

June 3, 2011

Via Federal Express

Mr. Dale Galassie
Chairman
Illinois Health Facilities and Services Review Board
525 West Jefferson Street, 2nd Floor
Springfield, Illinois 62761

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HEALTH FACILITIES &
SERVICES REVIEW BOARD

Re: Mercy Crystal Lake Hospital and Medical Center Inc. and Mercy Alliance, Inc. ("Mercy" or the "Applicant") (Project Number 10-089) (the "Project").

Dear Chairman Galassie:

The purpose of this letter is in response to numerous public comments made in opposition to our Project both at the public hearing held on March 18, 2011 and those public comments that have been submitted thereafter.

1. Cost/Financial

Several hospital competitors have claimed that the Project will increase costs in McHenry County. As reflected in Mercy's application, it is our belief that the Project will in fact lower health care costs. First, the Applicant will keep the cost of construction down by starting the project immediately after Board approval and open its hospital facility in 2014. Due to the ongoing economic recession, hospital construction has been down substantially from 2008 through the present time. As a result, the cost of new construction is the lowest in decades. For example:

- Hospital construction costs have been flat or declining, resulting in significant savings for hospitals who are choosing to build now; this is compared to more typical cost escalation of 2-4 percent per year all the way up to 9 percent at times during the previous decade.
- Because so many hospitals and health systems have delayed construction projects due of the impact of the recession, there is a strong fear that when prices do start to rise, there will be a significant spike in escalation as pent up demand exceeds supply. As a result, there is urgency to start construction in the next 12-24 months to avoid this large, anticipated escalation in hospital construction costs.
- If the State Board waits to approve a new hospital for Planning Area A-10 a hospital project will continue to get more expensive. When Mercy proposed to build a new hospital in 2004, the total project cost was approximately \$1.16 million per bed. For the

current proposed project in 2011, the cost is roughly \$1.56 million per bed, a 34.5 percent increase. Delaying a project any longer (into the future) will continue to increase the overall project costs. Completing the project now will help to accomplish the State Board's goal of minimizing the capital outlay.

- While Board rules require construction of a minimum 100 Medical/Surgical and Pediatric beds within a Metropolitan Statistical Area, in considering less costly alternatives, in its application Mercy proposed reducing the size and scope of its project to consider the construction of a facility with 70 beds. This project, with an estimated total project cost of \$115 million, would forego an additional capital outlay of \$85 million dollars. In looking at Illinois and four adjacent states, including Wisconsin, Indiana, Missouri and Iowa since the Year 2000, 15 new general, medical-surgical suburban hospitals have been built during this time period (Wisconsin and Indiana have no certificate-of-need laws, while Missouri and Iowa do). They have ranged in size from 32 to 143 beds, with the overall average size being 90 beds. Nine were built with less than 100 beds while 6 were established with more than 100 beds.

Second, Mercy will minimize capital outlay by constructing a secondary care hospital, not one which offers tertiary care services (such as Level I trauma, transplants, open heart surgery, neurological surgery, etc.). It will also emphasize convenient access to outpatient and emergency services in a cost-effective manner. Mercy will establish close working relationships with its hospital neighbors who offer tertiary care services to develop seamless referral and transfer relationships.

Third, Mercy will contribute to the containment and reduction of charges in McHenry County over time. In McHenry County, Centegra Health System currently operates nearly 92.5 percent of all hospital beds. Mercy representatives stressed during our public hearing, that the approval of Mercy's project will balance of competitive power in the county will improve as demonstrated by the chart below. Without more substantial competition, health insurance companies must negotiate with a virtual monopoly in McHenry County: Centegra Health System. Hospital competition has three benefits: greater consumer choice, better quality, and lower costs and prices. David Eisenstadt, Ph.D., Principal of MiCRA, Inc., an antitrust economist (and previously employed by the United States Department of Justice Antitrust Division), in analysis prepared for public testimony at Mercy's hearing on March 18, 2011, estimated that the entry of Mercy Crystal Lake Hospital and Medical Center would create expected declines in Centegra Health System's inpatient prices to insurance companies of between 4 and 9 percent depending on the geographic area. This would be favorable for health care consumers in McHenry County and adjacent counties of Lake, Cook and Kane.

Comparison of Current McHenry County Bed Complement and Future Beds Depending Upon Outcomes									
	Current			Future					
	Centegra	Mercy	Total	Mercy Project Approved			Centegra Project Approved		
				Centegra	Mercy	Total	Centegra	Mercy	Total
Medical-Surgical	206	22	228	206	122	328	306	22	328
Obstetrics	33	0	33	33	20	53	53	0	53
Intensive Care	33	3	36	33	11	44	41	3	44
Acute Mental Illness	36	0	36	36	0	36	36	0	36
Total McHenry County Beds	308	25	333	308	153	461	436	25	461
Percent of McHenry County Beds	92.5%	7.5%	100.0%	66.8%	33.2%	100.0%	94.6%	5.4%	100.0%

Fourth, as we emphasized in our application and public hearing testimony, as part of a fully integrated delivery system, Mercy Crystal Lake Hospital and Medical Center will be positioned to deliver costs well below other hospitals in Planning Area A-10 and beyond. Over the past ten years, Mercy – a model for integrated delivery systems – has consistently been rated among the top 20 Integrated Healthcare Systems (IDSs) in the United States by SDI and Modern Healthcare magazine. Irrefutable evidence has been established that IDSs improve healthcare quality, patient outcomes, and reduce costs – especially for patients with complex needs. Stanford University economist Alain Enthoven, who has been studying the nation’s health care system for more than 30 years, said integrated systems “are the disruptive innovation we need to turn loose on the rest of America.” A 2007 study by Chicago-based Hewitt Associates found that integrated systems like Mercy and Kaiser Permanente provide 22 percent greater cost efficiency than competing systems.

To further highlight this point, the Dartmouth Atlas of Health Care publishes differences in health care spending by Hospital Referral Regions. Directly to the northwest of McHenry County is the Madison, WI HRR, where Mercy operates the largest of its three hospitals in Janesville. In 2007, Medicare paid \$6,813 per enrollee for medical care. Conversely, in the Elgin HRR, which includes Centegra Hospital – McHenry, Advocate Good Shepherd Hospital, Sherman Hospital, Provena St. Joseph Hospital and St. Alexius Medical Center, Medicare paid \$9,518 per enrollee, nearly 40 percent more. Medicare pays higher rates to Illinois hospitals than Wisconsin hospitals, but nowhere close to 40% more. Mercy, through its vertically integrated delivery system, has learned to operate highly efficiently (and at considerably lower cost) in an environment where they are paid 39.7 percent less by Medicare than the primary hospitals serving McHenry County.

Hospital based systems throughout the U.S. are scrambling to organize hospitals, employ physicians, and eliminate duplication in order to succeed in the health reform environment emphasizing formation of accountable care organizations (ACOs). Mercy has been operating an “ACO-like” organization since 1991 with its health plan, employed physician model, and expansive network of clinics and hospitals. Mercy would further develop the “future” integrated model of health care to McHenry County by 2014.

The population projections supporting the Mercy Project reflect an expanding population in the service area. The payor mix of patients will represent the population as a whole, with an especially fast-growing segment of Hispanic residents. Medicare and Medicaid will comprise 43.3 percent of the hospital's volume.

Payor Source	FY 2015
Medicare	29.2%
Medicaid	14.1%
Commercial	51.8%
Self-Pay	3.5%
Charity	1.4%
TOTAL	100.0%

The project will lower Medicaid and Self Pay (mostly charity care) exposure of Centegra Health System and reduce the outmigration of Medicaid and Self Pay patients from the southeast part of McHenry County to other hospitals in Lake, Cook and Kane Counties. Since nearly 70 percent of Medicare inpatients are admitted outside of the southern one-half of McHenry County, Mercy (and the new physicians it will bring to the area) will seek to improve access for the geriatric population who current leave the county for hospital services.

2. Patient Access

Several hospital competitors claimed that there is an overabundance of beds. As we pointed out in our application and testimony, the Mercy Project will provide access to a large and growing area that is underserved for physician, emergency, and hospital services. This is demonstrated by several factors.

- Largest concentration of existing population and patients. By geographically segmenting McHenry County into four sub-areas (as reflected in the attached chart which was previously submitted as part of Mercy's public hearing testimony), including Southeast (Crystal Lake, Cary, Fox River Grove, Algonquin and Lake in the Hills), Southwest (Huntley, Marengo and Union), Central (McHenry, Island Lake, Wonder Lake and Woodstock) and North (Harvard, Hebron, Richmond, Ringwood and Spring Grove), the patient access issues become much clearer. Based on Nielson Claritas, Inc. McHenry County population estimates for 2010 and projections for 2015, and based on COMPdata inpatient admissions for 10/1/09-9/30/10, the largest number of McHenry County residents and hospital admissions are concentrated in the Southeast sub-area of the county.

McHenry County Sub-Area	Key Sub-Area Feature	2010		2015		
		Population Estimate	% of Total	Population Projection	Total Admissions	% of Total
Southeast	Location of Mercy Crystal Lake Project	163,664	46.6%	177,521	13,821	39.5%
Central	Current Location of Centegra Hospitals	113,196	32.2%	122,032	12,856	36.7%
Southwest	Location of Centegra Huntley Project	40,381	11.5%	44,630	5,216	14.9%
North	Location of Mercy Harvard Hospital	34,114	9.7%	37,696	3,131	8.9%
Total		351,355	100.0%	381,879	35,024	100.0%

- Extensive outmigration of patients. From 7/1/09–6/30/10, 53% of McHenry County residents received inpatient care outside the county (and 22% at hospitals outside the defined service area). During the same period, 70% of residents from the immediate service area (Crystal Lake, Algonquin, Lake in the Hills, and Cary) received inpatient care outside the county (and 21% at hospitals outside the defined service area). Accordingly, the population growth in southern McHenry County will continue to drive the need for additional facilities.
- Physician shortages. The Applicant believes that a shortage of specialty physicians is one of the primary reasons that residents of McHenry County are leaving the county in order to seek medical care. According to physician manpower ratios from Thomson Reuters, McHenry County has a deficit of 49.9 physicians as of March 2010.¹ This includes an estimate of a 29.4 FTE shortage in the area of primary care physicians and the balance in specialty care. This is consistent with the national experience. Both the Council on Graduate Medical Education and the American Medical Association recognize a current physician shortage in the U.S. that will worsen over the next several years. The operational model utilized by the Applicant has been implemented effectively to recruit and retain needed physicians.
- Undersupply of beds. As referenced in the supplemental materials we provided with our application, a recent study by the Henry J. Kaiser Family Foundation highlights the extreme shortage of hospital beds in Planning Area A-10 based on data reported for 2009. In 2009, the State of Illinois had 2.6 Hospital Beds per 1,000 Population. The U.S. average was also 2.6 Hospital Beds per 1,000 Population.² McHenry County, with 333 total hospital beds in 2011 and a population of over 351,355, has slightly less than 1.0 Hospital Beds per 1,000. If McHenry County were simply at the Illinois State Average, it would have 914 hospital beds. Based on this calculation, McHenry County is 174 percent below the State and National averages for beds.
- Lack of emergency services for the density of the population. According to the same Henry J. Kaiser Family Foundation study for 2009, the State of Illinois average for Hospital Emergency Room Visits per 1,000 Population was 412. Applied to this Southeast sub-area of McHenry County, this represents an estimated 67,430 Hospital

¹ Thomson Reuters Healthcare – MarketPlanner Plus, Market Expert physician demand ratios.

² Henry J. Kaiser Family Foundation; www.statehealthfacts.org, 2009.

Emergency Room Visits generated from this population. Based on a 2015 population projection of 177,521, emergency room visits from this part of McHenry County will grow to 73,139. In CY2009, IDPH reported the two Centegra Hospitals treated 68,519 emergency room visits. Because of a lack of hospital emergency room services in this densely populated, growing sub-market of McHenry County, all of these residents must go out of their local area to access these services.

The Mercy Project will open as a general, acute care hospital. What will be truly unique and new to the area, however, will be the model of care. This system is based on the Mayo Clinic model, where hospital and physician offices are part of the same entity under one organizational roof. An integrated system functions differently than other health care models. The fully integrated model lowers costs and improves patient care, as patients have all the benefits of a multi-specialty clinic, as well as access to diagnostic services, emergency services, surgery suites and other hospital-based services. Such integrated services will greatly benefit emergency room patients if they require attention by a pediatrician, cardiologist, ear nose and throat specialist, orthopedic surgeon or other specialists who are present on-site in the clinic at the time the patient is seen in the emergency room.

It is also the intent of the Applicant to establish a geriatric specialty clinic as part of its overall operations at Mercy Crystal Lake Hospital and Medical Center. Mercy is committed to establishing a geriatric specialty clinic to serve this growing segment of the McHenry County population. Using the experience gained from a similar geriatric specialty clinic operated by Mercy Health System in Wisconsin, it is Mercy's intent to bring the most comprehensive geriatric services to McHenry County as is possible.

The 2010 McHenry County Healthy Community Analysis³, cited to by competing hospitals, highlighted the rapidly expanding number of Medicaid recipients in the county. In 2000, there were 6,293 residents on Medicaid, or 2.4 percent of the total population. By 2009, this number grew to 25,623, or 8.0 percent of the population in less than 10 years. Most of this growth occurred in the southeast and central portions of McHenry County. In 2010, 30 percent of all Medicaid residents hospitalized from McHenry County live in the Southeast sub-area. All of these residents, many without access to good transportation, must travel outside the area for hospital care because they do not have a local hospital facility available.

3. Improved Quality

Several hospital competitors stated that the Project would hurt the quality of health care in the community. The Mercy Project will, in fact, promote high quality of care because it will extend Mercy's delivery model within Planning Area A-10. Mercy's commitment to patient care quality is best exemplified in its recognition by the U. S. Department of Commerce who honored Mercy with the Malcolm Baldrige National Quality Award. The award is the United States' highest Presidential honor for quality and organizational performance excellence. Mercy is

³ 2010 McHenry County Healthy community Study, Community Analysis, Chapter 7: Income & Poverty, Page 90.

unique in receiving the honor in that all entities in the vertically integrated health system have been recognized for organizational excellence.

Mercy is committed to provide health care services to all patients regardless of their ability to pay. Mercy will meet this goal by operating an emergency department that will provide services to all patients, including the poor, by implementing a charity care program to provide reduced fee and free services to qualifying patients and by participating in governmental payment programs, including Medicare and Medicaid. Mercy will measure this goal by dollar volume of services rendered and numbers of patients served. Further, Mercy will reach out to community-based organizations in an effort to collaborate in the provision of care to the indigent. Mercy has a reputation and track record in this respect of successful collaborations. Examples of successful program collaborations in programs serving the indigent include efforts with HealthNet of Janesville, a free primary care clinic, and Mercy's physician services arrangements with Beloit Area Community Health Center, a private, not-for-profit Federally Chartered Health Center. Mercy will also develop and implement a physician recruitment plan designed to reduce the identified physician shortage by 85 percent within three years of the opening of the Mercy Crystal Lake Hospital and Medical Center. These efforts will contribute to improving the health status for the community and address health disparities due to a shortage of physicians in McHenry County and a maldistribution of hospital services in the county.

The Mercy Project will measure its quality of care against other providers in Illinois and throughout the United States. It will seek to achieve five stars for the Centers for Medicare & Medicaid Services' (CMS) Five-Star Quality Rating system by implementing its vertically integrated delivery model throughout the market area.

Mercy currently employs 532 staff and doctors to support our 22 facilities including Mercy Harvard Hospital and Mercy multispecialty clinics in McHenry County and contiguous areas of Illinois. It will work off this large base of employees to fill the positions of the new hospital. Mercy uses a continuous staffing plan in order to fill new positions or replace individuals who have left employment. Through the use of newspaper advertising, trade magazines web sites, job fairs, colleges and technical training schools in Wisconsin and Illinois, Mercy partner positions are quickly and efficiently filled. Our experience in Illinois has shown that there are ample interested applicants for every job. Mercy will employ this proven process to fully staff the new facility. The staffing process will begin with the recruitment of physicians immediately upon approval of the project due to the long planning timeline necessary for physician's employment. For other staff positions, recruitment will begin one year prior to opening. All staff positions will be filled one month prior to opening so that our comprehensive training program can be completed and trial operation can begin prior to opening.

4. **Unnecessary Duplication**

Several hospital competitors claimed that the Project would duplicate services provided in the community. The Mercy Project will, in fact, promote the State Board's objective of avoiding unnecessary duplication of services by:

- Addressing Medical/Surgical/Pediatric bed need in Planning Area A-10, now and in the future. Unmet bed need has increased rapidly since 2002, when IDPH estimated a surplus of 35 Medical/Surgical and Pediatric beds in McHenry County. Between 2002 and 2008, the net increase in Medical/Surgical and Pediatric beds increased by 118 beds. By 2020, based on population projections, Planning Area A-10 will have a bed need of 131 Medical/Surgical and Pediatric beds, significantly higher than the bed complement proposed by Mercy Crystal Lake Hospital and Medical Center.

Planning Area A-10: Medical/Surgical & Pediatrics								
Year	Out Migration	Percent Change	Net Migration	Percent Change	Adjusted Beds Needed		Existing Beds	
2002	9,148	-	7,257	-	153	-	188	-35
2005	10,477	14.5%	8,455	16.5%	197	28.8%	218	-21
2008	11,091	5.9%	8,876	5.0%	289	46.7%	206	83
2015	11,091	-	8,876	-	295	-	206	89
2020	11,091	-	8,876	-	337	-	206	131

- Avoiding cannibalization of patient volume. In its CON application for Centegra Hospital – Huntley, Centegra Health System indicated that the closest hospital to its new hospital in Huntley will be Centegra Hospital – Woodstock at 11 miles (and 16 minutes drive time). The next closest hospitals are Sherman Hospital (12 miles, 20 minutes), Provena St. Joseph Hospital (15 miles, 24 minutes) and Centegra Hospital – McHenry (16 miles, 25 minutes). From July 1, 2009 to June 30, 2010, Centegra Hospital – Woodstock generated 1,072 discharges from Huntley (60142), Lake in the Hills (60156), Cary (60013) and Algonquin 60102). Each of these communities is closer (by more than one-half) to Centegra Hospital – Huntley than its existing Centegra Hospital – Woodstock facility. Other than mental health services, hospital services proposed for Centegra Hospital – Huntley will be identical to those offered by Centegra Hospital – Huntley. It is likely that Centegra Health System will shift up to 1,200 discharges or more from its Woodstock hospital to a new facility in Huntley, a clear duplication of services. Consequently, Centegra Health System would face the need to downsize its Woodstock hospital in order to support volume losses to a new Huntley facility.
- Providing primary and secondary hospital care. The Mercy Crystal Lake Hospital and Medical Center will be a general, acute care hospital offering community-based services to the local service area surrounding the facility. It does not plan to offer tertiary care

services and will work closely with area hospitals, which provide these services, to coordinate transfer of patients requiring this level of care.

- Addressing physician need in McHenry County. As of January 1, 2011, Mercy Health System employed 76 full-time and 11 part-time physicians in northern Illinois, a major contribution of physician providers to the area. Mercy plans to add 45 new physicians in Crystal Lake, which will assist in addressing the calculated physician need in McHenry County of nearly 50 physicians in March of 2010. These physicians will play a vital role in the future health of residents of McHenry County.

The Applicant has projected that, notwithstanding the increased admissions currently occurring as a result of the Patient Protection and Affordable Care Act of 2010, in years one and two of operations of the project, admissions will be further impacted at a rate of 5 percent first year and 3 percent second year over current rates. Mercy projects that other planning/market area facilities will see a similar impact. In combination of these factors, the Applicant is confident that its project will not lower the utilization of other area providers below the occupancy standards specified in 77 Ill. Adm. Code 1100. Further, the data and projections of the Applicant indicate that its project will not lower, to a further extent, the utilization of other area hospitals that are currently (during the latest 12-month period) operating below the occupancy standards.

Mercy formally and informally approached Centegra Health System about a joint venture to provide a hospital and multi-specialty physicians clinic in Crystal Lake. To date, Centegra Health System has not responded favorably to any of our requests. No other healthcare provider in the proposed market area has expressed any desire to pursue a joint venture with Mercy Health System.

I appreciate your consideration of this matter and Mercy's proposed project.

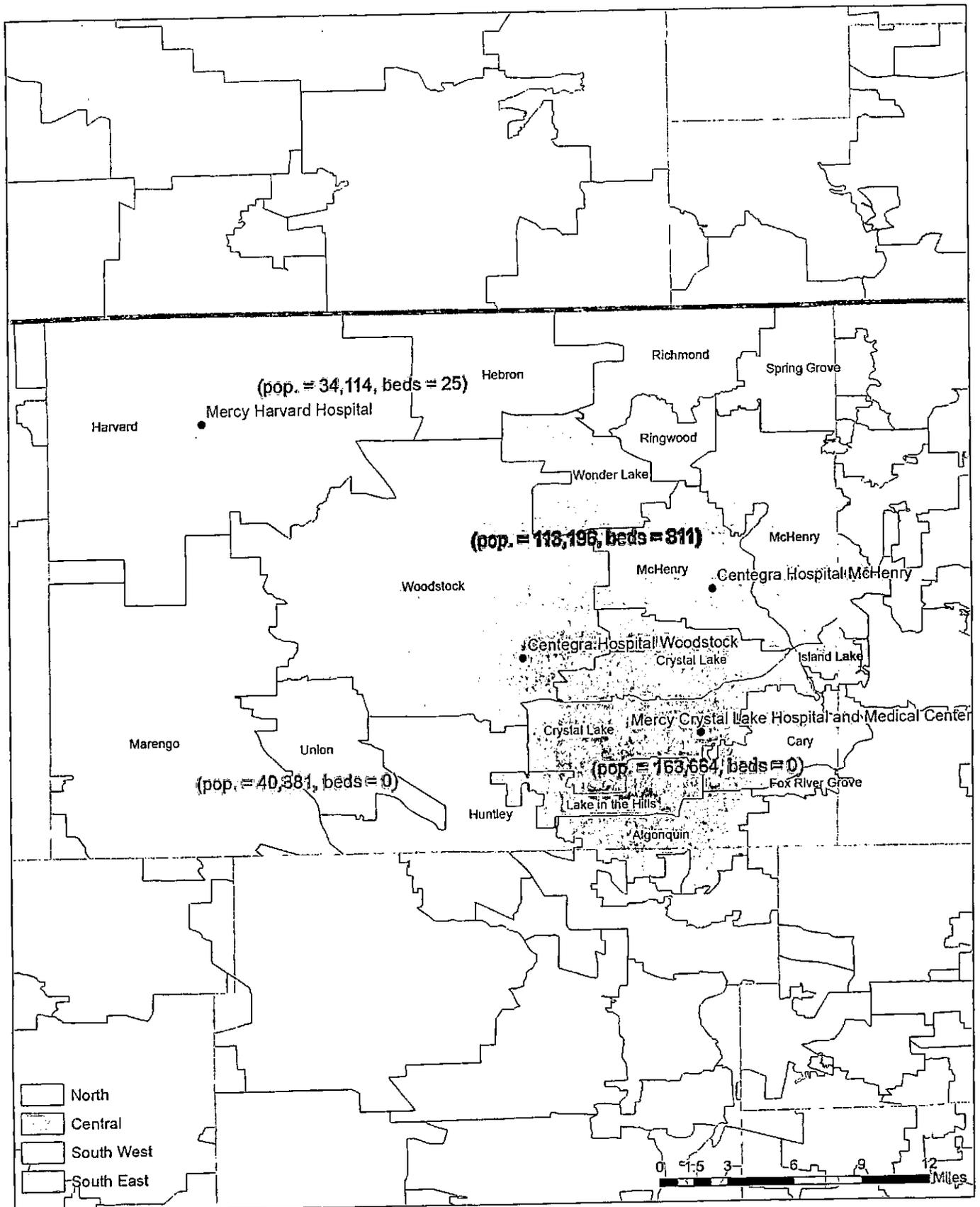
Sincerely,



Richard Gruber, Vice President
Mercy Health System Corporation

cc: Courtney Avery, Administrator

Residents and Hospital Beds in McHenry County



Sources: 2010 population figures from Claritas Nielsen, 2010 hospital bed counts from IDPH Inventory of Healthcare Facilities and Services and Need Determinations