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Stronger Together

Comments by the Service Employees International Union on Hospital Group Purchasing Organizations before The United States Senate Judiciary Committee, Subcommittee on Antitrust, Business Rights, and Competition

September 14, 2004

The 1.6 million members of the Service Employees International Union (SEIU) are pleased to submit testimony to the United States Judiciary Committee, Subcommittee on Antitrust, Business Rights, and Competition on the impact of hospital group purchasing organizations (GPOs).

We applaud the efforts of the subcommittee in investigating GPOs and are grateful for the leadership of Senators DeWine and Kohl. The Senate has made significant progress in bringing to light many of the anti-competitive practices of GPOs and encouraging the creation of voluntary codes of conduct. However, there is more work to be done to ensure that the entire GPO industry follow the lead of GPOs who have successfully reformed their practices.

This is not to suggest that all GPOs are problematic. In fact, SEIU believes that GPOs can be a positive force in reducing health care costs and SEIU stands behind the concept of group purchasing. We believe that many GPOs, including Premier, Broadlane, Consorta, and MedAssets, have greatly improved their practices. But no matter how hard some GPOs work for reform, those efforts will have little impact if Novation, the market leader, continues practices that do not result in the best product at the best price for health care consumers. Enhanced transparency and oversight could help control the cost of medical supplies by insuring that GPOs are truly controlling costs for health care consumers.

As a union whose members are both health care workers and health care consumers, SEIU is pleased to contribute our voice to this important matter of health policy. We look forward to working together with those who seek to control health care costs by creating openness, accountability, and true competition in the health care supply chain.

SEIU is concerned that questionable practices by the nation's largest GPO, Novation, lead to rising costs in the health care supply chain, while at the same time limiting provider choices in a way that risks the safety of both health care workers and their patients. These rising costs

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lead to short staffing in hospitals, loss of insurance for working families, increased cost pressure on small businesses, over-crowded emergency rooms, and growing burdens on public and private health care purchasers.

As committee members may be aware, nearly every time SEIU members reach the bargaining table, employers inform us that they are unable to maintain current levels of health coverage. We are then presented with the choice of either cutting back on coverage or paying more ourselves, either in wage freezes, salary givebacks or increased premiums. This is a choice no worker should have to make. While questionable GPO practices are one factor among many in rising health care costs, they are a factor that should not be ignored.

We believe that Novation continues to favor dominant manufacturers while excluding emerging technologies and smaller device manufacturers. While other GPOs claim to stay within the maximum 3% fee levels required by congress, a level that appears to be appropriate, Novation has continually sought new ways to collect additional fees from manufacturers, which drives up the cost of care.

Though we support the voluntary codes of conduct, we believe that health care consumers would benefit from greater transparency of GPO operations. For GPOs who have reformed their practices, greater transparency will serve to demonstrate the positive role they play in the health care marketplace. Disclosure is an unattractive option only for GPOs who abuse the safe harbor at the expense of hospitals and health care consumers. Increased transparency is necessary not because group purchasing as a concept is bankrupt, but rather because Novation does not appear to successfully self-regulate.

The flawed business practices of Novation call into question its commitment to its code of conduct, which it announced in August 2002. For example:

- In its code of conduct Novation states, "Participation in Novation contracts is not a prerequisite for membership or continued membership in VHA or UHC."[1] Yet, in at least one instance, a health system that recently chose to leave Novation was also forced to leave VHA, according to that health system's purchasing director.

- In October 2003, Novation sent a letter to its 2,400 hospital members recommending that they "recommit" to purchase pulse oximeters from Tyco/Nellcor. Novation apparently sent the letter, in spite of the fact that Tyco's patents were due to expire within months, which would have resulted in reduced pricing of certain products and created market opportunities for competitors. However, perhaps due to the incentive structure by which Novation generates revenue, it supported the higher priced incumbent's product. Regardless of the obvious cost issues, Novation should not have

[1] "Novation Commits to New Operating Principles to Enhance Value and Opportunities for Hospitals and Suppliers" August 8, 2002.

favored the incumbent vendor. Novation acted to protect the interests of Tyco while neglecting the interests of the hospitals and patients it purports to serve.

The following examples illustrate that while we face skyrocketing health care inflation and short staffing in our nation's hospitals, Novation is finding new ways to exploit its position as dominant GPO by receiving fees above and beyond the 3% ceiling mandated in the safe harbor.

- Novation's private label brand, NovaPlus, appears to serve little purpose other then to collect additional fees beyond those permitted by the safe harbor.

- Novation charges manufacturers for the required use of Neoforma, an e-commerce company whose largest shareholders are Novation's parent companies, VHA and UHC. Neoforma has lost hundreds of millions of dollars since its inception while adding unclear value, and represents yet another layer of administrative costs.

- According to our research, the VHA Health Foundation, a wholly owned not-for-profit subsidiary of Novation's parent, VHA, receives nearly all of its support from the same manufacturers who have benefited from sole-source or bundled Novation contracts. These manufactures include: Abbott Laboratories, Baxter Health, Cardinal Health, Eastman Kodak, Johnson & Johnson, and Standard Textile. Furthermore, the VHA Health Foundation received two questionable million-dollar donations from unnamed companies in the last two years.[2]

In order to insure that all GPOs work towards a more efficient health care supply chain, state regulators have begun to join with the federal authorities already examining GPOs. We are pleased that Connecticut Attorney General Richard Blumenthal has intensified his investigation of Novation in Connecticut. According to press reports, Attorney General Blumenthal is investigating whether Yale-New Haven Hospital and other nonprofit hospitals in Connecticut are overcharging Medicare and other government agencies for medical supplies. Attorney General Blumenthal's investigation is all the more important given that Novation is the dominant GPO in the state. Moreover, Connecticut's largest health system, Yale-New Haven Health System, plays a leading role in Novation's parent company, VHA.

Yale-New Haven's current CEO, Joseph Zaccagnino, is a long time board member of VHA, In April 2004, Zaccagnino was appointed Chairman of VHA and, according to his resume, sits on VHA's Executive Committee, Executive Compensation Committee, CEO Search Committee, and Finance and Audit Committee. C. Thomas Smith, President of Yale-New Haven Hospital from 1977 to 1991 (during which time Zaccagnino worked under him as COO), served as President and Chief Executive Officer of VHA from 1991 to 2003. Smith currently serves on the boards of companies who do business with VHA or Novation, including: Neoforma, Kinetic Concepts and IPC. Yale-New Haven's current

[2] VHA Health Foundation IRS Form 990, 2002, 2001.

Executive VP and COO, Marna Borgstrom, was a founding board member of Novation and sits on the board of the University HealthSystem Consortium. Yale's VP for Materials Management, Patrick Luddy, is a member of the Novation Materials Leadership Council and the Novation Information Leadership Council.

Zaccagnino and Borgstrom's leadership roles in VHA and Novation, create a potential conflict of interest between their responsibility to further Yale-New Haven's mission and their responsibility to increase profits for VHA. These potential conflicts are exacerbated by VHA's unusual ownership and governance structure. VHA is a for-profit cooperative owned by 2,200 nonprofit community hospitals and health systems.[3] VHA shareholders also include hospital administrators at VHA member hospitals. At the time of VHA's private offering in 1985, press reports revealed that hospital administrators were allowed to purchase shares in VHA's financing arm, Voluntary Health Enterprises. [4] As executives of Yale-New Haven in 1985, Zaccagnino and Borgstrom were in a position to personally profit at the possible expense of Yale-New Haven and its patients. We hope that in the coming months regulators will establish whether or not executives of VHA member hospitals like Yale-New Haven are using their positions for personal gain.

As purchasers of medical care for over one million SEIU members and their families, we have a responsibility to ensure that our health funds are not being overcharged for medical supplies. If Novation truly does save money for its members and health care consumers, then it should be willing to open its books to public scrutiny. Nevertheless, Novation and its parent VHA have thus far been unwilling to disclose more then the most superficial financial data.

For example, in a recent article in *Modern Healthcare*, a VHA representative refused to disclose executive compensation at VHA. According to the article, a VHA representative asserted, "we looked at the issue very carefully and the consensus was that there was not a lot to be gained from disclosing salaries."[5] Yet, in 1999, the VHA Health Foundation was forced to disclose in an IRS 990 tax form that it paid Daniel P. Bourque, President of the Foundation and Senior Vice President of VHA, an annual salary and benefits package of $352,920 for 4 hours of work per week.[6] In other words, Bourque was being paid $1,696.73 per hour to lead a tax-exempt, non-profit organization. If this excessive figure is consistent with VHA or Novation's general compensation practices, then a Senior Vice President at VHA in 1999 would have had an annual compensation package of $3,088,050 for a standard 35-hour week. SEIU believes there is much for the public to gain from increased disclosure from Novation and VHA.

[3] VHA Corporate Fact sheet available at https://www.vha.com/news/public/factsheet.asp
[4] Jenifer Fine, "Building a Health Care Giant: VHA's Unique Private Offering." Dallas Business Courier, August 19, 1985.
[5] Cinda Becker, "Going on the record; VHA offers financial information but withholds executive compensation" *Modern Healthcare*, June 28, 2004.

[6] VHA Health Foundation IRS Form 990, 1999.

If Novation and VHA drive up health care costs through high administrative overhead and anticompetitive practices, more and more Americans will join the ranks of the already 45 million without health insurance and the millions more who are underinsured. SEIU believes that all Americans will benefit when the medical device market is opened up to true competition. This can only happen if we hold GPOs accountable.

We are pleased that the Federal Trade Commission (FTC) addressed GPOs in its recent report on health care and competition. The FTC found that "Statement 7 governs Agency actions examining monopsony and oligopoly issues in connection with a GPO's formation. It does not preclude Agency action challenging anticompetitive conduct--such as anticompetitive contracting practices--that happens to occur in connection w/GPOs."[7] FTC scrutiny in addition to enhanced transparency and regulation of GPOs will demonstrate to the public that GPO's do serve a positive role in the medical supply chain.

We encourage the subcommittee to continue its important work on this matter. SEIU is committed to insuring that all GPOs operate in the best interest of hospitals, health care workers, and patients.

[7] "Improving Health Care: A Dose of Competition" Report by the Federal Trade Commission and the Department of Justice, July 2004. http://www.ftc.gov/reports/healthcare/040723healthcarerpt.pdf