

October 3, 2006

Kevin Donahue
Deputy Director, Solvency Standards Board
Department of Managed Health Care
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Sacramento, California 95814-2724

Kelvin Gong
Deputy Attorney General, Charitable Trusts Section
State of California Department of Justice
455 Golden Gate Avenue, Suite 11000
San Francisco, California 94102-7004

Dear Messrs. Donahue and Gong:

I am writing to you as an employee of Kaiser Permanente, regarding a number of serious concerns relating to the financial solvency and integrity of Kaiser Foundation Health Plan, Inc. In 2007 and 2008, our internal projections show that we could sustain operating income losses of \$2.15 and \$5.04 billion, respectively. Losses amounting to even a fraction of those projections would be potentially destabilizing to our organization and California healthcare.

On August 4 and September 8, I wrote to the Daniel Garcia, our chief compliance officer and a director of Health Plan and Hospitals, and copied the independent members of the Board of Directors of Health Plan and Hospitals. I expressed my concerns regarding the inefficiency and reliability issues relating to a number of our information technology projects, including the selection of specific key vendors by our chief executive officer, George Halvorson, and our chief information officer, J. Clifford Dodd. Specifically, the \$2.3 billion of member dues we will spend this year on information technology capital, operations, consulting, and projects undoubtedly has a significant direct impact on our financial stability. We are now facing exorbitant implementation and support costs relating to our recent adoptions of certain key software. Indirectly, we are facing significant losses in revenue, which we have had to forego as a result of unreliable billing information from these new systems.

I believe that, each year, we are wasting over \$1.3 billion on inefficient information technology projects. A significant portion of that waste is directly the result of the \$827.4 million we will spend, this year, on the acquisition and implementation of software from Epic Systems Corporation, of Verona, Wisconsin. On Mr.

Halvorson's first day at Kaiser Permanente, in 2002, he demanded a "review" of our own clinical and billing systems software, which we were jointly developing with IBM. Mr. Halvorson quickly ended our \$1.5 billion internal effort, in favor of (a now over budget, behind schedule, and highly unreliable) \$3.2 billion software package from Epic. Mr. Halvorson made his decision despite a similar review being completed only weeks before his arrival, which concluded that our internal effort was the most cost-effective and reliable option. In fact, our internal engineering reports condemned the software from Epic as having "untested scalability" and "minimal experience" with healthcare organizations like Kaiser Permanente. Those internal reports have, unfortunately, proven too accurate, by predicting the very scalability and reliability issues we are facing today.

It is notable that Mr. Halvorson had also selected Epic at his previously employer, HealthPartners, Inc. of Bloomington, Minnesota. In both instances (the selection of Epic for HealthPartners and for Kaiser Permanente), Mr. Halvorson unexpectedly gave Epic business which dramatically expanded its revenue. Although Mr. Halvorson's selection of Epic was heralded as an advancement for HealthPartners, we would later learn that HealthPartners was in the midst of an audit by the Minnesota Attorney General. The Attorney General uncovered years of financial irresponsibility and waste, and ultimately concluded that the HealthPartners Board of Directors provided inadequate oversight of Mr. Halvorson. The Attorney General also criticized the nature and extent of the consulting agreements HealthPartners had engaged in, not naming, but potentially including millions that would be paid to Epic. To date, HealthPartners has only been able to complete half of its initial Epic deployment, and has scaled back the project since Mr. Halvorson's departure.

Mr. Dodd, who had joined Kaiser Permanente just prior to Mr. Halvorson, quickly became a supporter of Mr. Halvorson's new strategy. After Mr. Dodd's hiring, he continued to serve as a director for a consulting company based in Denver, Colorado, Tanning Technology Corporation. Mr. Dodd "invited" and oversaw the selection of Tanning to "help ensure that the technical performance of Kaiser Permanente's Automated Medical Record (AMR) initiative meets the goals of the organization." Mr. Halvorson and Mr. Dodd authorized payment to Tanning of nearly \$1 million, and Tanning's "experts" apparently supported the selection of Epic, over the objections of our internal engineers. Mr. Dodd later resigned as a director of Tanning "to avoid even the appearance of conflict." Tanning, shortly thereafter, closed its offices.

Some could argue that you could chalk all of this up to just bad, but not illegal, business decisions. The fact remains that this waste is robbing consumers, primarily in California, of \$1.3 billion in money that could be funding direct improvements in their care. More alarmingly, this severe disregard for financial integrity is threatening our ability to provide quality healthcare, care which nearly 6.5 million Californians depend on.

The extent to which we have internally attempted to silence or ignore concerns regarding the selection of Epic

and other decisions by Mr. Halvorson and Mr. Dodd is alarming. The Board placed Mr. Garcia in charge of the the investigation of these issues, despite the fact that Mr. Garcia chaired the committee that hired Mr. Halvorson in 2002. The Board also authorized Deborah Broyles write their formal response to these issues. Ms. Broyles is our outside counsel who specializes in defending us against wrongful termination lawsuits.

It is clear to me that we are in serious jeopardy of facing insolvency, and that serious mistakes have been made by our senior management and Board of Directors which have led to and perpetuated this situation. It is my hope that the Department of Managed Health Care can assist us in averting such an event. It is also my hope that the Office of the Attorney General can ensure that our management has made decisions solely with the best interests of our organization in mind, and that our Board of Directors has provided adequate oversight of our operations and finances, as required by our bylaws and California law.

I urge you both to take appropriate action to ensure that Kaiser Permanente remains a strong and stable leader in California and American healthcare.

Sincerely,

Justen Deal

Attachments: *Capitalizing on Our Opportunities in 2006 and 2007*, financial projections presentation
August 4 letter to Daniel Garcia (also copied to Board)
September 7 and September 8 emails with Daniel Garcia
September 8 letter to Daniel Garcia (also copied to Board)
September 11 response from Daniel Garcia
September 13 email to Daniel Garcia
September 18 email to staff members for Daniel Garcia
September 18 letter to independent members of the Board
September 22 response from Deborah Broyles
September 25 letter to the Board and Deborah Broyles
September 26 response from Deborah Broyles
September 26 letter to Deborah Broyles