Written Testimony of David A. Balto

Hearing Regarding the Proposed Merger of Humana Inc. into Aetna Inc.

Before the California Department of Insurance

April 27, 2016

David A. Balto
1325 G St. NW, Suite 500
Washington DC 20005
202-577-5424
david.balto@dcantitrustlaw.com

Commissioner Dave Jones, I appreciate the opportunity to come before the California Department of Insurance ("CDI") today and testify about healthcare industry consolidation. As a former antitrust enforcement official and someone who represents everyday consumers and healthcare providers I know that highly concentrated healthcare markets, especially health insurance markets, can result in escalating healthcare costs for the average consumer, decreased innovation, decreased quality and consumer satisfaction, and decreased choice.

My comments in this testimony are based on my 30 plus years of experience as a private sector antitrust attorney and an antitrust enforcer for both the Department of Justice and the Federal Trade Commission ("FTC"). From 1995 to 2001, I served as the Policy Director for the FTC's Bureau of Competition and the attorney advisor to Chairman Robert Pitofsky. Currently, I work as a public interest antitrust attorney in Washington, DC. I have represented consumer groups, health plans, unions, and employers. I have testified before Congress and many state legislatures on healthcare competition issues, and was asked to present before the National Association of Insurance Commissioners in November 2015 concerning the mergers of Anthem-Cigna and Aetna-Humana.

My testimony makes the following points:

- The combination of Aetna and Humana will reduce competition for Medicare Advantage in eight separate counties – Fresno, Kern, Los Angeles, Orange, Riverside, San Bernardino, San Diego, and Ventura.
- Virtually all credible studies and retrospective analysis has concluded that increased concentration leads to increased premiums, decreased quality, and decreased innovation.
- The DOJ has relied on the structural remedy of divestiture in nearly every health insurance merger enforcement action during the last two decades, and most of those remedies have failed.

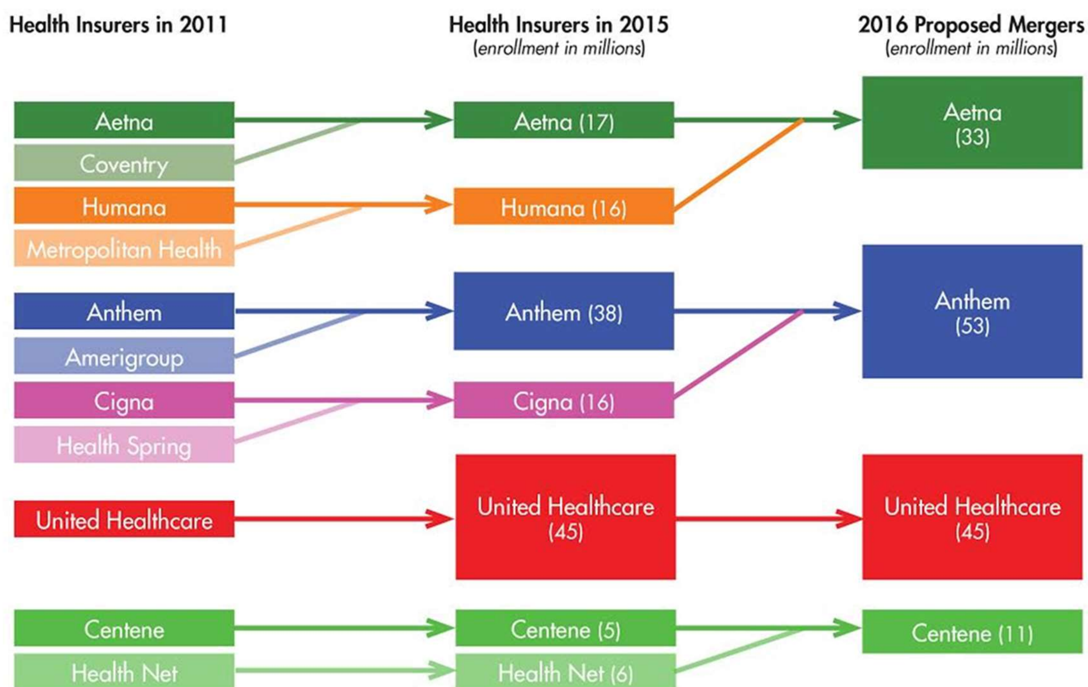
In considering its recommendations for the merger, the CDI should ask the following questions:

1. Will the proposed merger harm Californians?
2. Can this harm be remedied through conditions?

Background[1]

The Aetna-Humana merger is taking place during alarming trends in the health insurance market. In 2007, President Obama stated that "95% of insurance markets in the United States are now highly concentrated and the number of insurers has fallen by just under 20% since 2000. These changes were supposed to make the industry more efficient, but instead premiums have skyrocketed, increasing over 87% over the past six years." Things have not improved since then.

[1] I would like to thank Consumers Union Health Care Value Hub for the charts used in this section.

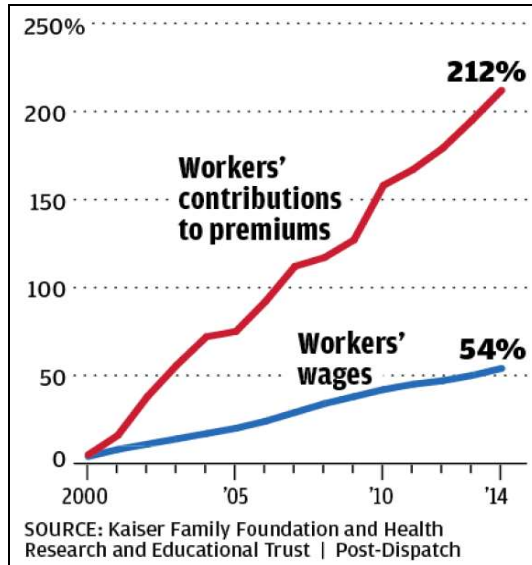


Both Aetna and Humana offer insurance products in California. While Humana is a smaller player in California offering only Medicare Advantage products, Aetna has a larger total market share and offers a range of products. Nationally, the newly formed Aetna will cover 33 million Americans, adding 3.2 million Medicare Advantage members, making Aetna the largest insurer in Medicare Advantage.[2] In California, according to a report presented to the DHMC, the combination of Aetna and Humana will reduce competition for Medicare Advantage in eight separate counties – Fresno, Kern, Los Angeles, Orange, Riverside, San Bernardino, San Diego, and Ventura.[3]

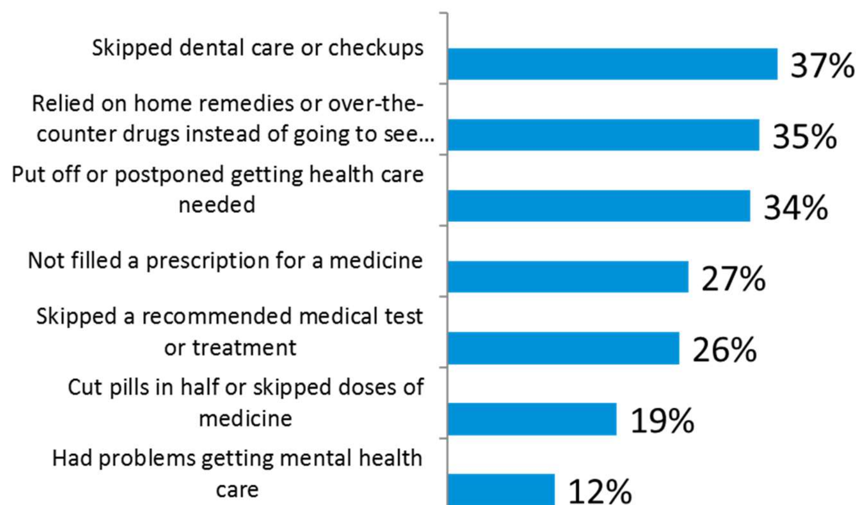
This proposed merger is taking place during a concentration trend in the California market. California has just approved the merger of Centene-Health Net and is also considering the proposed merger of Anthem-Cigna. Meanwhile, the growth in workers' contributions to premiums have greatly outpaced wage growth since 2000.

[2] Press Release, Aetna, Aetna to Acquire Humana for $37 Billion, Combined Entity to Drive Consumer-Focused, High-Value Health Care (July 3, 2015), *available at* https://goo.gl/dktKof.

[3] Cattaneo & Stroud, Inc., *Effect of Proposed California HMO Acquisitions*, presentation to the Financial Standards Solvency Board Meeting, 9 September 2015, slide 13.



It is no wonder that consumers are regularly putting off care due to their costs.



The Aetna-Humana Merger Will Have a Substantial Impact on Californians

Virtually all credible studies and retrospective analysis has concluded that increased concentration leads to increased premiums, decreased quality, and decreased innovation. According to David Lazarus, health economics expert at the University of Southern California's Schaeffer Center for Health Policy and Economics, "when insurers merge, there's almost always an increase in premiums."[4] Three separate, retrospective economic studies on health insurance mergers found significant premium increases for consumers post-merger. A study by Professor Leemore Dafny found that the 1999 Aetna-Prudential merger had resulted in an additional seven percent premium increase in 139 separate markets

[4] David Lazarus, *As Health insurers merge, consumers' premiums are likely to rise*, L.A. TIMES (July 10, 2015 4:00 AM), http://www.latimes.com/business/la-fi-lazarus-20150710-column.html.

throughout the United States.[5] Another study by Jose Guardado found that the 2008 United-Sierra merger had resulted in an additional 13.7 percent premium increase in Nevada.[6] Finally, a study by the Center for American Progress of the Humana-Arcadian merger found a substantial increase in premiums despite remedies.[7]

There is economic evidence that a dominant insurer can increase rates 75 percent higher than smaller insurers competing in the same state.[8] Increases in costs are not limited to higher premiums. Evidence shows that insurance mergers can impact out-of-pocket costs as patients see increases in deductibles or other insurance-related costs.[9]

Concentration also impacts quality. A recent report by J.D. Power concludes that there is lower consumer satisfaction and patient engagement in areas where there is lower competition.[10] The study analyzed member plan satisfaction among 135 health insurance plans throughout 18 regions, using six characteristics: provider choice, medical claims processing, pricing of health plans, customer service, communication, and information access. The report found that member plan satisfaction with regards to communication, information access, and pricing was reduced in regions where one health plan possesses over 50% of the market share.

Current market regulations will not fix these problems with the merger. Some supporters of this merger have argued that the medical loss ratio ("MLR") limits the level of insurer profits thus protecting consumers from price increases. While MLR is an important tool that requires health insurers to spend 80 to 85 percent of net premiums on medical services and quality improvements, it will not adequately protect consumers from anticompetitive harm. MLR, as health antitrust expert Professor Jamie King has observed, "does not guarantee that dominant insurers will not raise premiums and as such, it is not a substitute for the pressures toward lower costs and higher quality created by a competitive market."[11]

The Market Shares Understate the Competitive Problems in the State of California

---

[5] *See* Leemore Dafny et al., *Paying a Premium on Your Premium? Consolidation in the US Health Insurance Industry*, 102 AM. ECON. REV. 1161 (2012).

[6] *See* Jose Guardado et al., *The Price Effects of a Large Merger of Health Insurers: A Case Study of United-Sierra*, 1(3) HEALTH MANAGEMENT, POL'Y & INNOVATION 1 (2013).

[7] Topher Spiro, Maura Calsyn, Meghan O'Toole, *Divestitures Will Not Maintain Competition in Medicare Advantage*, CENTER FOR AMERICAN PROGRESS (Mar. 8, 2016), https://www.americanprogress.org/issues/healthcare/report/2016/03/08/132420/divestitures-will-not-maintain-competition-in-medicare-advantage/.

[8] Eugene Wang and Grace Gee*, Larger Insurers, Larger Premium Increases: Health insurance issuer competition post-ACA*, TECH. SCI. (Aug. 11, 2015), *available at* http://techscience.org/downloadpdf.php?paper=2015081104.

[9] *See generally* Leemore Dafny, *Evaluating the Impact of Health Insurance Industry Consolidation: Learning from Experience*, COMMONWEALTH FUND (Nov. 20, 2015), http://www.commonwealthfund.org/publications/issue-briefs/2015/nov/evaluating-insurance-industry-consolidation; see also Korin Miller, *6 Ways the Big Health Insurance Mergers Will Affect Your Coverage*, YAHOO HEALTH (July 24, 2015), https://www.yahoo.com/beauty/6-ways-the-big-health-insurance-mergers-will-124932195967.html (noting that "out-of-pocket payments could increase" because insurance coverage could limit certain services or number of visits forcing patients to pay more).

[10] Vera Gruessner, *Plan Member Satisfaction Reduced in Less Competitive Markets*, HEALTHPAYER INTELLIGENCE (Mar. 18, 2016), http://healthpayerintelligence.com/news/plan-member-satisfaction-reduced-in-less-competitive-markets.

[11] *Effects on Competition of Proposed Health Insurer Mergers: Hearing Before Comm. on the Judiciary Subcomm. on Regulatory Reform, Commercial and Antitrust Law*, 114th Cong. (Sept. 29, 2015) (testimony of Jamie S. King, Professor University of California, Hastings College of Law), *available at* https://judiciary.house.gov/hearings/?Id=020363B9-F9EF-4623-8E67-28A0B260675A&Statement_id=30A83B11-7A89-4261-9773-DCF6593808FF.

The market share data suggests, but understates the competitive concerns. Market shares are just an initial threshold to looking at the potential competitive effects of the merger.[12] The ultimate question under the antitrust law is whether the effect of the merger "may be substantially to lessen competition, or to tend to create a monopoly."[13] "Congress used the words 'may be' . . . to indicate that its concern was with probabilities, not certainties" and to "arrest restraints of trade in their incipiency and before they develop into full-fledged restraints."[14]

Typically, market shares are examined to predict whether the combined firm can exercise market power, that is raise prices and/or reduce services. In analyzing competitive effects, market shares must be calculated in a market defined by a product and geographic region.[15] The most appropriate markets to look at in this merger are the eight counties where there is substantial overlap in Medicare Advantage sales.

It is also important to note that there can be substantial monopoly concerns even at lower concentration levels. Mergers have also been successfully challenged between companies with large market shares and very small market shares.[16] Mergers have also been enjoined by courts in highly concentrated markets even when their combined share is relatively low.[17] The law is also clear that high entry barriers or a trend towards consolidation increase competitive concerns even where the market shares show that the markets are moderately concentrated.[18]

In addition, monopsony (buyer power) concerns can exist at lower market shares than monopoly concerns. Professor Peter Carstensen states that "the sequence of decisional power differentiates the buyer from the seller and is a major explanation for why buyers in many contexts can have significant power even if they do not dominate the buying side of the market in ways comparable to those associated with seller power."[19] Carstensen points out that doctors and hospitals are especially vulnerable to buyer power, even at lower shares.[20]

---

[12] Chi. Bridge & Iron Co. v. FTC, 534 F.3d 410 (5th Cir. 2008) (market concentration should be analyzed within the context of long-term trends and market structure).
[13] 15 U.S. Code § 18.
[14] Brown Shoe Co., Inc. v. United States, 370 U.S. 294, 323 n.39 (1962).
[15] Horizontal Merger Guidelines § 4.1 - 4.2.
[16] *See* Complaint at 6, In the Matter of Inova Health System Foundation, (No. 9326), *available at* https://www.ftc.gov/sites/default/files/documents/cases/2008/05/080509admincomplaint.pdf (challenging a merger of a firm with 67% of the market and a firm with 6% of the market).
[17] US v. H & R BLOCK, INC., 833 F. Supp. 2d 36, 72 (D.D.C. 2011) (enjoining a merger with a combined market share of 28.4 percent); FTC v. H.J. Heinz Co., 246 F.3d 708, 711 (D.C. Cir. 2001) (rejecting a merger with a combined market share of 32.8 percent).
[18] United States v. Pabst Brewing Co. 384 U.S. 546, 552-53 (1966) (finding that mergers with small market shares can violate the antitrust laws when there is a finding that the markets are trending towards increased concentration); Chi. Bridge & Iron Co. v. FTC, 534 F.3d 410 (5th Cir. 2008) (evidence in record supported the reasonable inference that entry barriers existed); FTC v. H.J. Heinz Co., 246 F.3d 708, 717 & n.13 (D.C. Cir. 2001) ("[T]he anticompetitive effect of the merger is further enhanced by high barriers to market entry.") Monfort of Colo., Inc. v. Cargill, Inc., 761 F. 2d 570, 579-80 (10th Cir. 1985), rev'd on other grounds 479 U.S. 104 (1986).
[19] Peter C. Carstensen, *Buyer Power and the Horizontal Merger Guidelines: Minor Progress on an Important Issue*, 14 U. PA. J. BUS. L. 775, 783-84 (2012).
[20] *Id.* at 785.

For example, even if the combined market share is only 20% of the market, doctors cannot easily replace 20% of their practice if a merged Aetna-Humana lowers their reimbursement rate. Consider an obstetrician in Santa Clara. Assume that 20% of her business is with Aetna. If Aetna reduces her reimbursement by 10%, she is not going to substitute for that business by adding low reimbursement Medicaid patients or seek patients from Sacramento. Market power is a question of the provider's options and where those options are limited a buyer even at a modest market share can successfully reduce reimbursement. For this reason, the Supreme Court found that even a 20% market share allowed a firm to impose anticompetitive restraints on the buyer side.[21] The Department of Justice also challenged the United-Pacificare merger on monopsony concerns even where there were not concerns that the merger would lead to higher premiums.[22]

The concerns of consumers are coincident with the concerns of providers. As former Congressman Tom Campbell explained "[t]he insurance company's economic incentive is to spend as little as possible on medical care. And if there is no competing insurance company to whom the physician can turn for an alternative offer, the doctor has no choice but to submit to offering the quality of care ordered by the insurance company."[23] Ultimately, when insurance companies possess monopsony power consumers lose, the quality of care goes down.

The Proposed Efficiencies Will Not Overcome a Finding That the Merger is Anticompetitive

No anticompetitive merger has ever been permitted because of potential efficiencies. Indeed, a recent Ninth Circuit case questioned whether an efficiencies defense even exists.[24] The efficiencies, which have never led to an approval of an anticompetitive merger, don't meet the legal requirements and can't outweigh the harms to consumers. But even if they did, they would have to exceed the harm created by the merger.[25] Those courts which have considered the defense have stated that merging parties prove the acquisition results in "significant economies and that these economies ultimately would benefit competition and, hence, consumers."[26]

The key question is whether the efficiencies are merger specific.[27] Do Aetna and Humana need a merger to achieve the efficiencies that they claim will result from this deal? "[C]ourts only consider efficiencies that are verifiable and merger-specific, and it is incumbent upon the court to undertake a rigorous analysis of the kinds of efficiencies being urged by the parties in order to ensure that those efficiencies represent more than mere speculation and promises about post-merger behavior."[28] The Merger Guidelines set three requirements for efficiencies: 1) the efficiencies must be merger specific

---

[21] Toys R Us v. FTC, 221 F.3d at 928 (7 Cir. 2000)

[22] Complaint at 5-12, United States v. UnitedHealth Group Inc., (No. 05-2436), *available at* https://www.justice.gov/atr/case-document/file/514011/download (finding market share sufficient for monopsony concerns in Boulder, Colorado but not sufficient for monopoly concerns).

[23] Tom Campbell, *Health insurer mergers a bad Rx for doctors, patients*, THE ORANGE COUNTY REGISTER (Jan. 23, 2016 12:00 AM), http://www.ocregister.com/articles/insurance-700940-doctors-patient.html.

[24] St. Alphonsus Medical Center-Nampa et al v. St. Luke's, 778 F. 3d 775, 789 (9th Cir. 2015).

[25] FTC v. H.J. Heinz Co., 246 F.3d 708, 715 (D.C. Cir. 2001); U.S. v. Baker Hughes Inc., 908 F.2d 981, 982-83 (D.C. Cir. 1990).

[26] *See* FTC v. University Health, Inc., 938 F. 2d 1206, 1223 (11th Cir. 1991) (respondent must prove the acquisition results in "significant economies and that these economies ultimately would benefit competition and, hence, consumers.").

[27] *Id.*

[28] FTC v. OSF Healthcare Sys., 852 F. Supp. 2d 1069, 1088-89 (N.D. Ill. 2012) (internal quotes omitted).

and unlikely to occur in the absence of the merger; 2) the efficiencies can't be vague or speculative and must be verifiable through reasonable means; 3) the efficiencies must benefit consumers and be sufficient to reverse the merger's potential to harm customers in the relevant market.[29]

The reason we have a free market system is because consumers benefit most when competitors have to roll up their sleeves and develop a better product. If one of these firms has a better product in one area, then all other companies in the market should have to learn how to do better to compete against that product. It does not benefit consumers for companies to consolidate simply to fill in their weaknesses. That is not a valid merger specific efficiency.

In St. Luke's, an important recent case on efficiencies, a dominant hospital wanted to acquire a physician practice 60 miles away. Their claimed efficiencies mostly revolved around being able to move the physician practice onto their computer system, which would allow them to better integrate their care.[30] The Ninth Circuit was explicit that "the Clayton Act does not excuse mergers that lessen competition or create monopolies simply because the merged entity can improve its operations."[31] If Aetna or Humana need to improve their operations, they can go and do it themselves. That is what the free market system is based on, they don't need a merger to accomplish that.

Another important question is whether the efficiencies actually lead to consumer benefits. There is no evidence or scholarly studies showing that insurance mergers lead to savings for consumers. In fact, as previously noted, evidence indicates that health insurance mergers lead to higher consumer costs, not increased consumer savings. Assistant Attorney General Bill Baer from the DOJ's Antitrust Division raised questions regarding the alleged cost efficiencies that would result from health insurance mergers. Baer noted that "consumers do not benefit when sellers . . . merge simply to gain bargaining leverage."[32]

That makes sense. Most large insurers are beyond the point where another merger would help them achieve any legitimate economies of scale. And there is little evidence that consumers would ever actually benefit from giving insurers increased bargaining power. In fact, Professor Greaney has noted that there is actually "little incentive [for an insurer] to pass along the savings to its policyholders."[33] As Consumers Union has suggested, a more likely result would be fewer choices for consumers, and providers being pressured to cut corners on quality of care in order to meet the insurer's demands – the opposite of what consumers need.[34] The American Antitrust Institute, the leading non-profit antitrust

---

[29] Merger Guidelines § 10.
[30] St. Luke's, 778 F. 3d at 791.
[31] *Id.* at 792.
[32] Speech by Assistant Attorney General Bill Baer, Remarks as Prepared for the Delivery at The New Health Care Industry Conference: Integration, Consolidation, Competition in the Wake of the Affordable Care Act at Yale University (Nov. 13, 2015), https://www.justice.gov/opa/speech/assistant-attorney-general-bill-baer-delivers-remarks-new-health-care-industry-conference.
[33] *See* Thomas Greaney, *Examining Implications of Health Insurance Mergers*, HEALTH AFFS. (July 16, 2015), http://healthaffairs.org/blog/2015/07/16/examining-implications-of-health-insurance-mergers/.
[34] *See Health Insurance Industry Consolidation: Hearing before the Sen. Comm. on the Judiciary, Subcomm. on Antitrust, Competition Policy, and Consumer Rights*, 114th Cong. (Sept. 22, 2015) (testimony of George Slover, Consumers Union), *available at* http://www.judiciary.senate.gov/imo/media/doc/09-22-15%20Slover%20Testimony.pdf ("[b]ut a dominant insurer could force doctors and hospitals to go beyond trimming costs, to cut costs so far that it begins to degrade the care and service they provide below what consumers value and need").

think tank, recently concluded that economic studies and evidence indicate that "consumers do not benefit from lower healthcare costs through enhanced bargaining power."[35]

All of these studies prove what hundreds of years of capitalism have already taught us - that companies need the fear of losing customers to competitors in order to improve their products and pass along savings to customers. Without this fear, any efficiencies will only benefit the merged Aetna-Humana.

Remedies Will Not Fix This Merger

In nearly every health insurance merger enforcement action during the last two decades, DOJ has relied on the structural remedy of divestiture.[36] Many of these remedies have failed; one only has to look to the airline industries for an example of how divestitures have been unsuccessful in remedying anticompetitive concerns. And, in particular, studies have shown that divestiture remedies used to resolve competitive concerns in the health insurance industry have failed. Recent studies by the Center for American Progress and the Capitol Forum found that the divestitures in the Humana-Arcadian merger had largely failed to address the competitive concerns, with 2 of the 3 firms failing and a substantial increase in premiums.[37] In fact, premiums were found to have risen in most retrospective studies of permitted health insurance mergers despite remedies. A study found that the 1999 Aetna-Prudential merger resulted in an additional seven percent premium increase in 139 separate markets throughout the United States.[38] Another study found that the 2008 United-Sierra merger resulted in an additional 13.7 percent premium increase in Nevada.[39]

There is little evidence that the benefits of competition are effectively restored after divestitures in health insurance markets. The merged companies in the three previously cited retrospective studies of health insurer mergers were still able to raise premiums by significant margins. This is not surprising. For any divestiture to be successful, the purchaser of the assets needs to have and maintain a cost-competitive and attractive network of hospitals and physicians. In addition, divestitures are not effective in health insurance markets in the long term because what is divested amounts to nothing more than contracts with specific policyholders. It is all too easy for a divested policyholder to return to the previous insurer in the next open season. For all these reasons, it may be difficult to genuinely preserve the competitive benefits of the pre-merger market structure through divesting subscribers or operations to a competitor.

---

[35] Letter from the American Antitrust Institute, Thomas Greaney, and Diana Moss, to William J. Baer, Assistant Attorney General Dep't of Justice (Jan. 11, 2016), *available at* http://www.antitrustinstitute.org/sites/default/files/Health%20Insurance%20Ltr_1.11.16.pdf.

[36] *See, e.g.,* Revised Final Judgment, *United States v. Aetna Inc. and Prudential Insurance Co. of Am*., No. 3-99-cv-1398-H (N.D. Tex. Dec. 7, 1999); Final Judgment, *United States v. UnitedHealth Group Inc. and Sierra Health Servs. Inc.*, No: 1:08-cv-00322 (D.D.C. Sept. 24, 2008); Final Judgment, *United States v. Humana Inc.*, No. 1:12-cv-00464 (D.D.C. March 27, 2012).

[37] Topher Spiro, Maura Calsyn, Meghan O'Toole, Divestitures Will Not Maintain Competition in Medicare Advantage, Center for American Progress (Mar. 8, 2016), https://www.americanprogress.org/issues/healthcare/report/2016/03/08/132420/divestitures-will-not-maintain-competition-in-medicare-advantage/.

[38] Leemore Dafny *et al*., *Paying a Premium on Your Premium? Consolidation in the US Health Insurance Industry,* 102 AM. ECON. REV. 1161 (2012).

[39] Guardado et al. *The Price Effects of a Large Merger of Health Insurers: A Case Study of United-Sierra,* 1(3) HEALTH MANAGEMENT, POL'Y & INNOVATION 1 (2013).

Most recently, the Florida Office of Insurance Regulation ("OIR") rejected divestitures as a potential remedy in the Aetna-Humana merger.[40] The OIR noted that the divestitures were "not in the best interests of Florida policyholders and also may be short term in nature."[41] The OIR noted that such divestitures may "result in unwanted changes in quality of services [and] benefits," and furthermore, that policyholders can switch insurance every year which would "lessen the effectiveness of divestitures as a means to manage market concentration."[42]

Without effective structural remedies, California loses its best bet at resolving the competitive problems in this merger. The DOJ has noted that conduct remedies have shortcomings for effectively protecting competition and consumers against the abuse of market power resulting from a merger.[43] This is a deal that cannot be fixed and therefore the CDI should recommend a denial of the merger.

The State of California Has the Authority to Reject the Merger

The California Attorney General has taken a leading role in the review of mergers in the book publisher, bookstore, health-care provider, school bus, and waste hauling markets.[44] The California Department of Insurance should work closely with the California Attorney General's office to review this deal in order to protect competition in the California market.

---

[40] Consent Order, In the Matter of Application for the Indirect Acquisition of Humana Health Insurance Company of Florida Inc. by Aetna Inc. at 9, Florida Office of Insurance Regulation (Feb. 15, 2016), *available at* http://www.floir.com/siteDocuments/AetnaHumanaAcquisition185926-16-CO.pdf.
[41] *Id.* at 8.
[42] *Id.* at 9.
[43] Dep't of Justice, *Antitrust Division Policy Guide to Merger Remedies* (2011), *available at* v (conduct remedies can be "too vague to be enforced, or that can easily be misconstrued or evaded, fall short of their intended purpose and may leave the competitive harm unchecked"); *see also* Deborah L. Feinstein, *Editor's Note: Conduct Remedies: Tried But Not Tested*, 26 ANTITRUST at 5, 6 (Fall 2011) ("Divestitures continue to be the remedy of choice—and with extremely rare exceptions—the only remedy for horizontal mergers at both the FTC and DOJ.").
[44] Antitrust Highlights, State of California Department of Justice Office of the Attorney General, https://oag.ca.gov/antitrust/highlights (last visited Mar. 31, 2016).