

# CtW Investment Group

January 12, 2017

Charles G. Berg  
Chairman, Compliance Committee  
DaVita, Inc.  
2000 16th Street  
Denver, Colorado 80202

Dear Mr. Berg,

In light of the recently released interim rule issued by the Center for Medicare & Medicaid Services (“CMS”),<sup>1</sup> the subpoena from the Department of Justice served on the company on January 6,<sup>2</sup> and the fact that DaVita is operating under a Corporate Integrity Agreement with the HHS OIG,<sup>3</sup> we are concerned that DaVita may have failed to comply with CMS rules surrounding the signing-up of Medicaid-eligible patients for commercial insurance through the Affordable Care Act (“ACA”) exchanges over the past three years. Any such compliance failures threaten the ability of DaVita to continue receiving reimbursement from federal health programs, while also opening the company to fines, other regulatory enforcement actions, and private litigation. We urge the Compliance Committee and the board to act promptly to limit the potential costs to DaVita shareholders by:

- Disclose corporate contributions to the American Kidney Fund (“AKF”), and the percentage of DaVita’s commercially insured patients receiving premium assistance from the AKF, since January 1, 2014.
- Appoint an independent “special master” to investigate unexpectedly large increases in commercially insured patients and revenues since FY 2014, and report on any inappropriate guidance of patients to commercial insurance plans.
- Move forward promptly with the appointment of at least one new, independent director to the Compliance Committee who possesses clear qualifications based on past professional experience in health care regulatory oversight, enforcement, and compliance.

The CtW Investment Group works with union-sponsored pension funds to enhance long-term stockholder value through active ownership. These funds have over \$250 billion in assets under management and are substantial DaVita, Inc. shareholders.

## **Regulators Concerned With American Kidney Fund Payments**

On August 18, 2016, the Center for Medicare & Medicaid Services issued a request for information concerning the steering of patients with end stage renal disease (ESRD) to commercial health care plans, even though these patients are eligible for Medicaid and/or Medicare, for the purpose of obtaining the higher reimbursement rates provided by commercial insurance payers. This announcement was quickly

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<sup>1</sup> 42 CFR 494 [CMS-3337-IFC] RIN 0938-AT11 Medicare Program; Conditions for End-Stage Renal Disease Facilities – Third Party Payment

<sup>2</sup> Reed Abelson and Katie Thomas, “Dialysis Chains Receive Subpoenas Related to Premium Assistance” *New York Times*, January 6, 2017.

<sup>3</sup> Katie Thomas, “DaVita to Pay \$389 Million to Settle Federal Charges of Illegal Kickbacks” *New York Times*, October 23, 2014.

followed by a drop in DaVita's share price. While DaVita defended the practice of third parties providing premium assistance for patients enrolling in commercial plans despite their being qualified for Medicaid, patient advocacy organizations such as the Center for Medicare Advocacy and the National Council on Aging disagreed and argued that this practice is unlawful.

Following press reports detailing DaVita's efforts to enroll Medicaid-eligible patients in Affordable Care Act plans, the company announced that it would immediately desist from this practice, and has acknowledged that a significant share of its patients were receiving financial assistance from the American Kidney Foundation in order to purchase commercial health insurance via the Affordable Care Act. While DaVita has not disclosed the percentage of its commercially insured patients that receive premium assistance from the American Kidney Foundation, it has estimated that it would lose \$230 million in annual operating income if it were to lose the 3,500 Affordable Care Act plan patients receiving support from the AKF.

Independent financial analysts have estimated that changes to the rules governing third-party insurance support for dialysis patients could cost DaVita an additional \$270 million to \$670 million in annual pretax income.<sup>4</sup> Unfortunately, DaVita has refused to answer analyst questions concerning the percentage of its commercial patients receiving premium assistance or comparable financial support from the AKF, with Chairman and CEO Kent Thiry remarkably stating that "I think at this point, we've decided that disclosing that is not in your best interests."<sup>5</sup>

#### **Shareholders Need Full Disclosure of Relationship with American Kidney Fund**

Needless to say, we disagree, and cannot avoid the suspicion that Mr. Thiry and his team may have their own interests, rather than those of shareholders, in mind in refusing to provide fulsome disclosure of DaVita's relationship to the AKF. Worse still, given both the 1997 agreement<sup>6</sup> with the federal government allowing third-party premium support payments and DaVita's 2014 Corporate Integrity Agreement, there appear to be significant potential financial and regulatory risks to DaVita stemming from its relationship to the AKF. We note, for instance, that the Corporate Integrity Agreement requires DaVita to report to the Office of the Inspector General all matters "involving DaVita Dialysis that a reasonable person would consider a probable violation of criminal, civil, or administrative laws."<sup>7</sup>

We are concerned that DaVita may not be in full compliance with this agreement, given information already in the public domain suggesting that the AKF was not acting in accordance with the 1997 agreement. As you know, this agreement requires that the AKF distribute premium support impartially; that is, not channeling funding to patients of service providers who contribute to the AKF. Additionally, the AKF acknowledges that it received close to 80% of its 2015 revenue from two contributors, and press reports suggest that DaVita is one of these major contributors<sup>8</sup>. Finally, following a steady decline in the share of patients with commercial insurance – from 36% in 2007 to 33% in 2014 – this trend reversed in 2015 in a

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<sup>4</sup> Gary P. Taylor, Patrick Feeley, and Tim Murray, "DaVita" J.P. Morgan North American Equity Research, October 26, 2016.

<sup>5</sup> <http://seekingalpha.com/article/4018621-davita-dva-q3-2016-results-earnings-call-transcript>

<sup>6</sup> Katie Thomas and Reed Abelson, "Kidney Fund Seen Insisting on Donations, Contrary to Government Deal" *New York Times*, December 25, 2016.

<sup>7</sup> Corporate Integrity Agreement Between The Office Of Inspector General Of The Department Of Health And Human Services And Da Vita Health Care Partners Inc., October 22, 2014.

<sup>8</sup> Thomas and Abelson, op.cit., December 25, 2016.

100 basis point jump. J.P. Morgan analysts suggest that the Affordable Care Act's impact on DaVita's commercial insurance share should only have been around 20 basis points.<sup>9</sup> Given the large difference in the prices paid by commercial insurance and Medicaid for dialysis treatment – which reporting indicates may be as great as \$3700 per treatment – any favoritism shown by the AKF toward DaVita patients could be construed as a violation of which DaVita was aware and should have informed the OIG. The fact that the current chair of the board of trustees of the AKF is a former DaVita executive only reinforces our concern that the relationship between these organizations creates risks for shareholders that the board must address.

### **An Independent Investigation of ACA Plan Enrollment Needed**

DaVita shareholders appear to face further risks of regulatory enforcement and private litigation stemming from the company's own actions in enrolling Medicaid-eligible patients in commercial insurance plans available on the ACA exchanges. *The St. Louis Post-Dispatch* reports that its review of hundreds of internal DaVita emails shows that DaVita representatives told patients that the AKF would pay their monthly premiums, that they would receive superior access to treatment under a commercial insurance plan, that DaVita employees were instrumental in helping patients sign up for such plans, that DaVita employees were told which patients to target for this initiative, and that progress in holding discussions with patients was carefully tracked by the company.<sup>10</sup> The large increase in 2015 commercial enrollment for DaVita patients suggests that these efforts were successful, and that DaVita's revenue and earnings benefited as a result.

While we understand DaVita management's claim that its efforts were educational and not a form of unlawful "steering," we are concerned that the board has so far remained silent and appears to have accepted management's explanation at face value. Given the large financial impact that the combination of AKF premium support, increased patient enrollment in ACA plans, and the differential in payment rates between commercial and public payers, we believe that the board needs to step forward and initiate an independent investigation of DaVita's educational efforts in order to determine if they were properly designed and executed so as to conform to law and regulation.

Additionally, while the interim rule adopted by CMS in December 2016 does not prohibit third-party premium support payments going forward, CMS was explicit that it has not yet determined if those payments should be prohibited or limited. Instead, CMS outlines what it believes to be the major potential harms that such steering may pose to patients, including "negatively impacting patients' determination of readiness for a kidney transplant, potentially exposing patients to additional costs for health care services, and putting individuals at significant risk of a mid-year disruption in health care coverage." CMS has asked for additional comments from the public specifically addressing the appropriateness of third-party premium support payments for dialysis patients.

In addition to possible enforcement actions, we believe that an independent investigation would enable the board to better assess and prepare for DaVita's exposure to private litigation. As you know, a major health insurer (United Healthcare) has already filed suit against another dialysis chain for allegedly steering Medicaid-eligible patients to commercial plans sold on the ACA exchanges, suggesting that

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<sup>9</sup> Gary P. Taylor, Patrick Feeley, and Tim Murray, "DaVita Healthcare Partners" J.P. Morgan North America Equity Research, August 18, 2016.

<sup>10</sup> Samantha Liss, "DaVita encouraged some low-income patients to enroll in commercial plans" *St. Louis Post Dispatch*, October 23, 2016.

other insurers may consider such litigation as well. We note that industry analysts have estimated that the “excess” enrollment of Medicaid-eligible dialysis patients in commercial ACA plans increased costs for the ACA exchanges by \$2 billion in 2015, which suggests that most or all of the insurer losses on ACA exchange policies stemmed from the increased enrollment of dialysis patients. Moreover, the significant risks to patients from improper steering identified by CMS may expose DaVita to litigation by patients who believe they have suffered such impact, increasing DaVita’s legal costs, potential liabilities, while further damaging its reputation. A thorough, independent investigation would enable the board to fully assess these risks and take appropriate action to minimize or forestall them.

#### **Time to Refresh the Compliance Committee**

While DaVita added Ms. Desoer to its Compliance Committee in 2015, she is both a senior executive at a major financial institution (CEO of Citibank, N.A.) and does not possess any profession background or experience in health care regulation or compliance. Of the other three directors serving on this committee, both Mr. Diaz and Dr. Roper also appear to be full-time senior executives. Given both the rapid pace and substantial volume of health care regulatory changes over the past decade, to say nothing of likely changes in the near future, we are concerned that the Compliance Committee as presently constituted may stand in need of addition reinforcement. The fact that the Compliance Committee does not appear to have anticipated the regulatory risks associated with AKF premium support payments reinforces this concern. Given the critical role that regulatory compliance plays in ensuring DaVita’s continued ability to serve patients and build shareholder value, we urge the board to promptly identify at least one new director with clear professional experience in health care regulation and compliance to join the board and the committee.

#### **Conclusion**

Shareholder concern over DaVita’s reliance on AKF premium support payments, and the risks that such reliance poses to the company’s future earnings, reputation, and legal and regulatory exposure, has resulted in a nearly 20% share price fall since early August. We believe that you and your fellow directors need to step forward and demonstrate your ability and willingness to objectively evaluate DaVita’s past and current practices, and take appropriate steps to minimize the risk for further shareholder losses. By taking the steps we have outlined, the DaVita board can reassure shareholders of its independence and commitment to shareholder accountability. Absent such steps, we would have difficulty in supporting the re-election of incumbent directors at this year’s annual meeting.

If you would like to discuss our recommendations, please contact our Research Director, Richard Clayton, at (202) 721-6038 to arrange a mutually convenient time to meet.

Sincerely,

A handwritten signature in blue ink, appearing to read "Dieter Waizenegger", with a stylized flourish at the end.

Dieter Waizenegger  
Executive Director