12 April 2006

The Competition Authority
Parnell House,
14 Parnell Square
Dublin 1

The Health Insurance Authority
Canal House
Canal Road
Dublin 6

Dear Sirs,

We have an interest in the discussions currently ongoing about the competition in the health insurance market in this country.

To this end we commissioned Dr. Patrick McNutt to prepare a submission on our behalf. A copy of the Submission is attached.

As you will no doubt be aware Dr. McNutt is a former Chairman of Competition Authority in Ireland. He is also a Visiting Fellow at the Manchester Business School and Visiting Professor at The University of Wales at Bangor. He has considerable expertise in this area and in the area of competition generally.

We trust that you will consider this submission.

Yours faithfully,

Edward Walsh,
Chairman,
Steering Committee,
Adare Hospital and Clinic,
Adare,
County Limerick.

Competition in the Health Insurance Market in Ireland: Some Observations

Patrick A. McNutt

Former Chairman of Competition Authority, Dublin, 1996-2000. Visiting Fellow at the Manchester Business School and
Visiting Professor, University of Wales at Bangor.

This brief submission has been prepared by *Patrick McNutt & Associates.* The author may be contacted at 01 284 3082 or by email at **peanutt@indigo.ie** or through the web portal **www.patrickmcnutt.com**

April 2006

Introduction

*The Tanaiste and Minister for Health and Children, Mary Harney, TD, has requested that the Competition Authority [**CA**, henceforth], and the Health Insurance Authority [**HIA**, henceforth] examine the private health insurance [**PHI**, henceforth] market in Ireland from a competition policy perspective. The Government's Health Strategy envisages community rated private health insurance continuing to play a major role in the overall sourcing of Irish health care.*

The Submission

In any analysis of the compatibility of a dominant position with the grant or conferral of an exclusive right by a government to a company to provide health insurance presents a time consistency challenge. In other words, when the capability of the holder of the exclusive right to satisfy the demands of the market in the past is led by the mere exercise of its exclusive right to abuse its dominant position that company is manifestly unable to satisfy market demand for private health services today. Therefore a dominant company like the VHI cannot disentangle its duty to perform from protecting its own commercial interests if they are attacked.

This submission speaks to the point that the organisation of the PHI market established by this exclusive right is at issue, and is in practice incompatible with the aims of a common market in the provision of health care services in Ireland. In this context, the question then becomes one of the extent to which restrictions on competition in a community rated private health insurance market are justifiable under the Competition Act.

A range of interrelated terms of reference from the published terms of reference are addressed, viz: (i) identify a relevant sub-market for competition purposes in terms of a 'closely related market' in the provision of private hospital care; (ii) identify practices and legislation that limit the degree of rivalry; (iii) identify barriers to switching; (iv) identify duties that could be assigned to the HIA and additional functions that might be assigned; (v) make recommendations for change to any administrative practice and, (vi) make any other recommendations deemed appropriate.

Risk-pooling

The Government's Health Strategy envisages community rated PHI continuing to play a major role in the future provision of resources within the broad parameters of the Irish healthcare market. But the Emperor has no clothes. Although leading insurance providers are present in the Irish life and non-life insurance markets they are conspicuous by their absence in the PHI market. Indeed their non-entry provides an important and often overlooked counterfactual to the achievement of an optimal risk pooling equilibrium in the Irish PHI market. For example, it is less risky, statistically, to have 10 people insured by 10 different companies than to have 10 people insured by one. Individual risks pooled must be independent: risks increase and risks decrease at different times to cancel each other out.

The objective of risk pooling, however, is to then aggregate independent risks in order to make the aggregate risk-certain. This optimal may not obtain in the Irish PHI market. One explanatory reason is the privileged position of one provider, the VHI, and the inherent risk to abuse its dominant position. The problem, however, is further

compounded by (i) the dependence of Irish consumers-as-patients on that one provider; and (ii) by a community rated PHI market wherein there is a dominant company, few entrants and risk equalisation. We look at each in turn.

i. *Consumer [Customer-as-Patient] dependence*

There is little EU law dealing expressly with the thorny question of fairness and reasonableness of consumer dependence[1] *arising from the conduct and behaviour of a dominant firm, although there are several regulations and directives and secondary legislation and case precedent on the conduct and behaviour of a dominant firm in terms of the essential facilities doctrine. However, the doctrine may have been weakened by the recent Trinko decision*[2] *in the US wherein the Supreme Court dismissed Trinkos' claims couched in terms of a monopolist's duty to aid competitors. The irony in the Irish PHI market is that it is the new entrants, for example, BUPA that aid the incumbent monopolist under the provisions of a risk equalisation community rated health insurance market.*

Therefore it is more appropriate to focus on the issue of fairness and reasonableness of consumer dependence in assessing any abuse of a dominant position by the VHI. For example, in both the telecoms and banking industries, wherein abuse of dominance was assessed, the issue of customer dependence had been addressed in terms of switching costs. They were identified by the CA as a barrier to entry to the provision of a competitive market in retail banking. In a telecoms market there is a tangible gain to the customer in the provision of number portability. However, in a PHI market per se, it is more complex: for the customer-as-patient there is a tangible gain (if you are hospitalised and require insurance cover) and an intangible right (in the event that one becomes ill). Another way of putting this is that a customer-as-patient as a policyholder has an insurable interest only if he or she becomes ill.

ii. *Anti-competitive Crowding-in effect*

It is this uncertainty that gives rise to a customer dependence on a monopoly provider like the VHI that further gives rise to an inherent and rational unwillingness of the customer-as-patient to switch. The net effect is an anti-competitive 'crowding-in effect' wholly biased in favour of the VHI. This only exacerbates the dominant position of the VHI. Irish customers-as-patients are faced with the classic Hobson's choice in health insurance providers. It is precisely because they have no real alternative choice that they have selected the VHI. The customer-as-patient will continue to subscribe to the VHI and the VHI know that to be the case.

The particular concern addressed in this submission is the abuse of that dominant position by the VHI in the downstream markets for the provision of health services (private hospitals). Not dissimilar arguments can be applied in the case of and new products and services (for example, mobile MRI scanning). There is a need to clarify the scope of private health insurance within the meaning of the Competition Act by narrowly construing the meaning of the business of private health insurance to the practice of transferring or spreading policyholders' risks. It should not be within the gift of a dominant firm such as the VHI to review or influence the reasonableness of particular

---

[1] *Considered in the Commission Case 77/77 BP v Commission 1978. More recently alluded to in the Napp v DGFT Case 1001/1/1/01.*

[2] *Vide Case history and discussion in McNutt (2005): Law, Economics and Antitrust, original tracking of Verizon Inc v Trinko (1996)*

professional charges or to endorse (by the provision of insurance cover) the provision of a new service or product. The practice of risk equalisation requires an urgent response from the CA to clarify the scope of private health insurance within the meaning of the Competition Act. There is precedent[3] for the CA to accept the introduction of competition into the currently monopolised PHI market by way of applying the EU competition rules up to the point at which it is still financially viable for the VHI to maintain a universal risk equalisation health insurance service.

iii. Risk Equalisation

The argument is simply that a community rated market requires risk equalisation to simply neutralise the different costs due to the health status of patients. There is a direct cash flow from a low-risk provider to a high-risk provider. It is appropriate given the public terms of reference for this consultation – notwithstanding the on-going High Court proceedings - to raise an important antitrust issue around risk equalisation as it applies in a market with an historically conferred government monopoly.

From an antitrust perspective it does not necessarily follow that the principle of community rating is dependent upon risk equalisation with a monopoly provider in the market. Community rating in the Irish PHI market requires that no plan can vary its premium, for example, based on age or health status except through a statutory group discount. For example, there are numerous plans now all of which are community rated and both the VHI and BUPA set premiums independently and cross-subsidize among their plans as they see fit.

iv. Irish variant of the US Midcal test

Against this background if a dominant company like the VHI is engaging in alleged anti-competitive behaviour there is a real danger that it may be acting to further its own commercial and business interests, rather than the interests of the State. There is a need in Irish competition law for the equivalent of the[4] Midcal test in US antitrust where the challenged action must be 'clearly articulated and affirmatively expressed' as not only policy conducive to the interests of the Irish customer-as-patient but also to the Government's Health Strategy. In the absence of such a test there is inconsistencies in the assessment of the PHI market from a regulatory HIA perspective and from a competition policy perspective.

Consider the following: risk pooling may be beneficial in maintaining premium competitiveness with multiple players on a relatively open PHI market wherein none of the providers have a putative dominant position. Indeed competing plans in a competitive market might force providers to price more competitively but that does not imply that risk equalisation necessarily equates with community rating. It is incumbent on the CA to clearly articulate the antitrust merits of risk equalisation in a market with a monopoly provider and the challenged practice of risk equalisation must not only be actively supervised by the HIA but also affirmatively expressed as compliant with the principles of competition law. In other words the price of compliance is real competition within the PHI market by the entry of the life and non-life insurers already present in the State.

[3] *Check the ECJ in Almelo [1995] CMLRev*

[4] *California Retail Liquor Dealers Association v Midcal Aluminium Inc (1980). A related discussion of the Noerr-Pennington doctrine in presented in McNutt (2005): Law, Economics and Antitrust.*

Privileged position of the VHI

The role and privileged position of the VHI is crucial in addressing the PHI market in Ireland from a competition policy perspective. The VHI is in a position to abuse its dominance in the Irish personal health insurance market. Principally, this arises because the VHI can behave to an appreciable extent independently of its competitors and its customers and consumers. Although it clearly is not an offence for a firm to have a dominant position the European Court of Justice declared in a key case[5] in 1981 that a firm in a dominant position has 'a special responsibility not to allow its conduct to impair undistorted competition on the common market'.

The special responsibility raises a number of issues as to the accountability of the VHI, in terms of the development of Irish health care, particularly in the absence of significant other providers in the PHI market. The Irish health care system has to be measured by the HIA in benefits accruing to consumers-as-patients and to national health care, in terms of prices, costs and the exercise of patient sovereignty through informed choice. The discharge of that special responsibility is not at all clear in terms of addressing the future of health care changes in a changing Ireland, and thus facilitating integrated health care, allowing economies of scale in delivery of primary care to be obtained, for example, by new entrants in the private hospital market. The VHI has historically assumed the role of granting insurance cover to the suppliers of all hospital services. Did the VHI assume the role on its own volition? How did this come about? Was it a decision arrived at independently of competitors in the PHI market and ultimately its customers – the patients and insurance policy holders?

Closely Related Market(s): Private Hospitals

There is a demand for private hospital care in Ireland – private hospitals have emerged as a 'closely related market' for the provision of private hospital care to consumer-patients in the State. However, notwithstanding this development, the obligation on the VHI to treat competitors fairly or to deal with customers' health needs has not been examined robustly at a time of economic change and wealth.

Private hospitals are a future pillar of health care in Ireland. The private hospitals market can be described as a 'closely related' market to the PHI market. In other words, the VHI is in a strategic position to hinder the maintenance of effective competition in the private hospitals market by delaying insurance cover for products and services at a private hospital. In a market exhibiting effective competition, the cost burden could be minimised if more private hospitals could enter the market at full capacity. In order to determine that an absence of effective competition impacts on the ultimate cost burden incurred by the VHI, the HIA and the CA would collectively have to show that there is a counterfactual to the status quo with foreclosed entry.

In other words, a private hospital is granted insurance cover, and as a direct and immediate consequence of the entry of the hospital, capacity constraints are eased and the cost burden for the VHI is reduced. In order to critically assess the extent of competition in the Irish PHI market we posit that there is neither demand nor supply substitutability in 2006 to warrant the market as open and competitive. If the Irish PHI market included the VHI and many other significant providers then a working template would exist in order to monitor the extent of open competition. But no template can be furnished in the

[5] *Case 322/81 Michelin [1983] ECR 3461*

absence of entry. Consequently there is only one conclusion a third party can come to: that the market outcome has benefited the business and commercial needs of the VHI, an outcome that may not have been obtained in an openly competitive market with multiple insurers where in the Irish consumer would be better served. The Irish consumer could be better off in a different market scenario - if the VHI monopoly were broken up.

The VHI & Consumer Dependence

From a competition policy perspective the CA has to consider whether or not health services are a commodity that should be traded freely in a private health insurance market in much the same way as consumers buy car or house insurance annually. On the anniversary of the policy, for example, the patient would be informed by the VHI of premium changes and proceed to choose from a number of insurance providers.

Substitutability should in principle be assessed both from the perspective of demand (from the consumer's perspective) as well as supply of new providers and new services and products. Both demand and supply substitutability should be considered in defining the relevant market for PHI in Ireland as distinct from the market for general life and non-life insurance. In addition there is also the issue of market power in a narrowly defined market. The CA and the HIA have yet to fully realise the potential scope of applying competition law and regulations to secure access for competitors and to ensure a switching between PHI providers in a changing economy.

The privileged position of the VHI cannot be challenged by the market itself because the market participants, the consumers of health insurance, are choice constrained, their interaction with the VHI in terms of determining premium, for example, has either been minimal or non-existent to date. Simply, the VHI announces premium increases and the consumer continues to pay. Consumer dependence facilitates the dominance of the VHI and the dominance is facilitated by customer dependence. It is therefore imperative for the CA to deal with the question whether the terms of the provisions of the competition legislation adequately protect the dependent consumer. Furthermore, the HIA should note that to deprive the consumer of a service of the right to choice, which the VHI implicitly constrains by a reliance on dependence on the VHI for private health insurance, might amount to an infringement of the health consumers' human rights.

Consumer Dependence

Not only is there consumer dependence on the VHI but also the VHI is in a position to abuse its dominant position by bundling its services in terms of the location of health service provided. If patient X wishes to avail of a private hospital in location Y the wishes of patient X are dependent on whether or not the VHI has bundled the VHI premium with the health services at the private hospital at location Y. If not, location Y is not an option. The benefits of unbundling consist of increased competition at all levels in the health value chain. If the benefits clearly outweigh the costs of unbundling then in general bundling cannot be justified on the objective economic criteria.

Bundling does have an economic rationale if it leads to a reduction in costs, allowing the firm to realise financial economies in the supply chain of the good or service provided. VHI bundling does not appear to have led to a reduction in VHI costs. Nor has bundling led to a reduction in charges borne by customers. The fact that the costs of the VHI have increased defeats the realising of financial economies (of scope) that would frustrate argument used to justify bundling practices. The net effect of the bundling is a direct and

immediate effect of a tie-in or lock-in effect of consumers with the de facto erection of significant entry barriers, thereby raising rivals' costs of entry and participation in the PHI market dominated by the VHI.

The Interests Served

The VHI is entitled to take action to defend its legitimate commercial interests, but that such action must be proportionate to the interests served. There is a duty in qualifying 'the interests served': serving the interests on a competitive market cannot be compared with serving the interests in a market where competition is restricted. Competition for specific services responding to economic conditions and which require private investment should not justifiably be excluded if provision did not endanger the economic equilibrium of the interests served by the VHI.

The questions to be considered by the CA and the HIA are whether the difference between the costs actually incurred and the price actually charged is excessive (as reflected by the premium paid) and if the answer to this question is in the affirmative whether a price as measured by payment of annual premium has been imposed which is either unfair in itself or when compared to competing products. In a situation of total dependence on one supplier it is not possible[6] to say at what point the cost of obtaining the supply becomes unreasonable to the purchaser: he or she simply has to pay the premium or cease functioning.

PHI Market

The PHI market raises the issue of the extent to which the VHI can influence the future development of the health services market generally. It also raises the extent to which the leveraged dominance or potential dominance of the VHI in the Irish health care system constrains the business opportunity of a potential entrant intent on entering the Irish market.

Specifically in terms of the on-going development of private hospitals in Ireland the s dominance or potential dominance of the VHI in the PHI market, for example, facilitates a leveraging of that dominance or potential dominance into the private hospitals' market, frustrating the commercial efforts of any potential entrant into the Irish health services market whether as a supplier of service or as a provider of alternative health insurance.

There is a dangerous probability that in an Irish market that encouraged the development of the VHI we could also observe a tangible illustration of the kind of product quality suppression and damage to dynamic competition that is more closely associated with monopoly abuse. Product quality is suppressed when new private hospitals or new alternative methods of supplying services – for example, mobile MRI scanning services – are delayed or not provided at all because of a failure to secure VHI insurance cover for the product or service.

Understanding Dominance

The concept of dominance is directly applicable to the VHI, where its position in the market for PHI has enabled it to behave to an appreciable extent independently of its

[6] *Vide Opinion of AG Jacob Joined Cases 110/88 Sacem III [1989] ECR 2811.*

competitors and customers and ultimately of its consumers. It derives from a combination of several factors, which if taken separately are not determinative, including the following

i. Leverage by the VHI: 'position of sufficient economic strength'

Leverage allows VHI to play a role of 'gatekeeper' in the market for private hospital services. It is in the interests of a gatekeeper to 'hold-up' or to delay the entry of a competitor or a competing product or service. The first test of monopoly leverage entails the use of monopoly market power in one market to gain a competitive advantage in another market. The second test of 'price squeeze' or delay in approving entry of a new product or service is really a specific form of monopoly leveraging wherein it applies where the seller of a monopoly good or service uses its pricing of that good or service at the pre-entry stage to give it a competitive advantage over the purchasers of the good or service in a downstream market. For example, whether or not a radiologist would work for provider X depends critically on the extent, if any, of the insurance cover provided by the VHI to the product or service of X.

ii. Leverage: does the VHI have the capability and the ability?

Leverage is intricately linked with the ability and capability of the VHI to behave independently of its competitors and/or customers. This can be determined by the capability of the VHI in one market (health insurance) leveraging its dominance in that market into a second market (private hospitals) and the ability of the VHI in one market (health insurance) leveraging its dominance in that market into a second market (private hospitals). The VHI has a capability arising from its position as a singly dominant player in the PHI market. And as long as the provision of health services in Ireland require the authorisation from the VHI, the VHI has the capability to leverage its dominance and act as a 'gatekeeper' by delaying the entry of competitors.

There are important parallels in understanding VHI dominance in the Irish PHI market in terms of the definition of dominance with the United Brands case[7], with the market power of VHI derived substantially from the degree to which it has integrated its various activities.

The economic strength and dominance of the VHI in the market is derived from the fact that at each stage of the health services provision it is able from its own resources to accept and reject variations in demand for new services and products. It is able to offer or decline insurance cover for hospital services, it is able to advertise its brand 'VHI' and to change the commercial exploitation of that brand, and the fact that the VHI obtains legal or de facto control of the commercial conduct of other health providers or suppliers of services or where agreements between VHI and private hospitals and public hospitals provide for commercial cooperation, collectively gives the VHI as a health insurer an important element of strategic leverage, placing all its competitors at a disadvantage.

[7] *United Brands [1978] 1 CMLR 486,487.*

Key Recommendations

The VHI as a monopoly provider of private health insurance cover should not be active in a downstream health services market.

The future of PHI in Ireland is intricately linked to whether or not the VHI continues to be active in the downstream markets in the health services. How far does the duty to allow access to new entrant competitors extend – how many entrants must be admitted? The HIA must be allowed to determine just how fair and reasonable the process of entry is into the Irish health market. How are alleged anti-competitive complaints against the VHI to be effectively handled and monitored, and by whom? The answers to these questions may be sought in the functions assigned to the HIA coupled with the provision under the Competition Act.

Unbundle the VHI as a provider of PHI from its provision of insurance cover for health services and products.

There is a need to separate the management and accounting of private health insurance and the provision of vertical integrated services by the VHI. A primary function of the HIA should be to ensure the creation of a transparent and non-discriminatory system of providing health insurance cover. This can only be achieved by an unbundling of the role played by the VHI in its provision of health insurance in the PHI market from its spillover role as an endorser of provision of new health services and products, an endorsement that requires the provision of insurance cover by the VHI.

It is imperative for the CA to ascertain whether or not the VHI's historic accumulation of a privileged position in the PHI market facilitated leverage and thus an abuse of a dominant position in the PHI market. Furthermore to ascertain whether or not that historic accumulation of a privileged position gave the VHI ample potential to favour its own selected service providers in the downstream markets to the detriment of other providers and to establish if this accumulation of exclusive rights had in fact resulted in discrimination. In particular the CA must be convinced that the conduct and behaviour of the VHI, its methods of organisation and exercise of its leverage did not run contrary to the rules on free movement of goods and services across the EU.

Provide for a predetermined detection mechanism under auspices of the HIA for each invitation to tender to provide insurance cover.

In practice, what is needed is the establishment of a predetermined selection mechanism, either with the creation of new HIA rules for each invitation to tender from existing life and non-life insurers companies in Ireland to provide insurance cover or to provide a new product or service. As a first step, this would be a mechanism to identify a possible HIA threshold differing by a certain percentage (10%) from a combination of the VHI estimate and from the average of the tenders. This could, if required, be corrected in order to avoid being distorted by tenders that might be too high in relation to the average. It is the lower of these two thresholds, the estimate of the VHI or the average of the tenders, which would be the determining factor. Such a mechanism would ensure that consumers are receiving greater value today for the same expenditure on private health insurance.

Structural remedy arising from an historic 'crowing-in' effect to the VHI due to dependence

Faced with the classic Hobson's choice in health insurance providers the customer-as-patient will continue to subscribe to the VHI and the VHI know that to be the case. It is our contention in this submission that a nefarious 'crowding-in effect' has evolved in the Irish PHI market as health consumers continue with the VHI because it was (until the entry of BUPA) and continues to be (in the absence of future entry) for many the only choice in the private health insurance market.

From a competition policy perspective the CA has to consider whether or not health services such as private hospitals or mobile MRI scanning services are a commodity that should be traded freely in a private health insurance market. It is our view that such services cannot be traded freely given the leverage of the VHI to the downstream closely related markets in the supply chain of the Irish health services. Unless it is accepted by the HIA and the CA that best interests of a PHI consumer are served by forgoing private medical care in order to reduce premiums, the contracting practices and policy positions of the VHI on additional private beds are not in the consumers best interest.

This recommendation goes to the core of this public consultation process – the consideration of a structural remedy such as the 'selling-off' of part of the book of the VHI business. It would create a more open and competitive PHI environment. Short of an outright break up or partial sale of book of VHI, the PHI consumer-patient would be better served in the long run if market forces were allowed to prevail.

Concluding Comments

Ultimately, consumers as patients have a right to choose the health service or product, and a right to exercise choice from a range of competitors in a community rated private health insurance market. Taking all these issues together we believe that the PHI market is sufficiently problematic and anti-competitive to reject faith in a model of competition that would justify no change in the present strategic role of the VHI in the private health insurance market. It is for the CA and the HIA to establish through this public consultation process whether the organisation of the PHI market, the monopoly position of the VHI and the exercise of that monopoly position runs contrary to the rules on free movement on goods and services and the competition rules.

There is a need to clarify the scope of private health insurance within the meaning of the Competition Act by narrowly construing the meaning of the business of private health insurance to the practice of transferring or spreading policyholders' risks. A key issue to consider for both the CA and the HIA is the privileged position of the VHI and the likelihood of an abuse of that dominant position through the aegis of its conduct in the health insurance market. Whether its conduct can be condemned, as a prima facie abuse of a dominant position as either anti-competitive or exploitative, it would still be possible for the VHI as a dominant firm to legitimise its conduct through objective justifications. Hence the urgency to seek clarification on the scope of private health insurance within the meaning of the Competition Act from the CA.

Ultimately we must ask: do the commercial interests of the VHI justify the direct and immediate impact of its conduct on third parties in the PHI market and is there a less restrictive alternative for protecting those interests? There is a less restrictive alternative provided by a more open and competitive market for private health insurance. But we

must be careful: consumers in the PHI market are potential patients. So in this submission we identify a need in Irish competition law for the equivalent of the Midcal test in US antitrust where the challenged action of the VHI must be 'clearly articulated and affirmatively expressed' as not only policy conducive to the interests of the Irish customer-as-patient but also to the Government's Health Strategy, and ultimately the future of the Irish health care market.

ENDS