

The Proposed Transaction between
Independence Blue Cross and Highmark Inc.

Pennsylvania Insurance Department Public Informational Hearings

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Comments by

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My name is Barry C. Harris. I am a Principal and Board Chairman at Economists Incorporated, an economic consulting firm in Washington, D.C. I have been an economist for more than 33 years.

I am an economist who deals with the study and analysis of competition. I have spent much of my career analyzing competition in health care. I have consulted for many hospitals, physician groups and health insurers, including many in the Commonwealth of Pennsylvania. In particular, I have analyzed the competitive impact of health insurance combinations, hospital consolidations, staff privileges and contracting decisions by hospitals, integration between hospitals and other health care providers, and a variety of claims involving monopolization and anticompetitive behavior.

My educational background includes a B.A. in mathematics, which I received from Lehigh University in 1970, and a Ph.D. in economics which I received in 1979 from the University of Pennsylvania.

I was a senior economist in the Economic Policy Office of the Antitrust Division of the United States Department of Justice, where I served from 1974 to 1979. I also was the chief economist in the Antitrust Division of the Justice Department in 1992 and 1993. My official title was Deputy Assistant Attorney General. While in the Department of Justice,

I worked on several health care matters, including the preliminary stages of the creation of the federal health care competition guidelines.

My consulting engagements for health care clients in Pennsylvania include both providers and insurers:

Abington Hospital	Lancaster General Hospital
Aetna Casualty and Life	Lehigh Valley Hospital
Capital BlueCross	Lewistown Hospital
Crozer-Keystone Health System	Mercy Medical Center
Delaware Valley Medical Center	PinnacleHealth System
Easton Hospital	St. Luke's Hospital
Gnaden Huetten Mem. Hospital	Susquehanna Healthcare
Highmark	WellSpan Health
Independence Blue Cross	Several physician practice groups

Highmark and Independence Blue Cross (IBC) engaged me to analyze whether their proposed transaction would have the effect of substantially lessening competition in the sale of health insurance in Pennsylvania or would tend to create a monopoly in any Pennsylvania health insurance market. I also was asked to prepare a report describing my analysis and conclusions. I submitted this report to the Pennsylvania Insurance Department (PID) in January of this year.

I have reviewed the issue of whether the consolidation of Highmark and IBC will have the effect of substantially lessening competition in the sale of health insurance in Pennsylvania or will tend to create a monopoly in any Pennsylvania health insurance

market. When I use the words Highmark or IBC, I'm generally using that term to include the parent companies and their subsidiaries.

My overall conclusion is that the proposed transaction, whether viewed as a change of control of various subsidiaries or as the overall consolidation of Highmark and IBC, will not substantially lessen competition in any relevant health insurance market in Pennsylvania.

Today I will discuss the reasons for this conclusion. While my report addresses several issues, my main focus today will be the market for commercial health insurance, which is the business that makes up the overwhelming majority of the health insurance business of both IBC and Highmark. However, I will make a few comments about the Medicare and Medicaid businesses of the two companies. In the case of the Medicaid business, I will also provide some information that will serve to update the information in my January report.

First, I will discuss what is meant by “competition.” Competition can be described, simply, as firms going head-to-head to win customer sales by offering competing products in the same geographic areas.

More formally, in a competitive analysis, two suppliers of a product or service are competitors when a set of customers considers them to be reasonable substitutes for each

other. If the two suppliers operate in the same geographic area but do not offer products that customers find to be reasonable substitutes for each other, then the suppliers are not competitors. Similarly, if the two suppliers offer products that are reasonable substitutes for each other, but these products are not available to buyers in the same geographic areas, then the suppliers are not competitors.

In other words, competition provides consumers with choices. The existence of choices from alternative suppliers – whether of drug stores, power tools, airline services or, in this case, commercial health insurance – motivates each competitor to offer its services in a price/quality combination desirable to buyers.

In a competitive marketplace, companies work to innovate, reduce costs and improve quality to gain customers. A failure to do so would result in lost sales and lost profits. Because there are alternative suppliers, the gains from innovation, efficiency and quality ultimately get passed to consumers.

In addressing whether a particular transaction or combination reduces competition, it is necessary to ask whether the transaction substantially reduces the choices available to customers. Put most simply, it is necessary to ask: Do buyers have fewer choices after the transaction and, if so, does that matter?

To answer these questions, a competitive analysis considers relevant markets to gauge the impact of transactions on competition. The word “market” can mean many things in

ordinary conversation. It may refer to a specific place where products are sold, such as a supermarket. Sellers sometimes use the term market to identify the geographic area where they sell their product. The word “market,” however, has a very specific meaning in competition analysis.

In competition analysis, a relevant market identifies (and includes) the choices available to consumers. The choices available to consumers must appropriately take into account both the competing products or services and the geographic area(s) within which those consumers have choices.

Identifying the proper relevant markets is a process that involves gathering facts about what and where buyers buy and what and where sellers sell. As I have mentioned, if the products sold by the two suppliers are not substitutes then they generally are not in the same market. For example, automobile repair services are not a substitute for appliance repair services. Similarly, two suppliers might sell similar products to buyers in geographically distinct areas, but they are not substitutes. For example, automobile repair services in Altoona are not a substitute for automobile repair services in Allentown. In that case, since customers in these areas cannot choose between the suppliers’ products, the two suppliers generally are not in the same geographic market.

My analysis first considers commercial health insurance (*i.e.*, what private employers and individuals purchase in the marketplace). Private employers and individuals can choose among a range of health insurance options, including managed care plans, such as HMOs

and PPOs, and indemnity products. I then consider whether the commercial health insurance products sold by IBC and Highmark are reasonable alternatives for any group of purchasers of commercial health insurance. My analysis indicates that IBC and Highmark do not compete with each other to sell commercial health insurance products to private employers and individuals in Pennsylvania, and that this finding holds whether I consider just the commercial managed care products sold by the subsidiaries of IBC and Highmark or all the commercial health insurance products sold by IBC and Highmark.

Commercial health insurers develop and sell commercial health insurance plans based on demands by commercial health insurance customers (largely private employers) for provider coverage (provider networks) convenient to employees' worksites and residences. Both IBC and Highmark market and sell their commercial health insurance within different and distinct geographic regions. IBC sells commercial health insurance in the southeast region of Pennsylvania, while Highmark sells commercial health insurance in the central and western regions of Pennsylvania.¹

My analysis of the business of Highmark and IBC leads me to conclude that the relevant geographic markets for commercial health insurance in Pennsylvania are local or regional

¹ AmeriHealth Administrators, a subsidiary of IBC, however, does provide ASO (administrative services only) and TPA (third-party administration) services to self-insured health plans. AmeriHealth Administrators has only two accounts in Pennsylvania located outside IBC's five-county service area for which it provides ASO services involving health benefits. The existence of these two accounts does not change my analysis or conclusions.

and not statewide.² IBC and Highmark are not actually competing in the same geographic markets for commercial health insurance.³

As I discussed, identifying a relevant market for competition analysis requires digging into the facts of what buyers can buy, where they can buy it and from whom.

IBC markets and sells commercial health insurance to approximately 45,000 groups (employer groups, associations, and unions) and individuals only in the five counties located in Southeast Pennsylvania. These counties are Bucks County, Chester County, Delaware County, Montgomery County and Philadelphia County.

Highmark does not market commercial health insurance to any employer group or individual in these five counties. Rather, Highmark participates through a Joint Operating Agreement (JOA) with IBC that has been in place for decades, pursuant to which IBC markets joint indemnity (not managed care) products. Under this JOA, Highmark provides, as a component of these indemnity health insurance products marketed by IBC, physician services that complement IBC's coverage in southeastern Pennsylvania.

² My analysis considers regions based on the marketing and selling areas of IBC and Highmark (and their subsidiaries) within Pennsylvania. There are four regions in Pennsylvania licensed as Blue Cross regions by the BCBS Association: Central, Southeast, Northeast and Western. I consider these regions because they reflect where and how both IBC and Highmark, whether directly or through their subsidiaries, market and sell their commercial health insurance products.

³ Although in this case there is substantial evidence to the contrary, I understand that when there is no such evidence, the governing statute assumes that the relevant market is the entire Commonwealth. Even if the Commonwealth were assumed to be the geographic market, the proposed transaction would not substantially lessen competition because the parties do not actually compete for the same commercial health insurance customers and there will not be any reduction in choice.

Highmark markets and sells its commercial health insurance products to employer groups and individuals in counties in the western and central parts of Pennsylvania.⁴

IBC does not sell commercial health insurance to groups or individuals in the counties where Highmark offers such products.

To summarize, IBC and Highmark are not competitors, and consequently the consolidation does not result in any anticompetitive effects. Put most simply, no employer groups or individuals in Pennsylvania currently have a choice between IBC and Highmark for commercial health insurance products. However, individuals and employers in the areas served by Highmark or IBC currently do have alternatives to IBC or Highmark for commercial health insurance.

For example, competitors to Highmark in western Pennsylvania include: Aetna, Health America/Coventry, United Health Care and UPMC Health Plan. In central Pennsylvania, competitors to Highmark include Aetna, Capital BlueCross, the Geisinger Health Plan, and Health America/Coventry.

Competitors to IBC in the five southeast counties include Aetna, Coventry and United Healthcare. Cigna also has a small presence in the five counties.

⁴ Highmark owns approximately 40% of two subsidiaries of Blue Cross of Northeastern Pennsylvania. These subsidiaries offer Blue Cross branded commercial health insurance products in the northeast region of Pennsylvania.

These competitors provide choices to consumers of commercial health insurance in these regions. These choices will not change as a result of the proposed transactions. The choices available to customers in western and central Pennsylvania will not change as a result of the proposed transaction. The choices available to customers in the five Southeast counties of Pennsylvania will not change with the proposed transaction.

In other words, customers will have the same choices both before and after the transaction. This means that there will be no elimination or lessening of competition as a result of the consolidation of Highmark and IBC.

In my report, I discuss Medicare Health Insurance at some length. The Center for Medicare and Medicaid Services (CMS) regulates entry by private plans for Medicare insurance products. CMS reviews local entry on a county-by-county basis, and its contracts with local plans are by county. There are more than 10 competing companies licensed to market and sell more than 50 plans to Medicare eligibles in the five counties in the Central Region, where both Highmark and IBC have business units approved to sell Medicare insurance products.⁵ The competing companies offering plans to Medicare eligibles in these five counties include: Capital BlueCross, Coventry, Geisinger Health Plan, Humana, Unison / United Health Care, and WellPoint.

⁵ The term Medicare eligibles includes all people eligible for Medicare, whether or not they are also eligible for Medicaid. The five counties are: Berks, Lancaster, Lehigh, Northampton, and York. Highmark offers MediGap and Medicare Advantage plans in these counties, and its Gateway subsidiary offers special-needs Medicare Advantage plans to dual eligibles in these five counties. IBC, through its AmeriHealth HMO subsidiary, offers special-needs Medicare Advantage plans to dual eligibles in these five counties.

I also discuss Medicaid Programs in my report. Since I submitted my report in January, four new firms have submitted responses to the Department of Public Welfare's (DPW) RFP to provide Medicaid Programs in the Lehigh/Capital region beginning on or about January 1 of next year. Thus, after the proposed transaction is concluded, the DPW will still be able to choose from at least 5 independent companies. This circumstance underscores the reality that the proposed combination will not substantially lessen competition for Medicaid enrollees or for DPW in connection with the Medicaid program.

My conclusion is that the proposed transaction will not substantially lessen competition for Medicare or Medicaid eligibles in any region of Pennsylvania.

Overall Conclusions

Commercial health insurance customers purchase health insurance products that offer the services of physicians, hospitals and other medical providers close to where they or their employees work and live.

The relevant geographic markets for commercial health insurance products in this transaction are regional, not statewide. There is no evidence to support an assumption of a statewide market in this transaction.

IBC and Highmark do not sell or market commercial health insurance products in the same geographic areas in Pennsylvania. Thus, IBC and Highmark do not compete for the same buyers of commercial health insurance in any part of Pennsylvania.

The proposed transaction does not reduce or change the choices available to buyers of commercial health insurance anywhere in Pennsylvania. Highmark's customers will have the same choices before and after the proposed transaction, and this is also true of IBC's customers.

The proposed transaction will not substantially lessen competition in any relevant market for commercial health insurance.

The proposed transaction also will not substantially lessen competition for Medicare or Medicaid eligibles in any region of Pennsylvania.

Thank you.