TESTIMONY OF THE STATE ATTORNEY GENERAL
TWENTY-FOURTH LEGISLATURE, 2008

ON THE FOLLOWING MEASURE:
H.B. NO. 2256, H.D. 2, S.D. 1, RELATING TO INSURANCE.

BEFORE THE:
SENATE COMMITTEE ON JUDICIARY AND LABOR

DATE: Tuesday, April 1, 2008 **TIME:** 10:00 AM
LOCATION: State Capitol, Room 016
Deliver to: Committee Clerk, Room 219, 1 Copy

TESTIFIER(S): WRITTEN TESTIMONY ONLY.
(For more information, contact James F. Nagle, Deputy Attorney General, at 586-1180.)

Chair Taniguchi and Members of the Committee:

We strongly oppose H.B. No. 2256, H.D. 2, S.D. 1, which would weaken consumer protection by affecting the tying prohibition of the insurance code found at section 431:13-103(a)(4), Hawaii Revised Statutes. We disapprove of forcing a consumer to purchase one product as a prerequisite for buying another. We object to a seller's exploitation of its control over the tying product to force the buyer into the purchase of a tied product that the buyer either did not want at all or might have preferred to purchase elsewhere on different terms. We believe in consumer choice.

Thus, we oppose any changes to the anti-tying provision. That provision is meant to eradicate certain evils, including the denial of free access to the market for the tied product, forcing buyers to forego their free choice between competing tied products, and restraining free competition in the market for the tied product. Consequently, we respectfully oppose this measure and ask that it be held.

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

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TO THE SENATE COMMITTEE ON JUDICIARY AND LABOR

TWENTY-FOURTH LEGISLATURE
Regular Session of 2008

Tuesday, April 1, 2008
10:00 a.m.

WRITTEN ONLY

TESTIMONY ON HOUSE BILL NO. 2256, HD 2, SD 1 – RELATING TO INSURANCE

TO THE HONORABLE BRIAN T. TANIGUCHI, CHAIR, AND MEMBERS OF THE COMMITTEE:

My name is J.P. Schmidt, State Insurance Commissioner ("Commissioner"), testifying on behalf of the Department of Commerce and Consumer Affairs ("Department"). The Department opposes H. B. 2256, HD 2 SD 1 which would weaken the anti-bundling provisions of the Insurance Code.

Under Hawaii Revised Statutes section 431:13-103(a)(4)(B), part of the unfair methods of competition and unfair and deceptive acts and practices in the business of insurance statute, insurance companies are prohibited from making the purchase of one class of insurance contingent upon the purchase of another class of insurance. This is known as the "anti-bundling" provision and is designed to protect consumers from an insurer who would seek to force consumers to purchase multiple types of insurance in order to buy a policy that they want to buy. The rule does not prohibit an insurer from offering different classes of insurance together in an attractively priced package. There is no violation if the consumer has the option of taking the package or just taking the

insurance wanted. The law only prohibits an insurer from refusing to sell one policy unless another policy or other policies are also purchased.

In other words, under current law a health insurer could pair a life insurance policy with a health insurance policy and offer the package to consumers who are free to accept or reject the life insurance. The insurer can not demand that the consumer buy the life policy in order to get the health policy.

H. B. 2256, HD 2, SD 1 would allow insurers with less than a 5% market share to require customers to purchase a bundle of insurance products as a condition of sale. The Insurance Division is aware of only one insurer engaging in this practice presently and that is the health insurer Hawaii Management Alliance Association ("HMAA"). Presently, HMAA requires sole proprietors to puchase not only health insurance related coverages such as vision and dental insurance, but also life insurance. The Insurance Division is moving to halt this practice. This bill seeks to reverse the Division's action.

Although this bill only applies to insurers with less than 5% market share, the issue is not market share, the issue is what the U.S. Supreme Court in *Jefferson Parish Hosp. Dist. No. 2 v. Hyde* called "market power", or "leverage".

In footnote 20, the court noted:

> FN20. .... "'Leverage' is loosely defined here as a supplier's ability to induce his customer for one product to buy a second product from him that would not otherwise be purchased solely on the merit of that second product." V P. Areeda & D. Turner, Antitrust Law ¶ 1134a at 202 (1980).
>
> *Jefferson Parish Hosp. Dist. No. 2 v. Hyde,* 466 U.S. 2, 14, 104 S.Ct. 1551, 1559 (U.S.La.,1984)

HMAA has that "leverage" – although it has a small share of the "accident and sickness insurance market", HMAA presently is essentially the only health insurer who offers group policies to sole proprietors.

HMAA portrays its practice of requiring the purchase of one, possibly undesired insurance product in order to purchase another desired insurance product as a customer benefit or a social good. The company characterizes the observation that this

conduct is illegal as irrational, unfair and misleading. We are happy to submit that matter to the committee on the basis of the Attorney General's testimony, which confirms that the practice is illegal. According to HMAA, the Department's concern over HMAA's practice of bundling products departs from 18 years of "practice and judicial precedent." In response we note first that in enforcing the law it is totally meaningless that HMAA has been violating the law for 18 years – that is no justification for being allowed to continue an unlawful practice. Second, the Insurance Division did not have a health branch 18 years ago or even 10 years ago and the reason that this matter was raised in 2006 and not sooner was that we received a complaint at that time from an HMAA member who objected to being forced to buy life and dental coverage from HMAA in order to purchase a health plan. During our investigation we discovered that 30 to 40% of prospective HMAA members objected to being forced to buy insurance coverage they didn't want. If any of those consumers had come to the Insurance Division earlier we would have moved to stop this practice earlier.

Contrary to HMAA's assertion, allowing this practice does not mean lower premiums for the consumer. In HMAA's case for example, HMAA got approximately $36,000 in "profit sharing" from the company issuing the life insurance policy that HMAA members were required to buy but, more significantly, an affiliated company of HMAA, AB & Associates, received $855,014 in commissions on the sale of this life insurance policy from 2001 to early 2006. AB & Associates is a for-profit company owned by the individuals who were officers of HMAA. This commission for placement of the life insurance did not benefit the consumer, did not benefit HMAA, and did not benefit HMAA's members. AB & Associates' commission in this transaction was 25% of the total premium, in other words, every year 25% of the premium that HMAA members pay for life insurance that they had no choice in purchasing goes to an HMAA for-profit affiliated company. Although the current draft of this legislation excludes life insurance from permissible bundling, this is an example of what can and does happen if bundling is allowed.

The anti-bundling rules are there to protect consumers; it would be bad policy to allow so called "small insurers" to use their market power to force consumers to take insurance they don't want or need. As noted above, evidence was presented that 30-40% of HMAA's members objected to being required to buy insurance that they didn't want and requested to buy coverages separately.

This bill is being presented as beneficial to small business. Small business would truly benefit by amending the definition of "small employer" in HRS §431:2-201.5 to include sole proprietor and thus clarifying that sole proprietors are entitled to group health insurance.. That way they will get the same protections under our HIPAA conformity statute enjoyed by other small employers. We support the language in Senate Bill 2530 Relating to Health Insurance Help for Small Business which takes this approach.

We thank this Committee for this opportunity to testify and ask that this bill be held.

HMAA
HAWAII MEDICAL ASSURANCE ASSOCIATION

BEFORE THE

SENATE COMMITTEE ON JUDICIARY AND LABOR

Senator Brian T. Taniguchi, Chair
Senator Clayton Hee, Vice Chair

HB 2256 HD2, SD1 RELATING TO INSURANCE

TESTIMONY OF
JOHN HENRY FELIX
Chairman of the Board and Chief Executive Officer

April 1, 2008, 10:00 am
State Capitol Conference Room 016

Chair Taniguchi, Vice Chair Hee and Committee Members:

My name is John Henry Felix, Chairman of the Board and Chief Executive Officer of Hawaii Medical Assurance Association (HMAA). HMAA **strongly supports the intent of HB 2256 HD2, SD1** which would enable small health insurers to continue combining different types of health and sickness-related insurance benefits into a single unified policy.

I. Amendment

HB 2256 HD2, SD1 has been amended in a way that detracts from its intended purpose – to formally authorize and encourage the longstanding approval by the Insurance Division of the combining of life, medical, dental, vision, and prescription drug coverage by small health insurers. Due to the amendments, HB 2256 HD2, SD1 now omits the ability to combine either drug or life insurance benefits. Accordingly, we respectfully request that the measure be amended to permit the combining of drug and life benefits, in addition to dental, vision and health benefits.

This would revise HB 2256 HD2, SD1 Hawaii Revised Statutes section 431:13-103(a)(4)(B) as follows (new statutory material underscored):

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(B) Entering into any agreement on the condition, agreement, or understanding that a policy will not be issued or renewed unless the prospective insured contracts for another class or an additional policy of the same class of insurance with the same insurer; provided that this subsection shall not apply to any accident and health or sickness insurer with less than five percent market share.

II. Background to HMAA and the Need for this Bill

By way of background, HMAA is a non-profit mutual benefit society which provides health insurance to over 30,000 Hawaii residents. HMAA occupies about three percent of Hawaii's health insurance market. As a small insurer, HMAA takes special pride in providing health insurance to sole-proprietors and small businesses, a segment of Hawaii's market which has a difficult time obtaining affordable health related insurance.

HB 2256 HD2, SD1 is intended to help self-employed workers and small businesses by continuing to allow broader coverage for less cost. This bill is necessary because the current administration has recently chosen to interpret Hawaii law in a different way than it has ever been interpreted by prior administrations, to prohibit the combination of drug and medical coverage, or the combination of medical, dental and drug coverage, or any other combination of health related coverages, into one insurance policy. Numerous Hawaii laws already permit the combination of various types of health coverages under one policy, and this should be encouraged, not discouraged, to help provide the broadest health coverage possible for Hawaii's residents.

III. The Insurance Commissioner's Departure from Practice and Judicial Precedent

Since its inception in 1989, HMAA's medical plans have always included life insurance, and its sole proprietor/independent contractor plans have always included medical, dental, vision, and prescription drug coverage.

HMAA's plans have been subject to the Insurance Division's triennial examinations as required by statute, including examination of HMAA's books and records. In all of these examinations, the Insurance Division knew how HMAA "bundled" benefits, and on no occasion did it ever question the bundling. Rather, on each and every occasion, the Insurance Division issued an order adopting the examination report on HMAA approving its plans. Significantly, in the examinations for the 1/1/93-12/31/94; 1/1/95-12/31/95 time periods, the examiners specifically stated that they "examined [HMAA]'s policies and procedures to determine whether they were engaging in any unfair methods of competition and unfair and deceptive acts and practices." Nevertheless, the resulting examination reports and orders adopting the reports did not mention any concern that HMAA's policies and procedures violated HRS section 431:13-103(a)(4)(B) or otherwise indicated any unfair methods of competition or unfair or deceptive acts or practices.

Although prior Insurance Commissioners have accepted HMAA's practice for the last 18 years, the current administration has departed from those years of acceptance and deemed these combined benefits as a violation of state anti-tying laws. This administration is doing so even though the U.S. Supreme Court has long since made clear that a company with less than 30% market share has no coercive power in the marketplace and cannot violate federal anti-tying laws. *Jefferson Parish Hospital v. Hyde*, 466 U.S. 2 (1984). *Jefferson Parish* is widely respected as a landmark decision on anti-tying law, wherein the Court stated, "the fact that [the hospital's patients] are required to purchase two separate items is only the beginning of the appropriate inquiry." *Id.* at 25 (emphasis added). "Only if patients are forced to purchase [the tied product] as a result of the hospital's market power would the arrangement have anticompetitive consequences." *Id.* (emphasis added). Emphasizing the point, the Court stated that "[w]ithout evidence that [the hospital is] using market power to force [the tied product] upon patients there is no basis to view the arrangement as unreasonably restraining competition whatever the reason for its creation." *Id.* at 25 n.41. The Court concluded that the hospital had no market power and therefore, the tying arrangement was not unlawful. In reaching that conclusion, the Court assumed that the hospital had a market share of 30%. *Id.* at 26.

Jefferson Parish reversed a trend in lower courts – now being copied by Hawaii's Insurance Commissioner - to condemn tying arrangements even when the defendant's share of the market was very small. Since *Jefferson Parish* was decided, courts have generally refused to prohibit tying arrangements where the market share is less than 30% of the market. *See, e.g., Marts v. Xerox*, 77 F.3d 1109, 1113 n.6 (8th Cir. 1996) (18% too small); *Town Sound and Custom Tops, Inc. v. Chrysler Motors Corp.*, 959 F.2d 468, 481 (3rd Cir. 1992) (10-12% insufficient); *Grappone, Inc. v. Subarus of New England, Inc.*, 858 F.2d 792, 797 (1st Cir. 1988) (recognizing market share of 5.6% or less as "minuscule").

Consistent with the federal standard, HB 2256 HD2, SD1 will encourage the existing practice by smaller accident and sickness insurers to "bundle" together different classes of insurance, such as health, dental, and vision, thereby continuing the State's historical acceptance of this practice by small insurers who lack coercive power in the marketplace. In these circumstances, bundling provides broader health care coverage in single unified policies, ultimately resulting in lower overall premiums, fostering greater competition within the Hawaii insurance marketplace, and providing consumers with greater flexibility, coverage and pricing options.

HB 2256 HD2, SD1 is intended to codify into Hawaii law the same rules applicable to similar federal anti-tying laws, though using a more conservative market share standard of 5% market share. HB 2256 HD2, SD1 does not change the Prepaid Health Care Act in any way, but rather simply provides that HMAA's 18 year practice of providing broad, cost- effective benefits to Hawaii's smallest business groups is not an unfair insurance practice. Without passage of HB 2256 HD2, SD1 hundreds of sole-

proprietors, small businesses, and their families currently insured by HMAA could be forced to shop for more expensive individual policies with much less coverage.

IV. HMAA's Lack of Market Power

In prior testimony, the Insurance Commissioner has repeatedly attempted to confuse the issue by claiming that HMAA has nearly one hundred percent (100%) of the "market" for accident and sickness insurance policies issued to sole proprietorships. *See e.g.,* Testimony of Insurance Commissioner dated February 14, 2008 re: H.B. No. 2256, H.D.1, at p. 2, and that HMAA therefore has "market power" even though HMAA has less than five percent (5%) of the market for accident and sickness insurance policies generally.

However, the Insurance Commissioner admits that "[o]ther insurers could sell group insurance to sole proprietors but they are not required to do so by law . . . so they don't." *Id.*, at p. 3. Plainly, if other insurers are free to sell group insurance to sole proprietors, HMAA cannot have any market power because if HMAA raises its premiums above competitive levels, other insurers would be free to start selling policies to sole proprietors. Thus, the Insurance Commissioner's claim that, on the one hand, HMAA has market power *vis a vis* sole proprietors, but, on the other hand, other insurers can sell group policies to sole proprietors, is contradictory and illogical.

In fact, HMAA does not control a majority of the sole proprietor / independent contractor market. HMAA currently covers 932 of these individuals. The annualized gross premium is currently $5.4 million out of HMAA's 2007 actual gross premium of $96 million. The premium is not significant, but the benefit to the sole proprietor/independent contractor is. *If HMAA were to cease offering this plan, the loss of premium would be equivalent to HMSA losing a single large group.*

The Attorney General's own testimony of February 14, 2008 stated "The sole proprietor market in Hawaii is not insignificant. According to the latest U.S. Census Bureau report (2004), 16,503 out of 31,605 Hawaii business, or 52%, have one to four employees." (emphasis added). *This would suggest that HMSA's Individual Business Plan, and not HMAA's plan that covers only 932 individuals, has the market share.*

Given the foregoing, and in light of the Insurance Commissioner's necessary concession that "[o]ther insurers could sell group insurance to sole proprietors," the attempt to impute market power to HMAA even though HMAA has less than a five percent (5%) market share must be rejected. Other insurers can sell group insurance to sole proprietors. If HMAA or another insurer offers bundled products that consumers do not want, other insurers can step in to offer products to satisfy that demand. This is how competitive markets work. If anything, the Insurance Commissioner's anti-bundling rules are anti-competitive because they prevent the development of bundled products in a competitive market by insurers who lack coercive market power.

V. Bundling by Other Insurers

Also in prior testimony, the Insurance Commissioner asserted that HMAA is the only health insurer which bundles, stating "H.B. 2256 would allow insurers with less than a 5% market share to force consumers to purchase a bundle of insurance products as a condition of sale. The Insurance Division is aware of only one insurer engaging in this practice presently and that is the health insurer ....HMAA".

This statement is not true. HMSA's "Individual Business Plan" has been available to sole proprietors and independent contractors for the last decade. It, too, combines medical, drug, vision, dental, and life insurance in one plan. However, HMSA and other insurers elect to treat the sole proprietor and independent contractors as individuals for insurance purposes, and not as 'groups' protected by the Hawaii Prepaid Health Care Act.

This election by other insurers reduces benefits and imposes additional eligibility rules to the detriment of sole proprietors and independent contractors, including the ability to deny coverage and a 12-month waiting period before benefits begin for certain conditions, such as:

Aids and HIV	Reflux Disease
Alzheimer's Disease	Hearing Loss
ALS	Heart, blood, and blood vessel diseases
Anemia for congenital or hereditary blood disorders	Hepatitis other than Hepatitis A
Arthritis	High blood pressure
Asthma	Multiple sclerosis
Cancer	Osteoporosis
Cataracts	Pelvic inflammatory disease
Cerebral Palsy	Radiculopathy
Cirrhosis of the liver	Reconstructive surgery for a previous illness or injury
Chronic Obstructive Pulmonary Disease	Sleep Apnea
Cohn's Disease	Spinal disk problems
Diabetes	Surgery and services related to hemorrhoids, hernia, tonsils, adenoids, and varicose veins
Diverticulitis	Thyroid conditions
Dysfunctional uterine bleeding	Tuberculosis
Endometriosis	Ulcers
Fibromyalgia	Urinary Incontinence
Gall Bladders disease and gallstones	Transplants

HMAA protects the sole proprietors and independent contractors by electing to treat them as regular groups. This means that there is **no waiting period** before benefits begin. This has been HMAA's mission since its inception. It was formed

specifically to give the 'little guy' as good or better benefits as so-called regular companies including the 'big guys'.

VI. Bundling of Life Insurance is Mandated by Current Law

For groups of two or more, HMAA's plan includes life insurance and accidental death and dismemberment benefits. The Division's insistence that these benefits be "unbundled" is contrary to existing Hawaii law, which requires mutual benefit societies to bundle life insurance if they choose to offer it:

> **431:10D-208. Mutual benefit society groups.**
>
> The lives of a group of individuals may be insured under a policy issued to a mutual benefit society, which shall be deemed the policyholder, to insure members of the society for the benefit of persons other than the society or any of its officials, subject to the following requirements:
> . . .
>
> (3) . . . a policy on which no part of the premium is to be derived from funds contributed by the insured members specifically for their insurance **must insure all eligible members**;[1]
>
> . . .
>
> (7) The amounts of insurance under the policy must be based upon some plan **precluding individual selection either by the members or by the society**.

See Haw. Rev. Stat. § 431:10D-208 (emphasis added). Plainly, the only reasonable interpretation of the statutory mandate that the insurer "must insure all eligible members" and must "offer the insurance in such a manner so as to "preclude[] individual selection either by the members or by the society" is to require that it be uniformly provided to all members, just as HMAA has been doing for years. The Division's position is squarely at odds with section 431:10D-208, and should be rejected accordingly.

Thank you for the opportunity to testify on this matter of critical importance. HMAA **STRONGLY SUPPORTS** HB 2256 HD2, SD1 and respectfully urges the passage of this measure with necessary amendments.

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[1] HMAA pays for the life insurance from its reserves, not member premiums.

HMSA

Blue Cross
Blue Shield
of Hawaii

An Independent Licensee of the Blue Cross and Blue Shield Association

April 1, 2008

The Honorable Brian Taniguchi, Chair
The Honorable Clayton Hee, Vice Chair

Senate Committee on Judiciary and Labor

Re: HB 2256 HD2 SD1 – Relating to Insurance

Dear Chair Taniguchi, Vice Chair Hee and Members of the Committee:

The Hawaii Medical Service Association (HMSA) appreciates the opportunity to testify on HB 2256 HD2 SD1 which would exempt small health plans that occupy less than five per cent of the health care market from adhering to a portion of the Insurance Code dealing with unfair methods of competition and unfair or deceptive acts or practices. HMSA opposes this measure in its current form.

The current language of this measure would allow health plans with less than a five percent share of the local market to engage in marketing that would be prohibited for both HMSA and Kaiser Permanente. We believe that this would create an unlevel playing field for plans operating in the State and that regulation should not be selective.

If passed, the language in this measure relating to market share would exempt health plans below an arbitrary cutoff (5% market share) from its scope. An application of law selectively applied based on the market share of an entity would be precedent setting. Passage of this measure could open the door for others doing business locally to approach the Legislature requesting a more favorable regulatory scheme based on their size. We believe that this is not in the best interest of consumers or the state and could raise questions of constitutionality.

Last legislative session, this Committee heard a similar measure and removed the market share component. We would respectively request that the Committee incorporate that again into this year's version. Our proposed amendment to Page 5, Lines 15-21 through Page 6, Lines 1-2 is noted below:

provided that this subparagraph shall not apply to any insurer subject to chapter 432 offering contracts for dental and vision insurance as a condition, agreement, or understanding to the new health insurance policy or renewal of a health insurance policy under chapter 432;

Thank you for the opportunity to testify on HB 2256 HD2 SD1.

Sincerely,

Jennifer Diesman
Assistant Vice President
Government Relations

SENATE COMMITTEE ON
JUDICIARY AND LABOR

April 1, 2008

HB 2256, HD 2, SD 1 Relating to Insurance

Chair Taniguchi and members of the Senate Committee on Judiciary and Labor, I am Rick Tsujimura, representing State Farm Insurance Companies, a mutual company owned by its policyholders. State Farm opposes House Bill 2256, HD 2, SD 1 Relating to Insurance.

State Farm requests this committee hold House Bill 2256, HD 2, SD 1 or, in the alternative, pass this measure as drafted.

Thank you for the opportunity to present this testimony.