an existing Medicaid presence
- Lack of aggressive marketing
- Detracted from Molina's core focus on Medicaid