

Testimony of
Richard Schott, M.D.

April 9, 2007

Testimony: IBC / Highmark Merger

Presented to
U.S. Senate
Committee on the Judiciary

On April 9, 2007

By
C. Richard Schott, MD
Vice Chair

Good morning. I'm C. Richard Schott, MD, vice chair of the Pennsylvania Medical Society's Board of Trustees.

Let me begin by thanking Senator Specter and this committee for inviting the Pennsylvania Medical Society to speak today on the proposed merger of Independence Blue Cross and Highmark Blue Cross and Blue Shield. It is truly an honor.

As you already now, according to news reports, the proposed IBC-Highmark merger is a mega-merger. It would form the third largest health insurance company in the country. By far, it would be the largest in Pennsylvania. And, the new company would control 53 percent of the Pennsylvania health delivery market. Based upon the enrollee figures from both companies that were mentioned in the merger news release, the new IBC-Highmark company is estimated to have 8 million enrollees. Some of these would be out-of-state residents, but the majority would be Pennsylvanians. Census numbers suggest that there are roughly 12 million Pennsylvanians; so needless to say, this new company would insure the majority of our state's residents.

Rumors of this merger have been floating around for quite some time. So, in all reality, it didn't surprise the Pennsylvania Medical Society when it was officially announced. And, prior to IBC and Highmark formally announcing their intentions, the Pennsylvania Medical Society was able to meet with the chief executive officers of both companies at which time we began a dialogue as part of our investigation to determine if this merger will be a good one for patient care. We are continuing our dialogue with the two companies as we further our review.

Even though historically the Pennsylvania Medical Society has expressed concerns when mergers are announced, we are not rushing to judgment until we have all of our questions answered. Similarly, we hope that regulators and others will not rush this merger marriage down the aisle until we can ensure it will do no harm to the public.

The Pennsylvania Medical Society believes that no merger should move forward until the benefits to patients and health care professionals are well defined. Until that is determined, the Pennsylvania Medical Society will closely monitor the proposed merger and articulate our concerns. Some believe the growing trend of consolidation within the health insurance market has the potential to imperil competition and threatens health care quality and patient access to care.

Highmark and IBC currently do not compete in the same areas of the state. But that doesn't mean it couldn't do harm. It's possible that a merger of this size could deter new competition in those markets, causing insurance premiums to increase at a more rapid rate than we are already experiencing. So, our first question is "will the size of this merger stop other health insurers from entering the Pennsylvania market?"

In theory, the new IBC-Highmark company should gain economies of scale that very favorably could impact the cost of health insurance. And, that leads us to our second and third questions. How long will those economies of scale benefit the public? And, when those economies of scale end, what happens?

The joint news release from Highmark and IBC on March 28, 2007, stated that "the new, combined company will have the resources to hold administrative fees flat for two years."

Published studies show that health insurers exhaust their economies of scale at 100,000 to 150,000 enrollees. Our own work confirms this conclusion, albeit at a slightly higher number. Insurers with one million, two million, four million, or five million enrollees are not any more efficient and may, in fact, be more inefficient than smaller ones. As stated earlier, based upon adding enrollee figures from both companies that were mentioned in the merger news release, the new IBC-Highmark company is estimated to have 8 million enrollees.

But, based upon the IBC-Highmark promise to hold administrative fees flat for two years, does that mean that after two years, we can expect a big jump in the merged companies operating costs? And, during those two years, will competition in Pennsylvania be stifled? When the IBC-Highmark promise to hold fees flat for two years ends will competition exist to keep their costs in check? Competition generally improves price, service quality, consumer choice, and clinical quality. Will the reduction in competition negatively impact those considerations?

If so, this could negatively impact everyone from patients to hospitals to health care professionals to government. With an insurance monopoly, the new company could exclusively control the insurance market that allows for premium competition. That could negatively impact employers, patients, and government. Similarly, could this create a monopsony in which there is only one buyer in the market? If so, this would negatively impact health care professionals and hospitals, giving them little opportunity to play on a balanced field.

A balanced playing field. Let me say that again. A balanced playing field. Ultimately, that leads us to our most important question.

If this merger goes through, will there ever be a balanced playing field between health insurers and health care professionals? Will those who contract to do work for health insurers be able to

select which insurance products they accept, or will the single mega-company dictate providers accept all of their products or none. Will there be fair contracts? Or will the standard "take it or leave it" approach and insurer imposed cost-cutting mechanisms be used?

The lack of competition among health insurers in health delivery markets throughout the country and in Pennsylvania, as well as the consolidation of health insurers across the nation, raises serious concerns for the provision of quality patient care. As patient advocates, physicians are often undermined by market dominant insurers and prevented from providing necessary care. As a result, dysfunctional markets have produced:

- ? annual double-digit health insurance premium increases going back to the early 1990s
- ? unilateral decisions about hospital payment
- ? physician fee schedules that are unilaterally imposed and have provided stagnant or declining compensation
- ? substantial profit levels for health insurers

Insurer market consolidation alone can be detrimental to consumers from a financial perspective. While many large Pennsylvania insurers are posting huge profits and surplus reserves, premiums continue to skyrocket (Pennsylvania has some of the highest premiums in the nation), and patient cost sharing continues to increase without any increased benefit.

Furthermore, based on a 2005 update by the American Medical Association, the Pennsylvania statewide Herfindahl-Hirschman Index (HHI) for all HMO and PPO products is 1513. This would make the Pennsylvania market "concentrated" based on the 1997 Federal Trade Commission / Department of Justice Horizontal Merger Guidelines (FTC/DOJ guidelines). This number is probably low since it is very difficult to obtain accurate PPO numbers. Under the guidelines, a merger in these markets that raises the HHI by more than 100 points may raise significant competitive concerns. If the market has an HHI above 1800, which the Pennsylvania statewide market probably is if accurate PPO numbers were known, the market is considered "highly concentrated" under the guidelines. A merger in these markets that raises the HHI more than 50 points may raise significant competitive concerns and mergers that raise the HHI more than 100 points are presumed to be anti-competitive. It is therefore imperative that the FTC / Justice Department collects accurate HMO / PPO numbers to determine the correct HHI for the Pennsylvania market. If the HHI were found to be above 1900, a combination of Highmark and IBC would not be permitted under existing FTC/DOJ merger guidelines.

In conclusion, I ask, "Will the proposed IBC-Highmark merger be good for Pennsylvania?" At first glance, maybe. But below the surface ... well, there are questions that need to be investigated.

And that's why something this big needs the attention of the federal government, either through the Department of Justice or the Federal Trade Commission.

Thank you.