Press Conference Materials

pennsylvania
INSURANCE DEPARTMENT

Excerpts from the Philadelphia Hearing *Blue-on-Blue Competition*

Exchange among Ario, Frick and Melani

Excerpt #1: pages 60-70, from Tues. 7/15 Phila. hearing—day session

COMMISSIONER ARIO: When I look at [IBC competing with Highmark], if I was trying to put myself in your shoes, I can understand some of the reasons why you might be skeptical of that. But to say that it's such a certainty that I'm not even going to do any due diligence, I'm not even going to analyze the issue, not even study the issue at all, does that seem like good due diligence to you? I 'm going to come to Doctor Melani. I'm just asking about the IBC side of it now.

MR. FRICK: Well, I would counter to that, I mean, in terms of hiring an external consultant at this point in time to evaluate that. And I think what Highmark looks at, and I'm not speaking for Ken, they have a significant long standing relationship with Independence BlueCross. We continue to jointly operate BlueCross and BlueShield products for folks who buy our traditional indemnity plans, for seniors who buy Security 65. We operate as an agent for them in selling their dental and vision programs to our health care customers. And so I think when they look at us, they look at us as partners, as a source of revenue and margin. And in their planning, I think their efforts are more toward how can we extend that partnership because it works well as opposed to how can we blow up that relationship and start from scratch in competing. So I would say that in their planning processes, just like we do, we always do strategic planning, but at this point in time when we have decided that there's such a compelling benefit for our two companies to come together, why at this point in time hire an outside consultant to look for starting anew from scratch? I can see why they wouldn't have it done at this time.

COMMISSIONER ARIO: Okay. Now, I do want to turn it to Doctor Melani because I think you [can] make a better case for the Highmark [opportunity] in the southeast. You get a branded competition there. You already have the doctor networks which are the thousands of relationships you have to establish versus just a few relationships on the hospital side and so forth, as far as we've discussed in the past. If Highmark isn't an ideal potential competitor in the Southeast, I don't know who would be. I do appreciate that you said, no, we don't really want to do it. And as I pressed on in Harrisburg, you said, yeah, if we can't do it, it would be pretty tough for somebody else to do it. I think you said that they'd have to quote/unquote, ramp up their look into Pennsylvania, which is why we get into this concern. As you said, competition is an important thing here and so if the story is we can't do it, even though we have many advantages that nobody else does, it really does raise questions whether anybody can do it and kind of causes me to go back and press harder on that potential competition issue. So for you, I just have to ask that same direct question. I know you to be a man of analytical rigor, looks---look at these things and analyze them and don't just go with kind of knee-jerk things, but what I heard you say today was since we don't have a presence in that part of the state, and you did in the central part of the state, it hadn't worked out perfectly for us in the central part of the state yet. And there's an easier route for us to just consolidate here, it's not worth even---I think your last words were exactly my question, which is we don't need a study to show us. I mean, how many other issues do you approach that way of just saying why bother even studying this, I've got a few kind of off-the-cuff judgments on the matter and I'm not even going to study it? Isn't there a due diligence issue here with not even looking at that as an option?

DR. MELANI: There are many times we take a high-level cursory look at something and make a quick assessment and decide it's not worth studying. We can ascertain the outcome from a high level. And I want to be clear on something. I don't believe I did say that it would be difficult for someone to come into a marketplace. I think I did say that there have been new entrants in the marketplace that have done significantly well. UPMC was cited by me as an organization that started just a few years ago and has 1.2 million members in their health plan. So that's a new entrant that's done extremely well. Three Rivers Health Plan, which became Unison, is now United, is doing fairly well in the state. Coventry continues to do well and continues to grow. We've seen entrants all across the marketplace throughout the years. And people find a way to get the networks they need to provide the services they need and then the market effectively competes. And there aren't those kinds of barriers that prevent competition. What I was saying is it's our decision not to enter the market and compete and why it would be unreasonable for us to do that and difficult for us to do that. First of all, yes, we do have physician networks, but we have no hospital network. As you know, in the southeastern Pennsylvania marketplace, the hospital systems are highly consolidated, highly concentrated. Our experience in central Pennsylvania shows that from a consumer perspective, when you compete Blue and against Blue and get multiple competitors, the price of playing in the market place goes up. The payment to providers goes up. And that's not healthy for our customers. And as I said, we've seen our premium increases rise more dramatically in central Pennsylvania over time because of that factor. And so that's not something that we take lightly. Our responsibility is to make sure healthcare is more affordable not more expensive. Secondly, as Joe outlined, we've had a relationship in southeastern Pennsylvania that's very healthy for us. We have a significant amount of business in our subsidiaries, our dental and our vision subsidiaries. We write a lot of stop-loss business over top of the IBC products. So we have revenue. We have profits coming from this marketplace. To enter a marketplace that from our perspective, based on history in central PA, looks like a marketplace would be, number one, very costly to enter, and secondly, would take a significant amount of time to ramp up to get to even a break even point doesn't make sense to put a risk business that's very profitable for you in a relationship that you have with another party. I think the third thing that's even more important is we currently have customers that we're responsible for that are headquartered in the western and central part of the state. Those customers rely on services in the southeastern part of the state. And so our partnership with Independence BlueCross allows them to access the current network they have in this marketplace freely and access the discounts that are available through Independence BlueCross. We would potentially jeopardize that benefit for those customers if we elected to come in and compete and potentially raise costs to them by what we've seen in central Pennsylvania. So I think all those things say that this is not something that's worth analyzing. We paid Booz Allen a lot of money, a lot of money, to study the consolidation. I don't want to pay them any more for a wasted study that's of no value.

MR. FRICK: Commissioner, the only other thing I'll add about southeastern Pennsylvania is, you know, we've talked about the competitive environment there with the national for-profit competitors, but also---and I wish this was a market that was growing, that population trends were on the way up, but you know, those of us in this community who are working very, very hard to do economy building efforts in this region, this is a flat market and it's been for some time. So there's not a lot of growth potential in this marketplace. We're all competing for the same existing membership and there's not additive growth in terms of jobs and population that enables this to be considered a market that has high potential for growth. It's just not.

DR.MELANI: The other thing, if you look at this market, you have well-established, high-capitalized organizations in this marketplace which make it very difficult for new entrants, again because of the Uniteds, the Aetnas, the other players you have in the marketplace. It's a very unique marketplace in that regard. These are longstanding players who have a significant relationship presence in the marketplace. In central Pennsylvania we had that. We didn't go in there de novo. We had an existence. We had a book of business. We shared with Capital BlueCross. That was substantial. We had relationships, we had employees, we had a foundation to build on. It wasn't de novo. Very, very different situation. And I will also add, the problem I see also in coming into this market is brand confusion and a diminution of the brand's value if we were to come in here and compete Blue against Blue. And that's very important. In central Pennsylvania it's very confusing to customers. It's very confusing to providers. Blue against Blue. No one knows if they have Cross or Shield. I've heard many times in many hearings, senators even saying they had the wrong coverage. They had the wrong company when they talked about which company they were doing business with or had an issue with. It's not healthy to destroy the Blue brand. It's of significant value. So our preferred approach is consolidation.

COMMISSIONER ARIO: Okay. Again, I can understand why that's your preferred approach. I've got to look at it in the perspective of consumers of the state and what's better for competition in the state and so forth. And I can tell you, we're going to have to study that issue. I mean, we will look at it. We will do the pro formas and so forth. We just wish we had some help from you guys on looking at that. And again, I just think, you know, ten years, Ken, is a long time and I think it probably merited a look. But let's move on.

Excerpt #2: pages 75-87, from Tues. 7/15 Phila. hearing—day session

COMMISSIONER ARIO: Assuming we get by the initial hurdles and now we're talking about well, it could be approved but may be there are conditions that are to go with it because there are some weaknesses in the case that have to be compensated for. On the competition question, one way to compensate for the weaknesses, because again, all the things that you've said about how hard it is to get in to that Philadelphia market, it's two-edged. It's hard for you to get in, but I have got to think about all the other competitors. And if you can't get in against United and Aetna and IBC, you know, again, who can today? So what could we do with the competition question in this transaction? Let's look at the Bluemark. Today the way the transaction is proposed, you would have one Blue mark in central Pennsylvania, you'd have one Blue mark in northeast Pennsylvania, and you'd have two Blue marks in Pittsburgh and two Blue marks in Philadelphia, which are the two markets that we're most concerned about competition in. What if we said this is a deal that's close on competition but needs a push to get across the line, and the way to get it across the line is for you to surrender one of the marks, Blue Cross mark in Pittsburgh and Philadelphia, as part of this transaction so that you end up with one mark state wide, giving you the full state to compete on? I don't think there's really a case to be made that you wouldn't be able to successfully compete with the Blue brand across the state. You don't really need two to do that. And what it would open up is the possibility - - - and the way I'm proposing it today wouldn't give the mark to anybody else. I don't think we could do that even if we wanted to. I think the Association's been pretty clear about its legal rights to control the mark. But the Association would sit there with a mark for Philadelphia, a mark for Pittsburgh, that they could choose to give Capital, Well Point , whoever they might want to give it to, to open up some competition. What do you think of that as a condition? I know you guys don't like it, but tell me why it's not good for the citizens of Pennsylvania to do that.

MR. FRICK: Well, first of all - - - .

DR . MELANI: I think we could both say no.

COMMISSIONER ARIO: That's why I said, tell me why it's not good for the citizens of Pennsylvania.

MR . FRICK: Well, first of all, our citizens have benefited from a 70-year investment in the Blue Cross brand in southeastern Pennsylvania. In addition to our employees, our community mission, our membership base, the data that we have, I can't think of any more significant and valuable corporate asset than our brand. If you drove down Market Street today, you saw Choose Blue. We market the Blue brand. As Ken said, in Pennsylvania the Blue brand is confused and diminished by our configuration. In most areas of the country, it's BlueCross/BlueShield. But the national Association is the Blue Cross and Blue Shield Association. As Ken said, many times in these proceedings the customer viewed this as one brand. When folks call our call center, they say is this Blue Cross and Blue Shield. We say yes, no, yes. The brand is our most significant asset. I can't---I can't imagine any price that would enable the Board of Directors of Independence BlueCross to consider giving up such a valuable investment that has been, you know, the equity of 70 years of doing business in this market place under any condition.

COMMISSIONER ARIO: Let me just move on a little bit. You said it's people confuse the brands, it's one brand and so forth, you still have Blue. You still sell Blue. How many people do you think know the difference between Blue versus, well, tomorrow it's BlueShield instead of BlueCross? Do you think people will go, gee, I'd really like to---oh, that brand went over to Blue Cross. But if it's BlueShield, it's a different thing and now I'm done with my brand loyalty there. It seems to me if you have a Bluemark, you have a Bluemark.

DR. MELANI: That's our point, they're seen as one. That's exactly the point. They are seen as one. And they have tremendous value, tremendous equity value in the market place. And as Joe said, for 70 years we've been building that equity in the market place and there's no way we'd give up that equity. This transaction is not worth giving up that equity.

MR. FRICK: No, we will not give it up. How does it make sense to the customers in the market place if then the new Blue comes in? So there, forget the old Blue, you got the new Blue. And that new Blue benefits from 70 years of work in this market place. I mean---I.

COMMISSIONER ARIO: Well, we asked Doctors Melani and Smith, you know, how that worked in central Pennsylvania, and there's---by the way, there are different stories about central Pennsylvania. You say it hasn't worked out well and so forth, other people say it's---their premiums are pretty good there, and so that's a question again we have at the table for Doctor Harris is really drilling down more on is central Pennsylvania, which does have more competition. Is that good for consumers or not? And I understand your view that it's not, but there's other views out there. It's not a closed question. It's not a slam-dunk question.

DR. MELANI: Well, I think when you look at the facts you'll see it's not. I mean you can't have companies that haven't made any money in operations for five years and say that that's healthy. You can't say the premiums that are increasing at a faster rate than they are in other parts of the state is healthy for consumers. You can't say that the providers' margins that are escalating at a higher rate than they are in the other parts of the market is healthy for consumers. But I think if you look at the---.

COMMISSIONER ARIO: But all I'm saying is all those predicates there are under contention. There are no---we've got one very simple comparison chart that doesn't allow for different ways of looking at those questions. So I'm not saying you're wrong. I'm just saying that that's a contested question, that's all. Do you want to say anything more about the brand? And you'd still have the brand and the Association, we won't tell the Association what to do. They might for all the reasons you---you're right. They wouldn't give the brand to anybody else because they would see it as polluting it. But they have chosen to do that in California, the biggest state in the country. They have---that market is a functional, effective market, I believe, and it has Cross-on-Shield competition state wide.

DR.MELANI: Well, let me be clear what happened in California. They didn't choose to give the brand. The brands existed. There were consolidations in California between Cross plans and Shield plans that eventually led to two singular plans in the state. There were massive consolidations. One plan went nearly bankrupt and they permitted that plan to go for-profit. And that was the choice they made, so it---it wasn't the Association---.

Excerpt #2: pages 75-87, from Tues. 7/15 Phila. hearing—day session

COMMISSIONER ARIO: That's the same as---the same as here, which was---it was that they didn't choose to do Blue on Blue here but as a result of the consolidations that were done in 1996 to create Highmark, you did at that time accept, not you personally, your company, accepted the Blue on Blue competition. You had a mark in the central region and in the northeast and really across the state. You took the Shield mark against somebody else having the Cross mark. So the precedent is right there for doing that.

DR. MELANI: I want to be clear on that. What you raised was the Association allowing forth a brand to be bastardized and to be used in a competitive basis, Blue against Blue, I would say that there's no real history of the Association having given brand to allow it to be bastardized and to lose its market value. There's no precedent for that. In fact, recently in Idaho,---.

COMMISSIONER ARIO: Distinguish the '96 case for me where the result of that transaction was that the brand was either, let's use your phrase, bastardized because the Shield was given to this new company in the same area where somebody else had the Cross, in fact, all of the state except for Pittsburgh. Wasn't that the same thing?

DR. MELANI: Oh, no. I'd like to be clear on this. Shield was already owned by the company or was already granted to the company. So the Shield already existed---.

COMMISSIONER ARIO: But it was given to a company that also had a Cross in one part of the state.

DR. MELANI: In 1996, the Shield and the Cross came together and Highmark got the right to use those two. At that time we had a joint operating agreement in central Pennsylvania. So there was no competition in central Pennsylvania when that transfer of the brand was granted.

COMMISSIONER ARIO: Okay. I think that, you know, I want to put the question on the table because these questions don't come from nowhere. They've come from people---

DR. MELANI: Absolutely.

COMMISSIONER ARIO: ---who have commented. I think it's a good question, and we'll probably have more follow-up on that as we go forth. A couple of other---.

MR. FRICK: I guess my last word on that is that, again, there's a key distinction between a licensing agreement with the Association and the ability to use the license as opposed to a brand that we invested over 70 years to build that brand to be regarded as the health plan of choice for our region. So as we talk about conditions for this combination and you've mentioned several times, and I know there's a lot of debate and discussion on that, to me, anything related to the brand would be a non-starter for IBC.

DR. MELANI: Commissioner, also, simplistically, why would we be here proposing a transaction or merger to create scale, which is the reason we're doing this, and then do something that simply takes away that scale? It makes us worse than we were to start with. It would be a silly move on behalf of the organization.

Excerpt #2: pages 75-87, from Tues. 7/15 Phila. hearing—day session

<u>COMMISSIONER ARIO:</u> If I agreed with your premise, that'd be right. But I don't necessarily agree with that premise. I think I need to hear more about that, because again, from my perspective right now, you would have the scale, you would have a Blue mark statewide, you'd have the scale to do what ever you wanted and all you'd have is another potential competitor that would have come from your own Association, would have to decide to do this. And so in that sense, you know, whether it'd be a WellPoint or some other national carrier, separately, you're always going to face potential competition. And for the same reasons I thought you'd be a good potential competitor in Philadelphia, it seems to me like you could enhance competition in the state to have at least the potential for another Blues plan, maybe a WellPoint Blues plan to come in and compete. Or maybe a local company like Capital, too. Anyway, I think we do want to get to public comment.