Bybee, Cressinda

From: Stover, Jack <jack.stover@bipc.com>
Sent: Thursday, February 19, 2015 3:01 PM
To: Bybee, Cressinda
Subject: Response to Public Comment of Insurance Federation
Attachments: HBG1_GENERAL-#1918656-v10-Letter_of_S__Marshall_Response.pdf

I am attaching a response of Highmark Inc. to the letter dated February 2, 2015 from Samuel R. Marshall on behalf of the Insurance Federation relating to the Highmark Inc. application for a change of control of Blue Cross of Northeastern Pennsylvania. We are providing a copy of this response to Mr. Marshall and others copied on his letter by mail.

Jack Stover
Shareholder

409 North Second Street
Suite # 500
Harrisburg, PA 17101-1357
717 237 4837 (o)
717 574 4655 (c)
jack.stover@bipc.com

vCard | Bio | BIPC.com | Twitter | LinkedIn

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BEFORE THE INSURANCE DEPARTMENT
OF THE
COMMONWEALTH OF PENNSYLVANIA

Statement Regarding the Acquisition of Control of or Merger with Domestic Insurers:

Hospital Service Association of Northeastern Pennsylvania
d/b/a Blue Cross of Northeastern Pennsylvania;
First Priority Life Insurance Company, Inc.;
HMO of Northeastern Pennsylvania, Inc. d/b/a First Priority Health

By

Highmark Inc., a Pennsylvania nonprofit corporation

Response of Highmark Inc. to
Comments of Samuel R. Marshall Dated February 2, 2015

Highmark Inc. ("Highmark") is responding to the Letter ("Letter") of Samuel R. Marshall on behalf of the members of the Insurance Federation of Pennsylvania ("Federation") received by the Pennsylvania Insurance Department ("Department") on February 2, 2015 regarding the proposed merger ("Merger") of Highmark and Blue Cross of Northeastern Pennsylvania ("BCNEPA"). The Letter is numbered as Document 0862 on the Highmark/BCNEPA Cumulative Log page of the Department's website.

At the outset, it is important to put the Letter and the comments contained in it in context. Although the Letter attempts to portray its content and purpose in public-spirited terms, the Letter is, in fact, an attempt by competitors of Highmark and BCNEPA to delay the Merger approval process and obtain competitive advantages for themselves.[1]

Although the Letter claims that the Federation "is committed to regulatory and legislative policies that foster, not control or limit, competition" and that "a properly regulated competitive market . . . best serves consumers", it is obvious from what follows in the Letter that the Federation's real interest is in protecting its insurance company members from competition from non-members – notwithstanding the beneficial effects that such competition might have for consumers.

This point is made clear by both the timing and content of the Letter. The Letter was delivered to the Department on the last day of a public comment period that was continuously open for more than 11 months, from March 1, 2014 through February 2, 2015, and 10 weeks

[1] In competition analysis, competitor positions are generally accorded less weight for the obvious reason that they are driven by self-serving concerns. See, for example, the DOJ/FTC *Horizontal Merger Standards*.

following a public hearing on November 12, 2014 at which interested parties had an opportunity to participate and at which no representative of the Federation commented.

The initial recommendation in the Letter that the Merger be "stayed" pending "further analysis of the [M]erger's impact" on other insurers -- i.e., the Federation's members -- is plainly intended to benefit those members by causing market confusion for BCNEPA customers and leaving insufficient time for Highmark to participate in open enrollment for 2016, thereby also (and not incidentally) delaying the benefits of the Merger.

The Letter follows the publication of five expert reports (three submitted by a highly qualified economist retained by Highmark and one each prepared by a nationally recognized economist and investment advisors retained on behalf of the Department) which demonstrate, among other matters, the procompetitive effects of the Merger and the benefits of the transaction to the insurance-buying public – the appropriate focus of the Department's approval process. These expert reports, all of which support the Merger, were prepared by individuals with recognized professional credentials in the relevant subject matter areas. By contrast, the Letter offers unsupported advocacy on behalf of a group with a vested interest in the outcome of the review process. In short, there is no legitimate reason for further delay in the Department's consideration, and delay is not in the interest of consumers. The sole beneficiaries of delay would be the Federation's members.

The Letter's recommendation in the alternative that, if the Department approves the Merger, it should do so only subject to various conditions which the Letter says will "promote competition and sound fiscal oversight" of the merged company also lacks any legitimate basis. In fact, to the extent they are even relevant, the proposed conditions would accomplish nothing more than to tilt the competitive landscape -- across the Commonwealth of Pennsylvania -- in favor of the Federation's members and to the detriment of Highmark and the insurance-buying public. For this reason, Highmark respectfully requests that the proposed conditions should be rejected.

Highmark addresses Mr. Marshall's specific individual comments below.

1. The absence of competitive impact of the Merger

The central premise of the Letter is that the Department should focus its competitive analysis on the impact that the Merger will have on the "competitive abilities" of other insurers; i.e., the Federation's members. In this regard, the Letter misses the fundamental point that the goal of a competitive analysis is to evaluate the effect of a transaction on competition, not on individual competitors. Contrary to the Letter's position (for which the Letter offers – and can offer -- no authority), "a primary benefit of mergers to the economy is their potential to generate significant efficiencies and thus enhance the merged firm's ability and incentive to compete, which may result is lower prices, improved quality, enhanced service, or new products." DOJ/FTC *Horizontal Merger Guidelines*.

The Letter devotes much of its commentary regarding the competitive impact of the Merger criticizing the work of the Department's engaged economist, Compass Lexecon,

recognized professionals in the field of competition. In its criticism, the Letter states, among other things, that, "Highmark promises to bring new ideas and new efficiencies" to the market, suggesting that this somehow justifies a competition concern. Highmark does, in fact, intend to strengthen BCNEPA's current competitive position by bringing new ideas and efficiencies to the market, but it strongly disputes the idea that Federation members should be shielded from having to meet this competition, offer their own new ideas and find their own new efficiencies. This is the essence of competition; it will benefit consumers. The Letter's real concern appears to be that the efficiencies may force the Federation's insurance company members to become more competitive. This would be a benefit of the Merger, not a reason to object to it.

2. The fiscal soundness of the Merger

The Letter also argues that the Department should delay further consideration of the Merger based on a purported concern for the "fiscal soundness" of the transaction. The Letter states that, for BCNEPA, the Merger "is needed to survive" (which, if true, also would be an argument in favor of the Merger).

Contrary to this misstatement, BCNEPA is in a relatively strong position today but recognizes that the need for scale and availability of capital as well as the requirement to transition to new health care delivery models under the Affordable Care Act have created challenges that are best addressed by a combination with a larger company.[2] As noted above, the fact that the Merger will generate efficiencies which in turn will benefit consumers is an argument in favor of the transaction, not an argument against it. It certainly is not a reason to delay its approval.

The Letter also expresses "concern" for the effects the Merger could have on Highmark's financial well-being. This "concern" has been addressed by the Department's engaged experts.

To assist it in its analysis of the Merger, the Department employed Blackstone Advisory Partners L.P. ("Blackstone"), an internationally recognized financial advisory firm. Blackstone was charged with reviewing the financial aspects of the Merger under the standards of the Insurance Holding Companies Act and, after many months of work and analysis, concluded that the standards were met. The Letter takes issue with Blackstone's conclusions. Thus, the Letter claims that Blackstone did not do a "sufficient study" and, that while Blackstone "apparently attempted" to conduct the appropriate review, it failed to complete a "comprehensive

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[2] The Letter also substantially misrepresents Highmark's relationship with BCNEPA when it claims that Highmark has been an "equity partner" and has not "engineered a turn-around" in that position. As the expert reports filed with the Department make clear, while Highmark has invested in BCNEPA subsidiaries, it owns only a minority interest in those subsidiaries. It does not control the operations of BCNEPA in any way or the operations of BCNEPA's subsidiaries on a day-to-day basis. In addition, while BCNEPA and its subsidiaries today utilize some of Highmark's systems, they do not have the advantage of the full range of benefits available from those systems. These advantages will be made available through the Merger.

examination". The Letter provides no support for these claims and, in fact, acknowledges that the Federation does not have access to all the information and data that Blackstone has.

The facts are that Blackstone has been reviewing Highmark and its activities on an almost continual basis since at least 2008 when it was engaged by the Department to assist in the review of the then-proposed consolidation of Highmark and Independence Blue Cross. Thereafter, Blackstone served as financial advisor to the Delaware Department of Insurance in connection with Highmark's successful affiliation with Blue Cross Blue Shield of Delaware. It also served as financial advisor to the Department in connection with the affiliation of Highmark and West Penn Allegheny Health System ("WPAHS"). It continues to serve in that capacity today in connection with the implementation of the affiliation. In the latter capacity, Blackstone is privy to regular reports regarding developments in the integrated delivery network being constructed by Highmark's parent company, Highmark Health. It has examined the currently proposed transaction for over a year. In light of Blackstone's extensive history of involvement with Highmark and this transaction, the suggestions that Blackstone does not have sufficient information to assess the Merger or has not done a complete and thorough review are simply not sustainable.

With respect to the Letter's statement that further delay in approval of the Merger will not "unduly prejudic[e]" either Highmark or BCNEPA, Highmark notes that, as observed by State Representatives Tina Pickett and Anthony M. DeLuca, the Majority and Minority Chairs of the House Insurance Committee in their letter to the Department dated February 2, 2015 (Document 0863 on the Department's website BCNEPA cumulative log), any delay beyond May 2015 could seriously jeopardize Highmark's plans to offer new products, and thereby improve competition, in the current BCNEPA service area for at least a year. The Federation's request for delay, then, is a request that the Department deprive the citizens of northeastern and north central Pennsylvania of the benefits of enhanced competition so that members of the Federation can profit.

3. The unnecessary and self-serving conditions for the Merger proposed by the Letter

The Letter presents a series of proposed conditions which the Letter says the Department should impose if it chooses to approve the Merger. Many of the proposed conditions bear no relationship to the Merger. A number are duplicative of existing law or conditions already binding on Highmark. Many seek to impose constraints on Highmark that do not and will not apply to Federation members. In brief, the proposed conditions are designed for the sole purpose of providing Federation members with a competitive advantage over Highmark, in the current BCNEPA service area and beyond. Certainly none of the proposed conditions would "promot[e] fair competition" -- and, in fact, they would have the opposite effect.

Ongoing Highmark orders, decrees and settlements

The Letter first suggests that all "orders, decrees and settlements" Highmark has "accepted and entered into over the past two years" should expressly be made part of any order approving the Merger "and [made] applicable to the merged entity and all subsidiaries and

affiliates." Since, if the Merger is approved, BCNEPA will be merged with and into Highmark, with Highmark being the surviving entity, and since current BCNEPA subsidiaries First Priority Health ("FPH") and First Priority Life Insurance Company ("FPLIC") will become Highmark subsidiaries, Highmark is uncertain as to the intent of this proposed condition. If the intent is to make it clear that the merged company will continue to be subject to all obligations currently applicable to Highmark, that will happen as a matter of law. Similarly, if the intent is to extend to FPH and FPLIC obligations to which Highmark insurance company subsidiaries are subject today, that also will happen as a matter of law. To this extent, then, the proposed condition is unnecessary. If the Letter has another, less obvious intent, its articulation of that rationale is missing, and Highmark is unable to further respond.

The Letter goes on to state that, before approving the Merger, the Department should first decide (and deny) Highmark's August 27, 2014 Request for Modification ("Request") of the Department's April 29, 2013 Approving Determination and Order relating to the WPAHS affiliation ("2013 Order") because, the Letter says (without explanation), the Request and the Merger "are incompatible."

Highmark's parent company, Highmark Health, previously has addressed various errors and misstatements of facts and law and faulty logic of the arguments made on behalf of the Federation in objection to the Request (Document 27 on the Department's WPAHS Order implementation log on its website). There is no need to repeat those points here. Highmark notes, however, that, contrary to the statements made in the Letter, the Department's expert consultants were aware of the Request and its contents well before they completed their reports concerning the Merger. Highmark believes that they did not mention the Request in their reports because, contrary to the arguments in the Letter, it is completely irrelevant to the Merger.

While Highmark believes that the issues raised in the Request will be addressed prior to the time an order issues in respect of the Merger, it also believes that there is no need for the Merger approval to be conditioned on a decision -- much less a denial -- of the Request. The two items are completely unrelated.

Provider contracting

The Letter proposes a series of conditions relating to Highmark provider contracting practices. The first is that the Department should "clarify" that the terms of the 2013 Order apply to "all [Highmark] provider contracts" and that Highmark should be prohibited from using exclusive contracts and most favored nations requirements.

As noted above, following the Merger, BCNEPA will cease to exist, and Highmark will be the surviving organization. Highmark is bound today by the 2013 Order in accordance with its terms and, upon closing of the Merger, the merged company will continue to be so bound. Similarly, FPH and FPLIC will be bound by the 2013 Order as Domestic Insurers (as defined in the 2013 Order). This suggested condition, therefore, is not only irrelevant to the Merger, it is unnecessary.

Other suggestions with respect to provider contracting, such as that the Department should prohibit certain loans or investments by Highmark and/or service by employees, officers and directors, and that Highmark and its subsidiaries should be required to disclose various confidential and proprietary information, including "all provider reimbursements and other financial incentives," to competitors, also have nothing to do with the Merger. Moreover, they are transparent efforts to use the Merger approval process to obtain a competitive advantage for Federation members. If imposed, conditions of this type would assure that Highmark and Federation members compete on different competitive playing fields, not just in the current BCNEPA service area, but throughout the Commonwealth of Pennsylvania. In short, the Federation is seeking to use the Merger approval process to assure that its members have a competitive advantage over Highmark wherever they compete. These types of conditions would harm, not further, competition.

Marketing practices

In a similar vein, the suggestions in the Letter that Highmark – and Highmark alone – be held to a different standard in its marketing practices (e.g., by being required to share confidential and proprietary information regarding group claims and renewal information) in a manner that is different from that applicable to all of its competitors are further efforts by the Federation to use the pendency of the Merger and Highmark's need to obtain regulatory approval for it to gain a competitive advantage. Again, these types of conditions, if imposed, would harm rather than further competition.

The Letter specifically requests a condition barring Highmark from entering into various types of agreements on the grounds (unsupported by any authority) that they "seem" to be "a presumptive violation of the Unfair Insurance Practices Act" ("UIPA"). There is no "presumption" that the agreements referred to violate the UIPA or any other law, and, in fact, agreements of this kind ancillary to procompetitive types of transactions such as the Merger have been upheld by the courts. The request for this kind of condition is another example of the Federation attempting to use the approval of the change of control relating to the Merger to hamstring Highmark's ability to compete.

Social mission conditions

The proposed conditions in the Letter relating to Highmark's social mission also have no logical nexus to the Merger, and are unnecessary. Highmark already is subject to a requirement that it report its community health reinvestment activities to the Department under the provisions of the Insurance Holding Companies Act. In addition, the 2013 Order imposes certain specific community health reinvestment requirements on Highmark.

Surplus and financial conditions

In a similar manner, the Letter's recommendation that the Department impose a requirement that "excess" surplus of Highmark be "disgorged and distributed to state health initiatives" is an attempt by the Federation to use the Merger approval process to gain a competitive advantage for its members. The issue of the appropriateness of the surplus levels of

Pennsylvania's Blue plans was addressed by the Department in its 2005 Determination and Order. The Letter's suggestion that the Department should take the opportunity of the BCNEPA transaction to reexamine the surplus issue represents another effort to delay the approval process, reopen settled issues and, ultimately, weaken all Blue plans and their ability to compete effectively with the Federation's members.

The same is true with respect to the Letter's recommendation that the Department use the opportunity of the BCNEPA transaction to impose limitations on Highmark's ability to make investments, including investments in insurance company subsidiaries. This condition, if imposed, would put Highmark in a unique category among all Pennsylvania insurers and health plans. The Letter's argument in support of this proposed condition (again, totally unrelated to the Merger) is that it would "benefit the policyholders of Highmark". In fact, the parties who would benefit most from the imposition of such a condition would be the members of the Federation as they would not be fettered by the same constraints.

Conditions on subsidiaries and affiliates

The Letter's recommendation that the Department "[r]equire that all [Highmark] subsidiaries and affiliates be subject to the same conditions as the merged entity" evidences a lack of understanding of Highmark's organizational structure. Highmark's subsidiaries and affiliates include a broad range of entities, many of which are insurance companies; others of which are not. Some are nonprofits; some are not. Some of its insurance subsidiaries and affiliates are Pennsylvania-domiciled companies; many are not. Its affiliates include out-of-state hospital and health service plans and in-state provider organizations. A suggestion that any one set of rules could apply across the entire Highmark organization does not take into account this complex structure.

Future transactions

The Letter recommends as a further "condition" that the Department "[c]larify" whether, following the Merger, Highmark intends to "expand Highmark's current operations as an Integrated Delivery System into the [BC]NEPA service area." Leaving aside that this suggestion does not appear to be a "condition" at all, the possibility simply is not before the Department, nor is it relevant to the Merger.

The Letter also recommends that, as a condition of its approval of the Merger, the Department should prohibit Highmark from converting to for-profit status absent specific statutory authority and should require prior approval of any "shift of funds" from Highmark's non-profit operations to its for-profit operations, including annual reporting of its asset allocations. The Letter does not even attempt to argue that these proposed conditions bear any relationship to the Merger. Nor does the Letter suggest why they are relevant or how Federation members – or anyone -- would be harmed by an approval which did not include them. If the question of conversion ever were to present itself, the Department and other agencies of the Commonwealth are well-positioned to address it. It is not presented in this matter. Similarly, existing statutory investment limitations and other limitations within the Insurance Holding Companies Act already adequately address issues relating to the movement of funds between and

among members of Highmark's holding company system. There is no reason to supplement the existing provisions of law by imposing conditions of these types in the context of the Merger.

BCBSA conditions

Finally, the Letter asks the Department to bar Highmark from participating in any "territorial allocation agreement" among members of the Blue Cross and Blue Shield Association ("BCBSA"). The Letter claims that such arrangements "run afoul" of the UIPA and the goals of the Insurance Holding Companies Act. As with many other assertions in the Letter, these claims are just wrong. In fact, the service areas established by the BCBSA have procompetitive impacts in their application, and they have been upheld throughout the long history of Blue plans. What the Letter is asking, in effect, is that the Department require that, as a condition of Merger approval, Highmark cease its participation in the BCBSA; i.e., that it surrender its Blue licenses – across Pennsylvania, and in Delaware and West Virginia, as well. Loss of its Blue licenses would deprive Highmark of a valuable market asset for no good purpose. The request for the imposition of this condition, which, like many of the other conditions proposed in the Letter, has nothing whatsoever to do with the merits of the Merger, is the final demonstration of the true purpose of the Federation's goal in its comments: not to create benefits to consumers but to weaken Highmark and BCNEPA as competitors so that the Federation's insurance company members can operate in a competitive environment that is more favorable to them. It is impossible to understand how the imposition of any such condition possibly could "foster competition" or "best serve consumers".

Highmark Inc.
120 Fifth Avenue
Pittsburgh, PA 15222

DATE: February 19, 2015

cc: Samuel R. Marshall
Honorable Donald C. White, Chairman
Honorable Matt Smith, Minority Chairman
Senate Banking and Insurance Committee
Honorable Tina Pickett, Chairman
Honorable Anthony M. DeLuca, Minority Chairman
House Insurance Committee