Testimony of

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Consolidation in the Pennsylvania Health Insurance Industry: The Right Prescription?

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My name is Barry Harris. I am board chairman of Economists, Inc., here in Washington and am a former Deputy Assistant Attorney General in charge of economics at the Antitrust Division of the Department of Justice.

I submitted a report to the Pennsylvania Insurance Department in January of this year. In that report, I addressed whether the proposed consolidation 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 health insurance market in Pennsylvania.

My overall conclusion is that the proposed transaction will not substantially lessen competition in any relevant health insurance market in Pennsylvania.

Let me now turn to the reasons for this conclusion. My primary focus today is the market for commercial health insurance which makes up the vast majority of the health insurance businesses for both Highmark and IBC. First, I will discuss what is meant by competition.

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. That is, if customers cannot choose between the products of the two firms, then the firms simply are not competitors and are not in the same market. For health insurance products, it is appropriate to focus separately on individuals, small group purchasers and large group purchasers because these groups may not have the same choice of insurers to which they can turn. For example, individuals and small group customers do not normally have the choice of self insurance that is often selected by large group customers.

More generally, if two suppliers operate in the same geographic area but do not offer products that customers find to be reasonable substitutes for each other, then these 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 area, then these suppliers also are not competitors.

In order to address whether a particular transaction reduces competition, it is necessary to ask whether the transaction substantially reduces the choices available to customers. This is a fact-based inquiry that requires a careful review of the specific facts related to the specific transaction. To answer these questions, a competitive analysis typically considers relevant markets.

The word "market" can mean many things in conversation, but it has a very specific meaning in competition analysis. A relevant market for competition analysis identifies and includes the choices available to customers, and it accounts for both the competing products or services and the geographic areas in which they are offered. At the end of the day, the concept of a market is quite simple. If the products are not substitutes, then they are not in the same product market.

Let me now turn to the specific facts of the proposed Highmark/IBC consolidation. I found that IBC and Highmark are not reasonable alternatives for one another. The simple reason is that IBC and Highmark do not sell commercial health insurance to the same customers in the same geographic markets, whether the focus is on sales to individuals, small groups, or large groups.

I found that the relevant geographic markets for commercial health insurance in Pennsylvania are distinctly local or regional and certainly are not statewide. 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 same conclusion about the local nature of health insurance markets was reached by the American Medical Association in its 2007 update of competition in health insurance. This is not simply an opinion, but reflects the actual facts about where customers in Pennsylvania can buy commercial health insurance products and from whom.

In considering these local markets, I first focused on IBC. IBC markets and sells commercial health insurance products to groups and individuals in only the five counties located in the southeastern region of Pennsylvania. Highmark does not market or sell commercial health insurance in these five counties, though it does provide a variety of services to IBC through their Joint Operating Agreement and other joint venture agreements that have been place for many years.

For its part, Highmark markets and sells commercial health insurance products to groups and individuals only in the 29 counties located in the western region and the 21 counties in the central region of Pennsylvania. IBC is not licensed to use any Blue trademark in those areas of Pennsylvania and does not sell commercial health insurance to groups or individuals in the counties where Highmark offers its products. Consequently, Highmark and IBC are not competitors and are not in the same geographic markets.

The mere fact that Highmark and IBC both sell commercial health insurance products to customers in Pennsylvania does not make them competitors, since they operate in different geographic markets and since individuals and business owners in Pennsylvania cannot and do not choose between IBC and Highmark when buying health insurance.

Highmark and IBC, however, do compete against other commercial health insurers in their respective geographic markets. Competitors to IBC in the southeast region of Pennsylvania include Aetna, United Healthcare, CIGNA and HealthAmerica. Customers in southeastern Pennsylvania cannot turn to Highmark; they cannot turn to Capital Blue Cross; they cannot turn to UPMC; they cannot turn to Geisinger; and they cannot turn to Northeastern Blue Cross. And moreover, they cannot access the rates Aetna and the other commercial insurers offer to consumers residing outside the southeastern region. For these reasons, the southeast region is an appropriate market for competition analysis.

With respect to western Pennsylvania, competitors to Highmark in western Pennsylvania include UPMC Health Plan, HealthAmerica, Aetna, and United Healthcare. Residents of western Pennsylvania cannot turn to IBC or Capital Blue Cross or Northeastern Blue Cross, nor can they access the rates offered to residents of other areas. Consequently, the western region of Pennsylvania is an appropriate market for competition analysis.

And finally, turning to the central region of Pennsylvania, competitors to Highmark include Capital Blue Cross, HealthAmerica, Aetna and the Geisinger Health Plan. Residents of central Pennsylvania cannot turn to IBC or Northeastern Blue Cross or UPMC, nor can they access the rates offered to residents of other regions of the Commonwealth. Consequently, the central region is an appropriate market for competition analysis.

These other competitors that I mentioned provide choices to consumers of commercial health insurance in each of these regions. These choices will not change as a result of the proposed transaction. That is, choices will not change as a result of the transaction in the southeastern region, the central region, the western region or anywhere else. Consumers will have the same choices before and after the proposed transaction. This means there will be no elimination or lessening of competition as a result of the consolidation of Highmark and IBC.

This conclusion applies equally to individual purchasers, small group purchasers and large group purchasers. It also applies to so-called statewide purchasers. It is true that some purchasers of health insurance want coverage throughout the state or the nation for their employees. This, however, does not mean there is a statewide or nationwide market. There is a difference between where consumers physically consume or use a product and where they can actually turn to purchase that product. It is the second consideration that determines the geographic market definition. For example, a company headquartered in Harrisburg that wants health insurance for its employees located throughout Pennsylvania or the United States cannot turn to IBC to purchase this product.

The issue of potential competition has been raised in this matter, and specifically whether Highmark would enter the southeast Pennsylvania market if there were no Highmark/IBC consolidation. In the past I have dealt with the issue of potential competition under the federal antitrust laws, and I would like to comment on its relevance here. First, potential competition is an issue that only comes into competition analysis under very specific circumstances and thus is fairly unusual. Second, several conditions must all be present for the concept to apply. The most important of these conditions is that if Highmark does not plan to enter the southeastern Pennsylvania region in the absence of the transaction, then there is no basis to apply the concept of potential competition.1

My overall conclusions may be summarized as follows. First, markets for commercial health insurance products are local and regional and are not statewide. Second, IBC and Highmark do not compete for the same buyers of commercial health insurance in any part of Pennsylvania and therefore are not in the same geographic markets. Third, the proposed transaction will not reduce or change the choices available to buyers of commercial health insurance anywhere in Pennsylvania.

My conclusions are entirely consistent with the decisions of the Department of Justice, which has twice reviewed and cleared the proposed consolidation through the HSR process. The second filing became necessary because HSR clearance is effective for one year, and the Pennsylvania Insurance Department process has extended beyond that initial one-year period. During one or both of these reviews, the DOJ investigated the horizontal competition and potential competition issues I have addressed, including an evaluation of both commercial and noncommercial health insurance products. The DOJ's repeated clearance of the transaction demonstrates that it concluded, as I have, that the consolidation would not eliminate meaningful competition or potential competition in any geographic market or for any Pennsylvania customers, including individuals, small groups or large groups.

1 The potential competition doctrine also does not come into play unless a market is suffering from a lack of competition already and unless the potential competitor is the most likely source of new competition absent the transaction at hand.