



U.S., et al. v. Anthem, Inc. and Cigna Corp.

Testimony of David Dranove, Ph.D.

**PLAINTIFFS'
EXHIBIT**

U.S. v. Anthem et al., Civ. No. 16-cv-1493

PDX005

Outline

- **Summary**
- Market Definition
- Market Shares
- Competitive Effects: Anthem Territories
 - The merger is presumptively anticompetitive in the Anthem territories
 - Shares and HHIs understate the harm
 - Static Price Effects
 - Dynamic Effects
- Competitive Effects: All U.S.
- Entry
- Efficiencies

Evidence Considered in Analysis

- Testimony: industry participants
 - Insurers
 - Customers
 - Consultants/Brokers
 - Healthcare providers
- Ordinary course documents
- Public and private data

Summary of Opinion

- Merger substantially harms competition in two well-defined antitrust markets
 - Sales to national accounts headquartered in Anthem territories
 - Sales to national accounts anywhere in the U.S.
- Static and dynamic effects
- Entry, repositioning, and efficiencies will not offset or prevent harm

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Market Definition: Overview

- Purpose of market definition:
 - Identify commerce at risk
 - Identify market participants and measure market shares and concentration
- Two components:
 - Product market
 - Geographic market

Product Market: Methodology

- Identify candidate market
- Apply hypothetical monopolist test
 - Would a hypothetical monopolist that controls all present and future sales of the candidate products profitably impose a SSNIP?
 - SSNIP = Small but Significant and Non-transitory Increase in Price, usually about 5% or 10%

Product Market: Methodology

- Targeted customers and “price discrimination markets”
 - Two requirements under *HMG*: differential pricing and limited arbitrage
 - Appropriate where each customer pays an individually determined price
 - Markets can be as small as a single customer

Product Characteristics:

Funding type

- Self-insured (ASO)
- Fully-insured (FI)
- Both can involve
 - Claims administration
 - Access to provider networks

Product Characteristics:

Plan Design

- Preferred Provider Organization (PPO)
 - Typically fee for service
 - Self- or fully-insured
 - Typically has broad provider network with limited coverage of out-of-network care
- Health Maintenance Organization (HMO)
 - Capitation
 - Typically fully-insured
 - Generally a narrower network than PPO
 - Generally doesn't cover out-of-network care

Seller Characteristics: Insurers

- Big Four national carriers
 - Blues (serve over 76% of Fortune 500), United, Aetna, and Cigna
- Non-national carriers
 - Include provider-sponsored plans
 - Geographically limited
 - Target small set of national accounts
- TPAs

Customer Characteristics:

National Accounts

- Very large employers, often with employees in multiple states
 - Usually offer generous health benefits
 - Sophisticated HR departments
 - Most self-insure
- Industry consensus that national accounts are a distinct customer segment

Product Market Definition: Analysis

- Commercial health insurance sold to national accounts is a relevant product market
- Market includes all funding types and plan designs
 - ASO, FI, PPO, HMO
- Conservative: large HMOs like Kaiser are included in market shares

Product Market Definition: Analysis

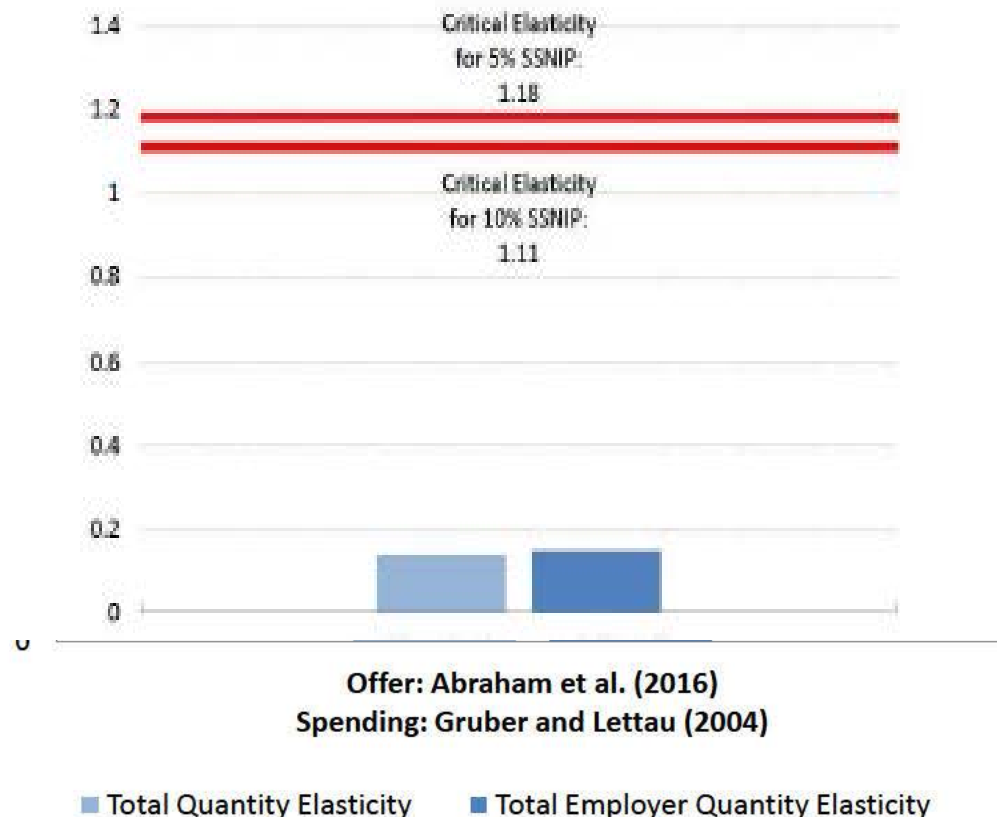
- National Accounts are targeted customers under the *Horizontal Merger Guidelines*
 - Identifiable
 - Prices determined individually
 - Arbitrage impossible
- Common needs → similar competitive conditions

Product Market Definition: Analysis

- Passes hypothetical monopolist test
 - Forgoing the purchase of health insurance is not reasonably interchangeable with insurance products
 - Virtually all large employers offer health insurance to their employees
 - Confirmed this empirically using critical elasticity (next slides)
 - Self-supply is not reasonably interchangeable

Product Market Definition: Analysis

- SSNIP is successful if actual elasticity is less than critical elasticity
- Published research estimates of elasticity confirm that SSNIP would be successful



Sources: Dranove Initial Report, Tables D-4 and D-5

Note: Showing elasticities for employers with 1,000+ employees

Geographic Market: Methodology

- Purpose: identify parts of U.S. where merger may affect competition
- Similar methodology to product market
 - Identify candidate market
 - Apply hypothetical monopolist test
 - Aggregation of customers

Geographic Market: Methodology

- “Price discrimination markets” defined around customer location
 - Prices are determined individually
 - Arbitrage is impossible
- Supplier location irrelevant except to extent it affects ability to reach the targeted customers

14-State Geographic Market: Analysis

- Blues rules give Anthem exclusive control in these territories
 - Merger will eliminate head-to-head competition
 - Greatest potential for direct competitive harm
- Competitive conditions similar throughout these territories

14-State Geographic Market: Analysis

- Passes the hypothetical monopolist test
 - Forgoing insurance and self-supply not reasonably interchangeable with insurance products
 - Large employers won't move their headquarters to another state in response to a 5-10% increase in health insurance prices

U.S. Geographic Market: Analysis

- Passes hypothetical monopolist test for same reasons
 - Forgoing insurance and self-supply not reasonably interchangeable with insurance products
 - Large employers will not leave country in response to a SSNIP

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Market Shares: Data

- Before Anthem–Cigna and Aetna–Humana
 - Third-party sources like HealthLeaders Interstudy (HLI) and Mark Farrah
 - Widely used but have limitations
- After DOJ investigations
 - Enrollment data from 26 insurers
 - Data covers **114.5** million commercial lives

Market Shares: Methodology

- Need common definition of national accounts for purposes of analyzing market structure
- Two alternative definitions
 - 5,000+ employees
 - 5,000+ employees with 5% or more of members residing outside headquarters state

Market Shares: Methodology

- Construction of Market Shares
 - All U.S. market: enrollment throughout country
 - Anthem territories: enrollment within Anthem territories
 - Reflects competitive strength of each insurer
 - Allows use of Census-based denominator
 - Fits available data
 - Treat Blues as single competitor

Calculation of Market Shares

$$\text{Insurer's National Accounts Share} = \frac{\text{Insurer's National Accounts Enrollment (Numerator)}}{\text{Estimate of National Accounts Market Size (Denominator)}}$$

Numerators: CID Enrollment Data

- Identify National Accounts enrollment: accounts with more than 5,000 employees
- 26 carriers produced enrollment data through Second Requests or CIDs
- Data were not produced in a uniform format

Numerators use CID enrollment data from a wide range of carriers

	Buckets by number of employees	Groups with 5,000+ employees	-
	Individual data, identifying subscribers	Groups with 2,885+ subscribers	Employers with 5,000+ employees have 2,885+ subscribers
	Buckets by number of subscribers	Groups with 3,000+ subscribers	
	Buckets by number of eligible employees	Groups with 3,000+ eligible employees	Employers with 5,000+ employees have 3,740+ eligible employees
	Buckets by number of members	Groups with 5,000+ members	Employers with 5,000+ employees have 6,607+ members

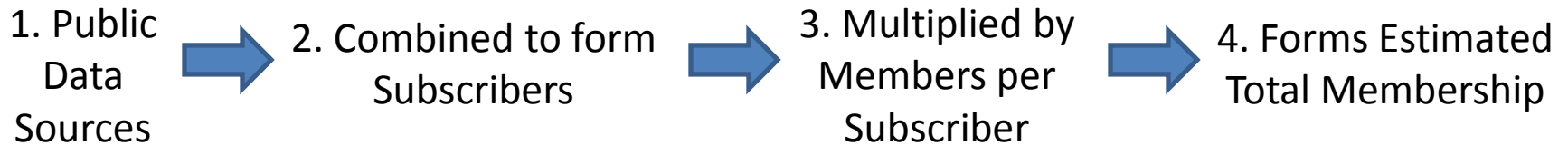
Denominator: Two Approaches

1. Estimate market size
from public data
sources

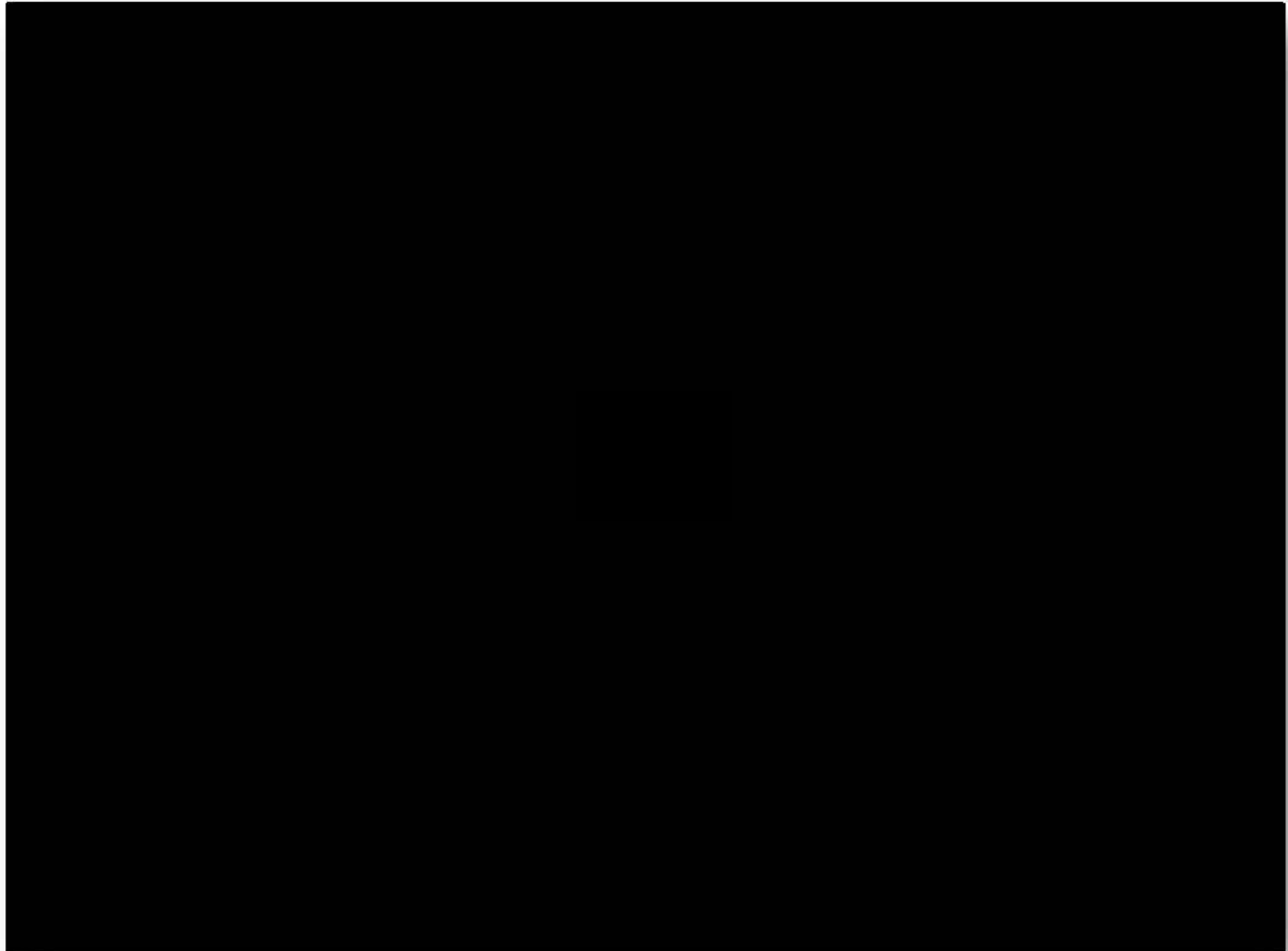
2. Calculate sum of
numerators

Denominator is the
larger of the two

Estimate Market Size from Public Data Sources



Anthem has used similar methods in the ordinary course

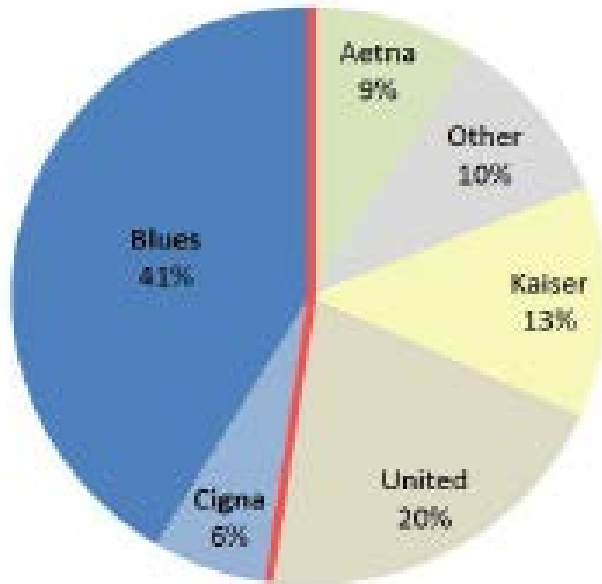


Market Share Methodology: Alternative Definition with Geographic Screen

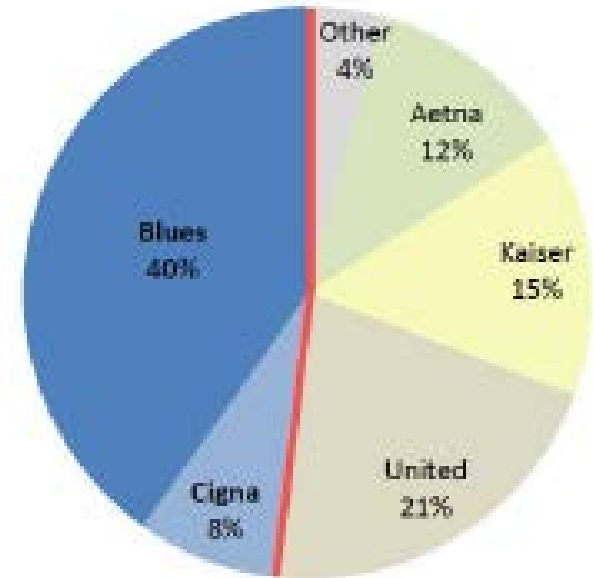
- Similar methodology for calculating shares using 5,000+ market
- Used state with most subscribers as proxy for an employer's headquarters location
 - HQ location not identified for some employers in data
- For insurers whose data did not allow application of geographic screen:
 - Adjusted 3 non-Blues by 20%
 - Adjusted 2 Blues by 30%

Anthem Territories Market Shares

ASO and Fully-Insured



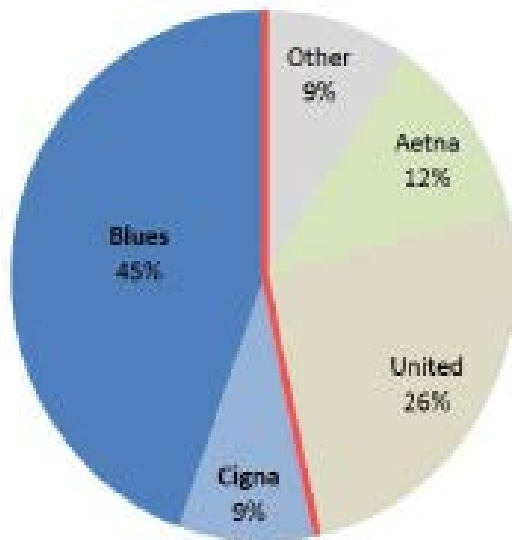
5,000 or more employees
Build-up denominator



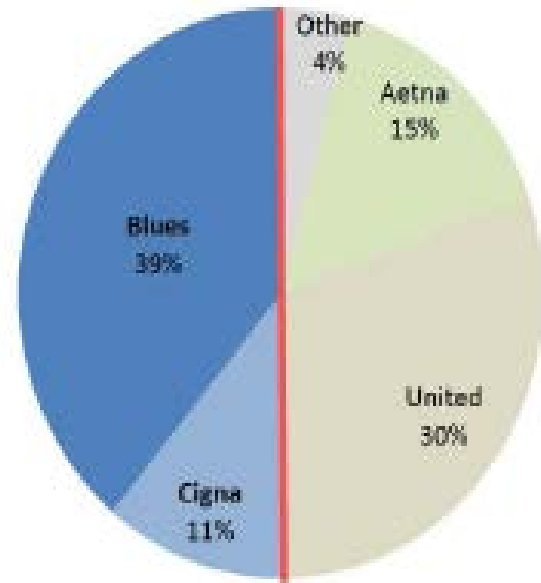
5,000 or more employees
Geographically dispersed
Build-up denominator

Anthem Territories Market Shares

ASO only

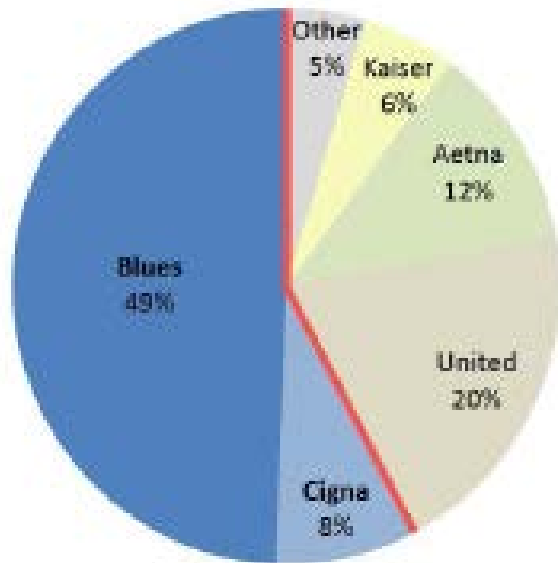


5,000 or more employees
Build-up denominator

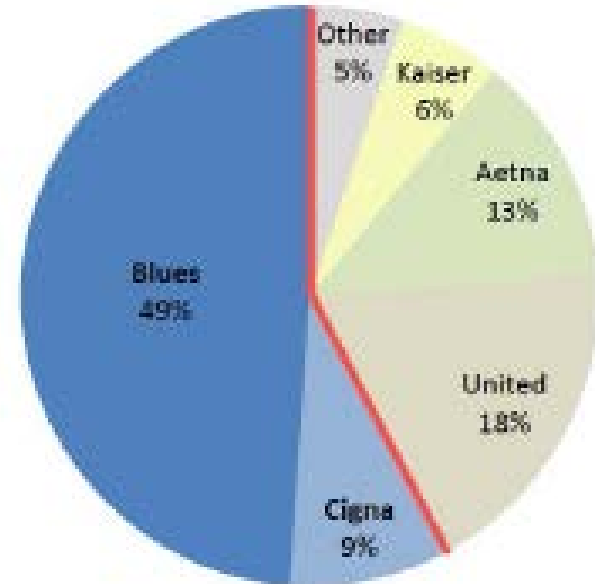


5,000 or more employees
Geographically dispersed
Build-up denominator

U.S. Market Shares ASO and Fully-Insured



5,000 or more employees
Build-up denominator



5,000 or more employees
Geographically dispersed
Census denominator

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Competitive Effects: Overview

- Structural analysis: market concentration
- Closeness of competition
 - Qualitative and quantitative evidence
- Static price effects
- Dynamic effects
- Entry, repositioning, and efficiencies

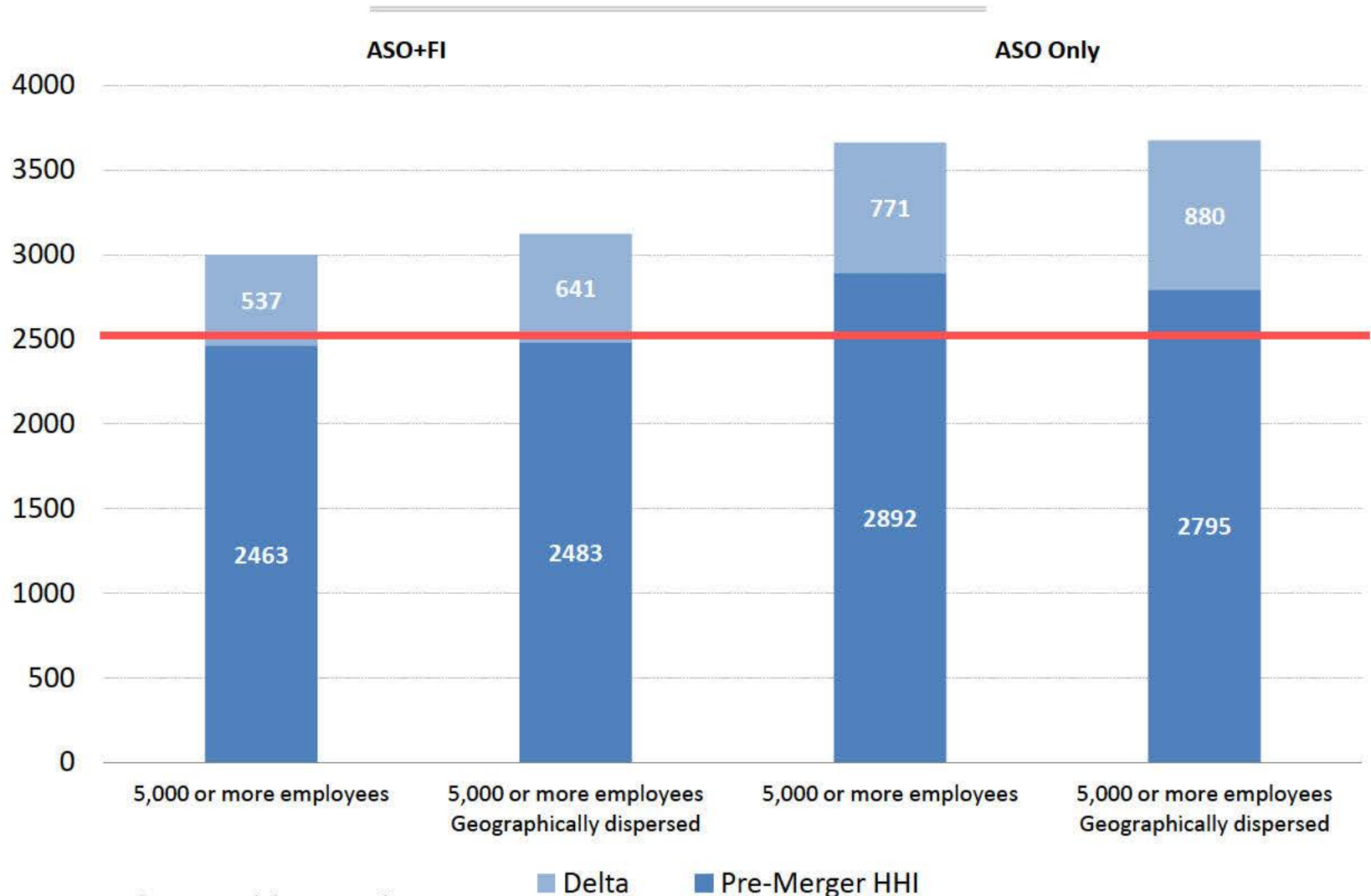
Concentration: HHIs

- Concentration usually measured by the Herfindahl-Hirschman Index
- $HHI = \text{sum of squared market shares}$
- Examples
 - Monopoly: $HHI = 10,000$
 - Two equal-sized firms: $HHI = 5,000$
 - Four equal-sized firms: $HHI = 2,500$
 - Many very small firms: HHI is close to 0

Concentration: HHIs

- Under *Horizontal Merger Guidelines*, mergers that result in an HHI above 2,500 with a change of more than 200 are presumptively anticompetitive
- For Anthem territories, the merger exceeds these thresholds for both definitions of national account

Change in Concentration: Anthem Territories



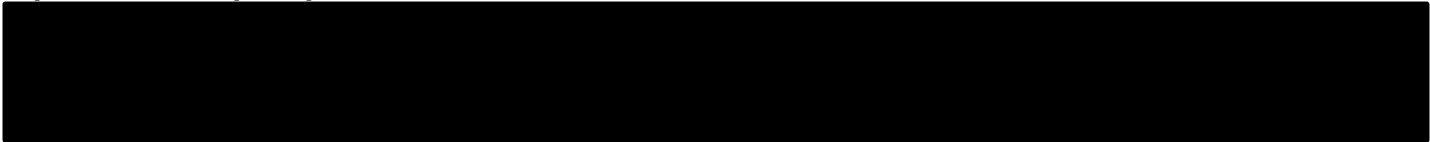
Industry Facts: Big Four

- Advantages of Big Four
 - Proprietary networks: strong discounts, breadth
 - Reputation/brand recognition
 - Dedicated support staff for national accounts
 - Advanced wellness programs
 - Powerful technology platforms

Industry Facts: Regional/Local Insurers

- Regional or local carriers are not strong competitors for national accounts
 - Cannot compete on full-replacement basis
 - Many specialize in fully-insured plans
 - *E.g.*, provider-sponsored plans
 - Even Kaiser competes mostly as geographic slice option offered *alongside* a national carrier

Industry Facts: TPAs

- TPAs are not strong competitors for national accounts
 - Several of the biggest are owned by Aetna (Meritain), United (UMR), and Cigna (Allegiance)
 - Many rent networks from a national carrier, meaning they must pay a rental fee
 - 
 - Some must sign a non-compete
 - Others would need to patch together rental networks
 - “Less than 1 percent” of a major consultant’s 1,100 U.S. clients use TPAs

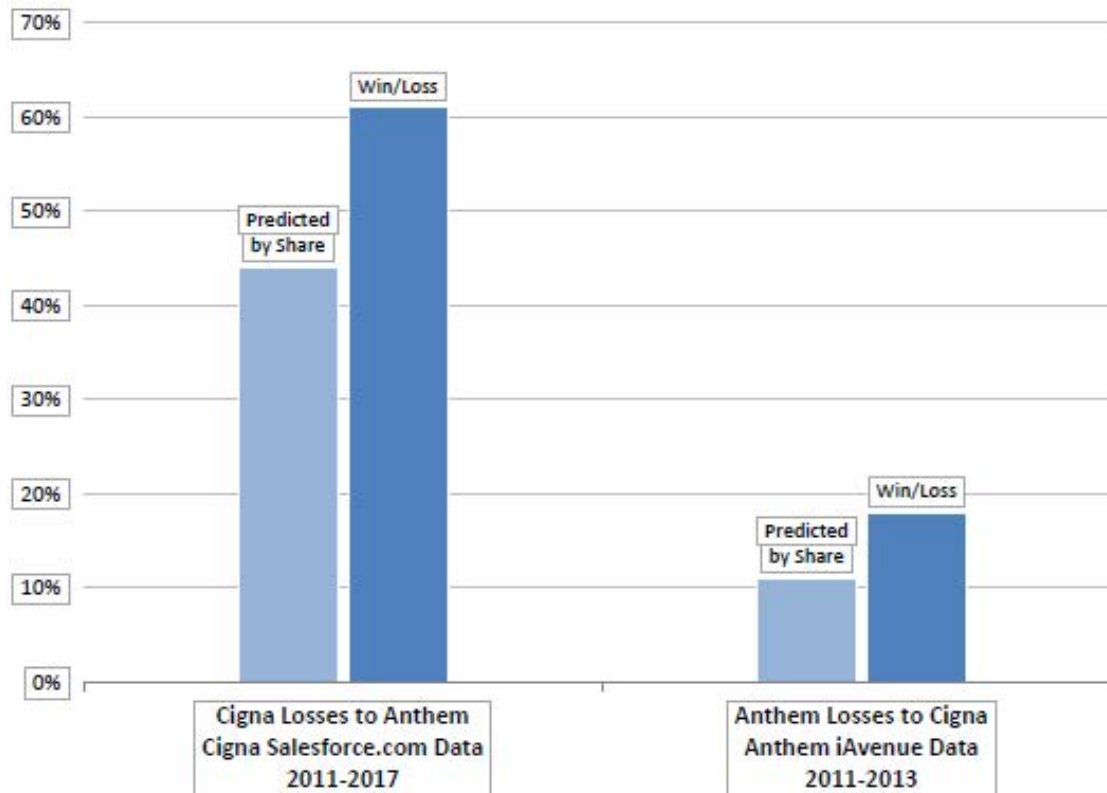
Loss of Head-to-Head Competition

- “Bounty” program
- Account-specific examples
 - Examples cited in reports
 - Examples covered in trial (*e.g.*, Thackeray testimony)

Win/Loss Data

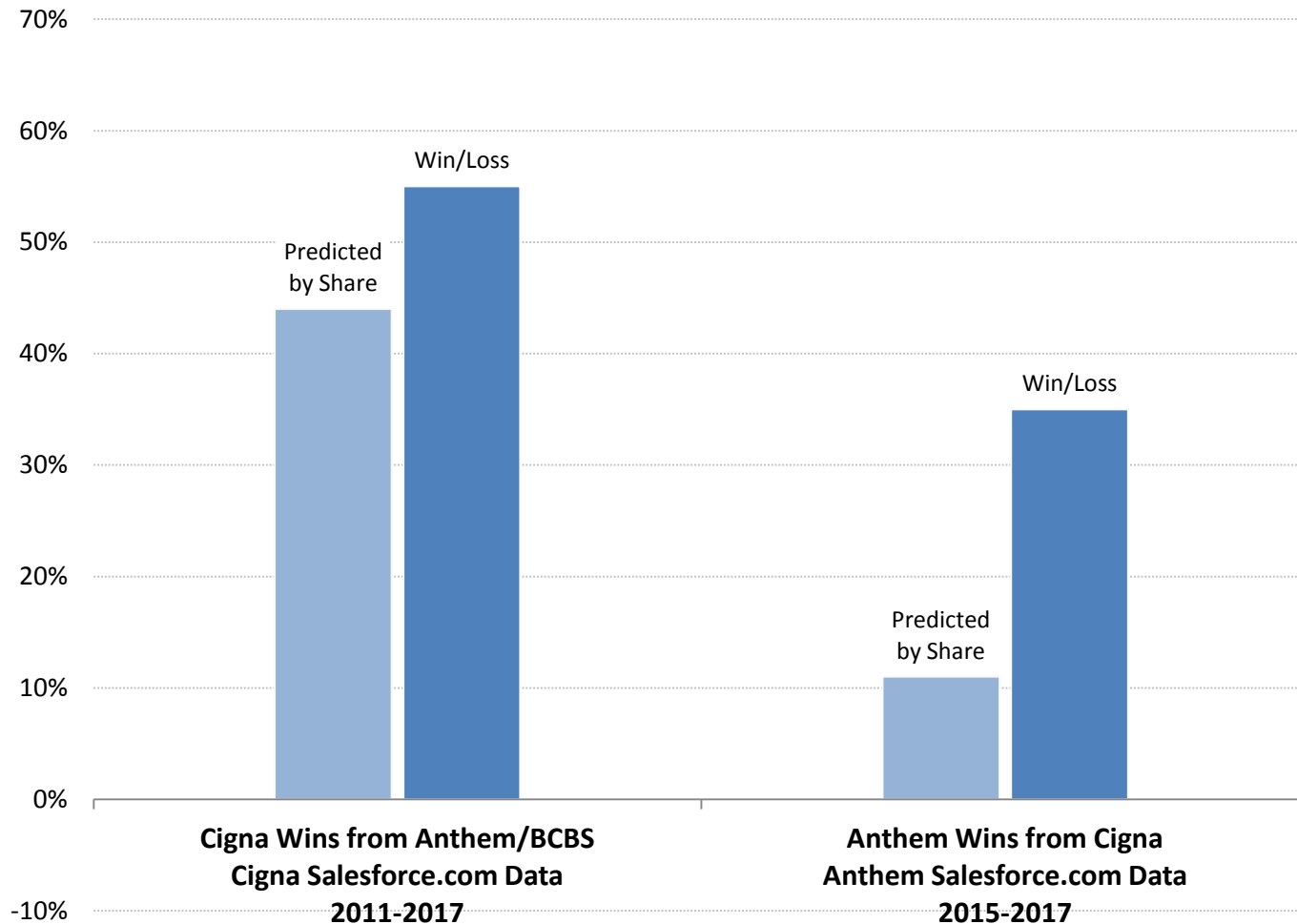
- Parties maintain win/loss data in ordinary course
 - Tracks wins, losses, and customer information
- Cigna: Salesforce.com
- Anthem: iAvenue and Salesforce.com
- Condition on incumbency

Win/Loss Results



Source: Dranove Initial Report,
Exhibits G-2 and G-6
Note: Anthem Territory only

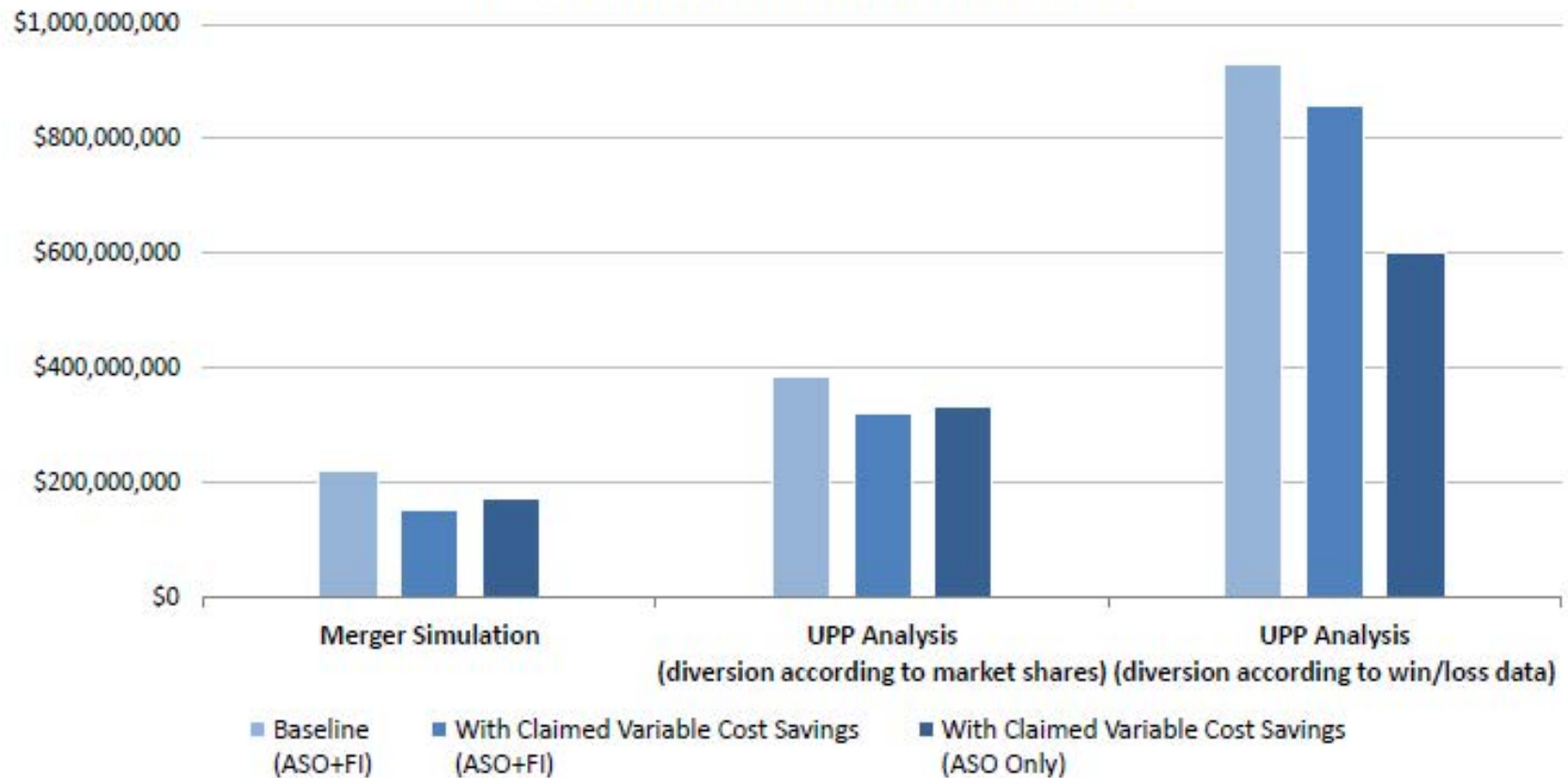
Win/Loss Results



Source: Dranove Initial Report,
Exhibits G-4 and G-8
Note: Anthem Territory only

Merger Simulation and UPP Results

Total Static Employer Harm per Year




Dynamic Effects

- Innovation is important
 - Decades of cost growth
 - Aside from HMOs, little history of innovation by insurers
 - Big Four are now innovating
 - Provider collaboration
 - Payment reform: rewarding provider quality
 - Care coordination
 - Wellness
- Cannot ignore this merger's potential effects on innovation

Dynamic Effects

- Economic framework
 - Effects of mergers on innovation are theoretically ambiguous
 - Must look at facts on the ground
 - Contestability: Will merger impact a firm's incentive to innovate to win business from rivals?
 - Appropriability: Will merger make it more likely a firm can capture benefits of innovation?
 - Synergies: Will merger make new innovations possible?

Dynamic Effects: Contestability

- Cigna has strong incentive to innovate
- Cigna Collaborative Care (CCC)/Cigna Accountable Care (CAC)
 - Early ACO
 - Care coordination fee available to all providers
; aligns incentives of providers and patients
 - Data collection and reporting

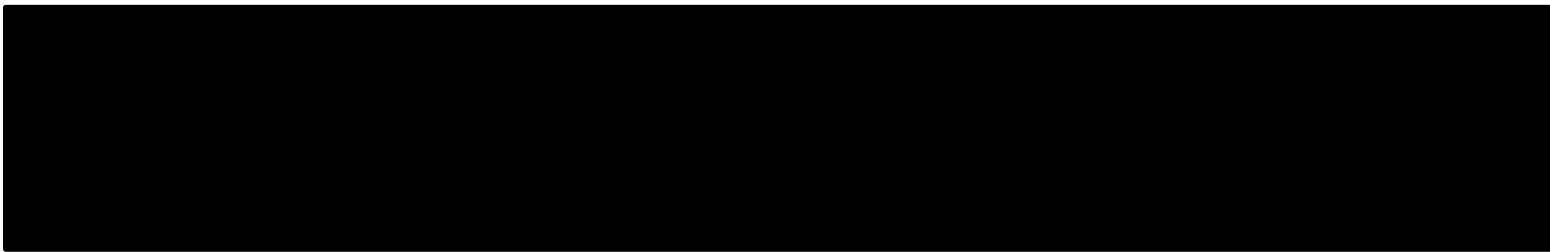
Dynamic Effects: Contestability

- Delivery System Alliance (DSA)
 - Joint venture with providers
 - Upside and downside risk
 - Substantial technology and IT investment
- Leader in health and wellness programs
 - Wellness credits (discounts or credits on premiums)
 - Programs integrated into core medical offering

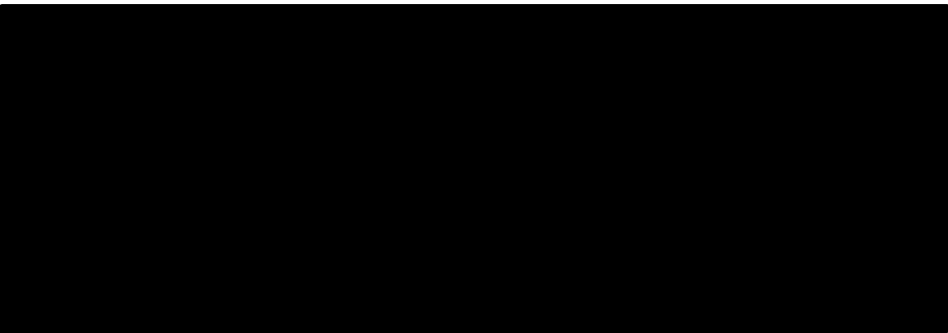
Dynamic Effects: Contestability

- Anthem has less incentive to innovate
 - Typically has best provider discounts
- Anthem does not innovate as aggressively as Cigna
 - Anthem ACOs vs. Cigna CCC/CAC
 - Provider collaboration
 - Cigna executive: Cigna's strategy is to "improve the health and wellness of Cigna's customers"; Anthem's strategy is "to provide a low cost product" or "Wal-Mart approach"

Provider Collaborations: Two Different Approaches

- Provider testimony
 - Cigna more willing to negotiate over terms of value-based programs
 - 
 - Anthem dictates terms, changes metrics and targets
 - Anthem fails to provide relevant or timely information; Cigna is “more open and transparent with the data,” which is “incredibly invaluable”

Dynamic Effects: Contestability

- Anthem must innovate, to some extent, to defend share from Cigna
 - ACOs: Anthem recognized need to share “meaningful and actionable data” with providers, noting Cigna’s “strong reporting and analytic package” provided to ACO partners
 - *Provider collaboration*: 
 - *Level-funded plan*: Anthem developed in several markets in response to customer demand for similar Cigna product

Dynamic Effects: Appropriability and Synergies

- Merger not likely to increase appropriability of innovations
- Merger is not necessary to pursue innovations
 - Both firms have sufficient scale to innovate
 - Cordani testimony: Cigna rolling out new innovations regardless of whether merger goes through

Dynamic Effects: Other Insurers

- Merger will also reduce innovation by other insurers
 - Less incentive: fewer competitors, no Cigna to respond to
 - Less ability: loss of “spillover” from merged firm’s innovations

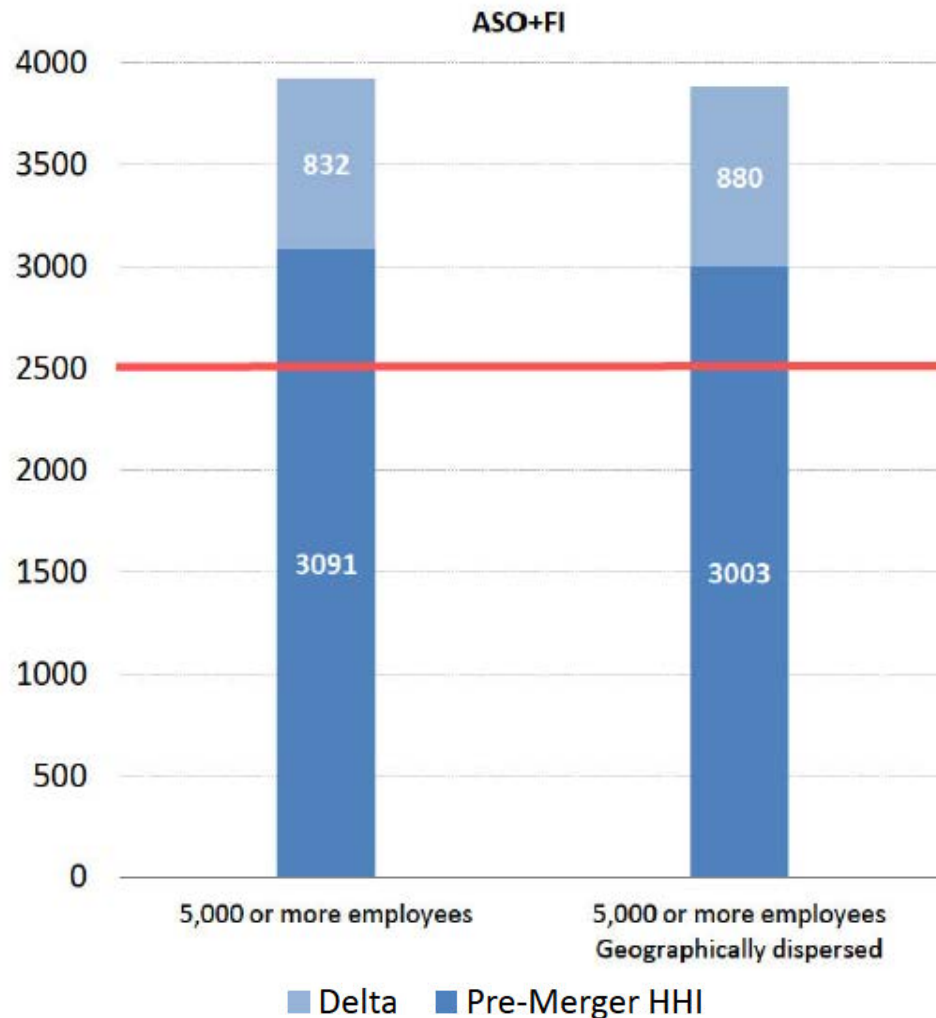
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Competitive Effects: All U.S. Market

- Big Four are major players in nearly every state
- In Anthem territories, direct merger of competitors
- Outside Anthem territories, akin to acquisition of partial ownership
 - Per *Guidelines*, raises concerns about lessened incentives, access to sensitive information, opportunities to collude

Change in Concentration: All U.S. Market



Competitive Effects: All U.S. Market

- Four types of competitive harm
 - Loss of head to head competition in Anthem territories
 - Loss of *some* head-to-head competition outside Anthem territories (ceded accounts)
 - Lessened incentives for Cigna to compete against non-Anthem Blues
 - Entanglements between Cigna and non-Anthem Blues

Head-to-Head Competition for Ceded Accounts

- The merger will eliminate competition between Anthem and Cigna for ceded accounts
- Non-trivial amount of commerce
 - In mid-2016: [REDACTED] accounts representing [REDACTED]
[REDACTED]

Lessened Incentives for Cigna to Compete Against Non-Anthem Blues

- Three concerns
 - “Best Efforts” rules
 - Business relationships among the Blues
 - BlueCard recapture
- Must be considered collectively

Best Efforts Rules

- Under the Best Efforts rules, each Blue must:
 - Draw 80% of its local revenue from the Blue brand and
 - Draw 2/3rds of its national revenue or enrollment from the Blue brand
- To comply, Anthem may have to restrict Cigna's growth or rebrand accounts "Blue"

BlueCard Recapture

- Anthem provides network access to enrollees of other Blues in exchange for “BlueCard fees”
- Post-merger, the BlueCard fees will dampen Cigna’s incentive to compete
- In 2014, Anthem earned nearly [REDACTED] in revenues and nearly [REDACTED] from BlueCard fees collected as a host Blue

Relationships with Other Blues

- Lessened incentives for Cigna to compete against other Blues
- Entanglements with other Blues
 - Competitively sensitive information
 - Cede reciprocity and retaliation

UniCare History

- **2004:** Anthem acquires UniCare (through WellPoint merger) to compete as non-Blue brand
- **2006:** Anthem freezes UniCare expansion to improve BCBSA relationship
- **2008:** Anthem considers selling UniCare to “[e]liminate[] source of friction with other Blues”
- **2010:** Anthem abandons UniCare, transfers assets and membership to Blues, retains brand name

UniCare Lessons

- UniCare dismantled to eliminate friction
- Blues relationship more important than UniCare (non-Blue) expansion
- Cigna presents a UniCare problem
 - Possibility of BCBSA friction
 - Risk that Anthem will reduce or eliminate competition between Cigna and Blues

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Entry: Horizontal Merger Guidelines

- Must consider whether entry into relevant market will “deter or counteract” competitive effects
- Three questions: Is entry **timely, likely, and sufficient** to counteract competitive effects?

Entry: Horizontal Merger Guidelines

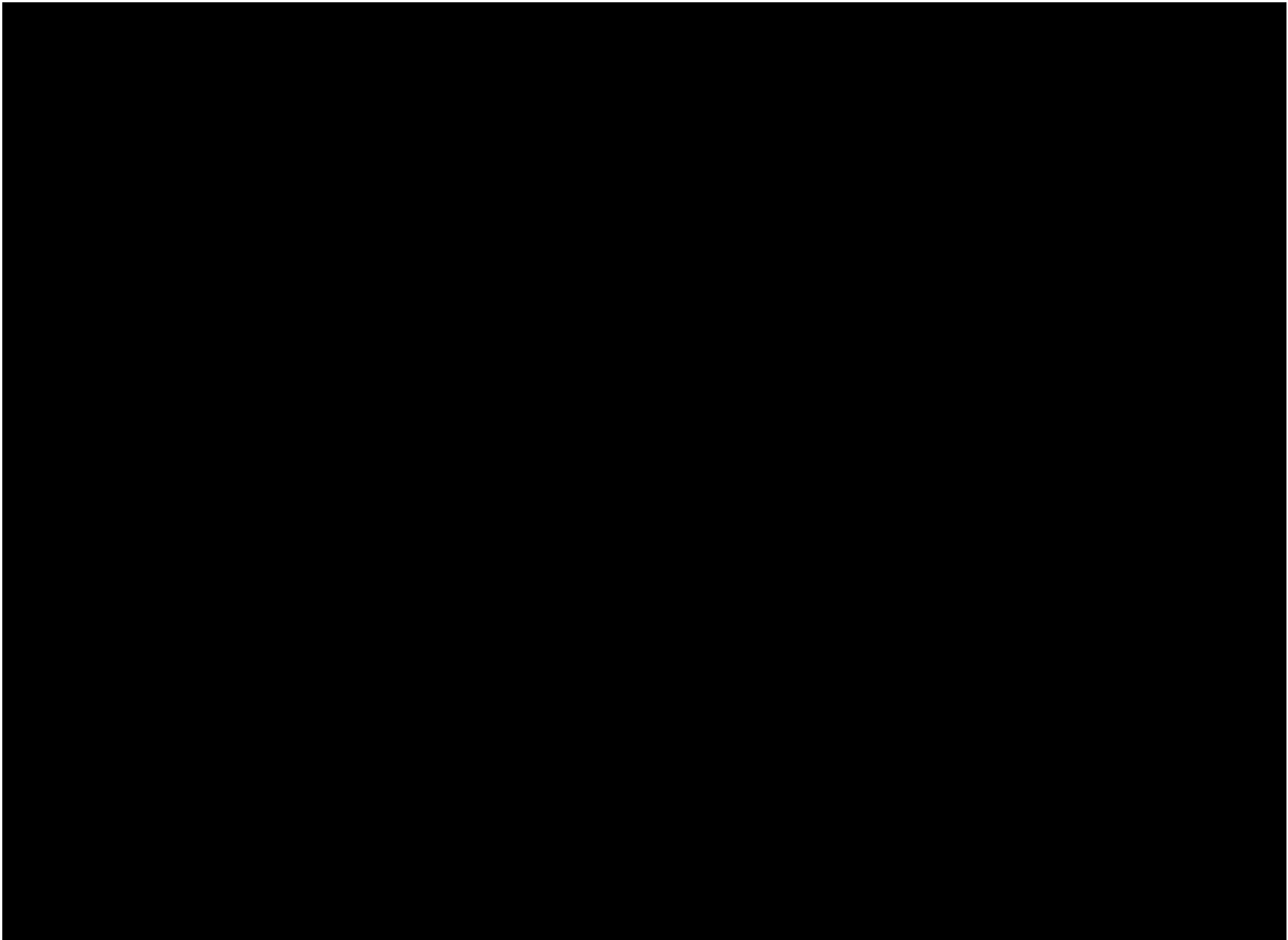
- Timely
 - Must be rapid enough to make price increase unprofitable or prevent significant customer harm
- Likely
 - Must be profitable in light of assets, capabilities, and capital needed, and risk incurred
- Sufficient
 - Must replicate “scale and strength” of one of the merging firms or, if smaller, not be at significant competitive disadvantage

Entry: Chicken-and-Egg Problem

- An entrant needs competitive provider discounts to compete for national accounts and win members
- But an entrant needs sufficient member volume to obtain competitive provider discounts

Entry: Costly and Time-Consuming

- National provider network
- Claims system
- Clinical programs
- Brand development
- Wellness programs
- Provider collaborations
- Relationships with consultants



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Efficiencies: Horizontal Merger Guidelines

- Efficiencies: variable cost reductions that make the merged firm more competitive
- *Guidelines* provide framework for analyzing whether such reductions are “cognizable”
 - Verifiable, merger-specific, and not achieved through anticompetitive reductions in output or service

Efficiencies: Horizontal Merger Guidelines

- “Projections of efficiencies may be viewed with skepticism, **particularly when generated outside of the usual business planning process**”
- “By contrast, efficiency claims **substantiated by analogous past experience** are those most likely to be credited”

Anthem's Efficiencies Defense

- Two components: traditional variable cost savings and “medical network synergies”
- Will address in rebuttal phase
- A few high-level points:
 - Claimed variable cost savings do not offset static price effects
 - Claimed medical network savings fail on multiple fronts

Flaws with Claimed M&N Synergies

- Not an economic efficiency
- No coherent plan for achieving lower rates
- If achieved, would likely harm quality of care
- Significant *disefficiencies* if merged firm attempts to achieve these savings
- Calculation methodology a non-starter