

***Recent Hospital Merger Enforcement:
The case of FTC v. Evanston Northwestern Healthcare***

Monica G. Noether

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History of Hospital Merger Enforcement

- **String of wins during 1980s**
 - Administrative litigation
 - Federal court preliminary injunction cases
- **String of losses from mid-1990s to 2001**
- **No prospective merger challenges filed in federal court from 2001 to 2007**
- **Merger litigation task force and retrospective merger investigations started in 2002**
 - Evanston Northwestern – Highland Park merger (consummated on Jan 1 2000) challenged in 2004
- **One prospective case filed in 2008**
 - Inova Health System

Economic Issues Raised by Hospital Mergers

- **Antitrust scrutiny of hospital mergers frequently raises interesting economic issues, requiring both theory and empirical analysis**
 - Market definition, both relevant product and geographic markets
 - Degree and relevance of differentiation
 - Likelihood of either unilateral or coordinated anticompetitive effects resulting from combination
 - Quality of care
 - Other efficiencies
- **Other issues considered**
 - Testimony of managed care plans
 - Nonprofit character of hospitals

Evanston Northwestern Healthcare

FTC sued to break up merger four years *after* consummation

- **Allowed analysis of market post-merger unavailable to prospective review**

Economic issues included:

- **Whether post-merger price increases provided clear evidence of market power obtained through merger**
- **Relevance of evidence on closeness of substitution in differentiated products/services merger**
- **Types of evidence that help to determine geographic market in a hospital merger**
- **Role of quality enhancements**
- **Optimal remedy**



FTC Complaint

- **Count I: Traditional merger allegations**
 - Merger lessened competition in the relevant market – based on Horizontal Merger Guidelines analysis
 - Relevant product and geographic markets alleged
 - General acute care inpatient hospital services sold to private payers
 - Triangular area defined by the three ENH hospitals and contiguous geographic areas in northeast Cook County and southeast Lake County (15 miles north and south along Lake Michigan and 10 miles inland)
- **Count II: Novel approach**
 - Merger lessened competition in a line of commerce in a section of the country – based on actual competitive effects with no defined market
- **Count III: Price fixing of physician services**
 - By contracting on behalf of salaried and independent physicians

ALJ's Initial Decision

- **Count I sustained**

- Found lessening of competition based on price increases
 - “[P]rice increases significantly above its premerger prices and substantially larger than price increases obtained by other comparison hospitals.”
- Documentary and testimonial evidence important

- **Count II dismissed as moot**

- However, ALJ notes that Complaint Counsel failed to identify relevant markets for this Count
 - “[B]y not alleging a relevant product or geographic market, Complaint Counsel asks the Court to adopt a novel theory of Clayton 7 liability. To do so would undermine decades of established merger jurisprudence – a departure that this Court is unwilling to undertake.”

- **Count III resolved by consent decree prior to trial**

- **Proposed divestiture as remedy**



FTC Decision

- **Found violation based on econometric analysis of price increases**
- **Relevant geographic market consisted of “triangle” of merging hospitals**
 - Rejected use of patient flow data
 - Based market definition on price increases
- **Accepted unilateral effects theory of competitive harm due to increased leverage in managed care negotiations**
- **Confirmed importance of pre- and post-merger documentary evidence**
 - Testimony of health plans considered but not relied on heavily
- **Rejected key defense arguments**
 - Learning about demand
 - Efficiencies: quality improvements
 - Broader geographic market



To What Extent did Evanston and Highland Park Compete Pre-merger?

- **When firms providing a differentiated service merge, the degree to which consumers view them as close substitutes affects how much their combination enhances their market power**
- **Hospital services are differentiated in both -**
 - Product dimensions (range of services, reputation, academic affiliation) and
 - Geographic dimensions (location matters for many patients)
- **Can consider question in context of patient or Managed Care Organization (MCO) customers**
- **Evidence suggested that Evanston and Highland Park were not viewed as particularly close substitutes prior to their merger**



Evanston and Highland Park Were Not Close Substitutes

- **Product dimensions**

- Evanston was teaching facility with 400+ beds, handling about 380 DRGs
- Highland Park was community facility with 160 beds, treating about 210 primary and secondary service DRGs

- **Geographic dimensions**

- 16 hospitals closer to Evanston than Highland Park
- 5 hospitals closer to Highland Park than Evanston

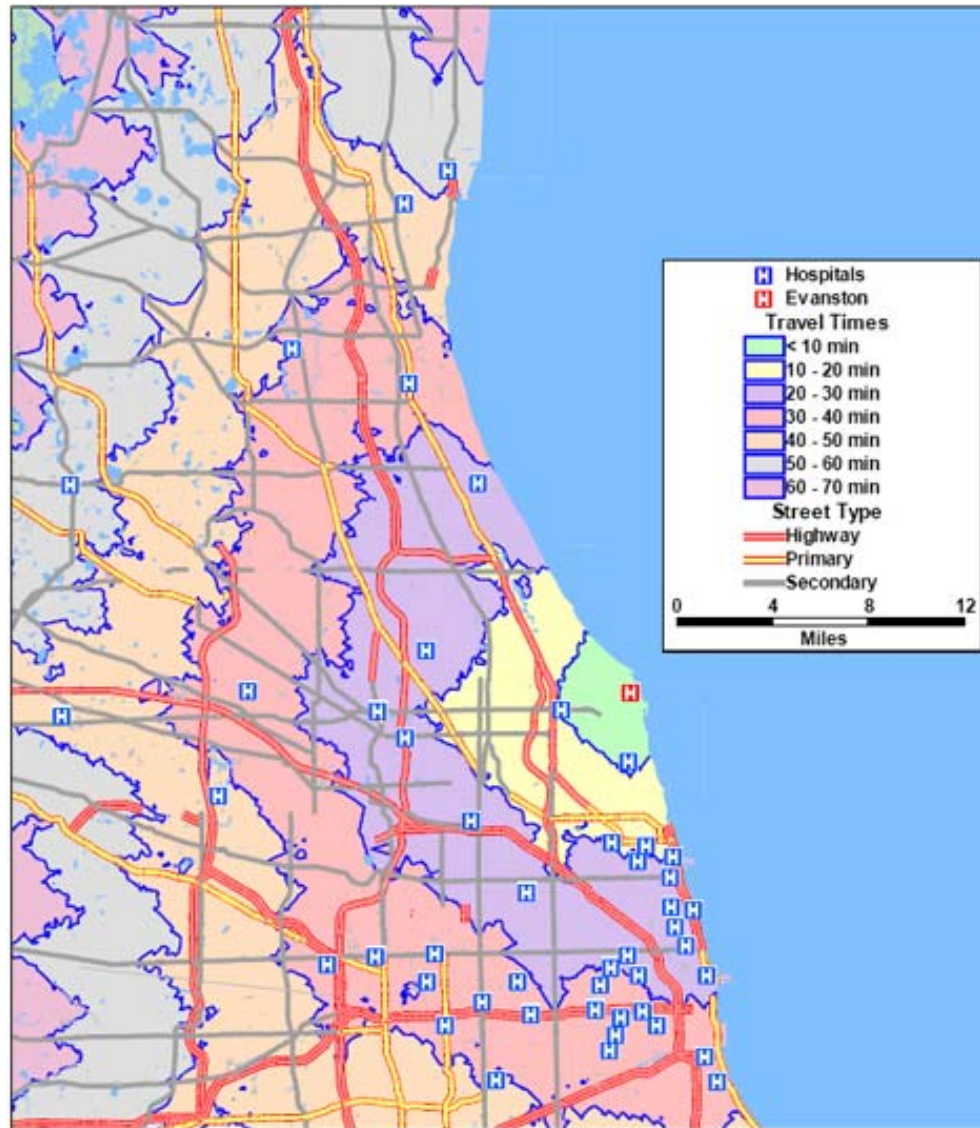
- **Managed Care Organizations acknowledged that they did not play the two hospitals off against each other in contract negotiations**

- **No evidence in hospital documents that viewed each other as close competitors**

- **Evidence suggests merger was unlikely to increase market power substantially since each constrained more by other facilities**



Travel Times from Evanston Hospital



Source: Caliper Corporation's Streets 2003 CD



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What do Post-Merger Price Increases Signify?

- **Undisputed that prices at ENH rose post merger**
 - Cause of the price increase is disputed
- **Validity of alternative explanations for ENH's post-merger price increases must account for**
 - extent to which they competed before their merger
 - concomitant extent of reduction in competitive restraint the merged entity faced afterward
- **Econometric analysis used by both sides to assess whether market power gained by merger led to the price increase**
- **“Difference-in-Difference” analysis compared changes in prices at merging and at non-merging facilities**
 - Requires control group of hospitals that are identical to merging facilities except for the merger to isolate effect of merger
 - Assumes that pre-merger price levels at all facilities were competitive



Price Analysis - Findings

FTC Expert

- Compared price increases at ENH to price increases at all Chicago area hospitals as well as at all teaching hospitals
- Found larger price increases at merging hospitals for several payors but also found that they differed in other characteristics from control group
 - Calls into question results of DID analysis
- Found no differentially larger price increase for Blue Cross (largest payor)

ENH Experts

- Focused on narrower control groups of (1) geographically proximate community hospitals and (2) teaching hospitals
- Looked at both changes in prices and price levels over time
 - Found larger price **increases** than at control group hospital for most payors (but, not BC) – but smaller than those found by FTC
 - Found price **levels** were similar to those of community control group prior to merger and rose closer to level of academic control group post-merger

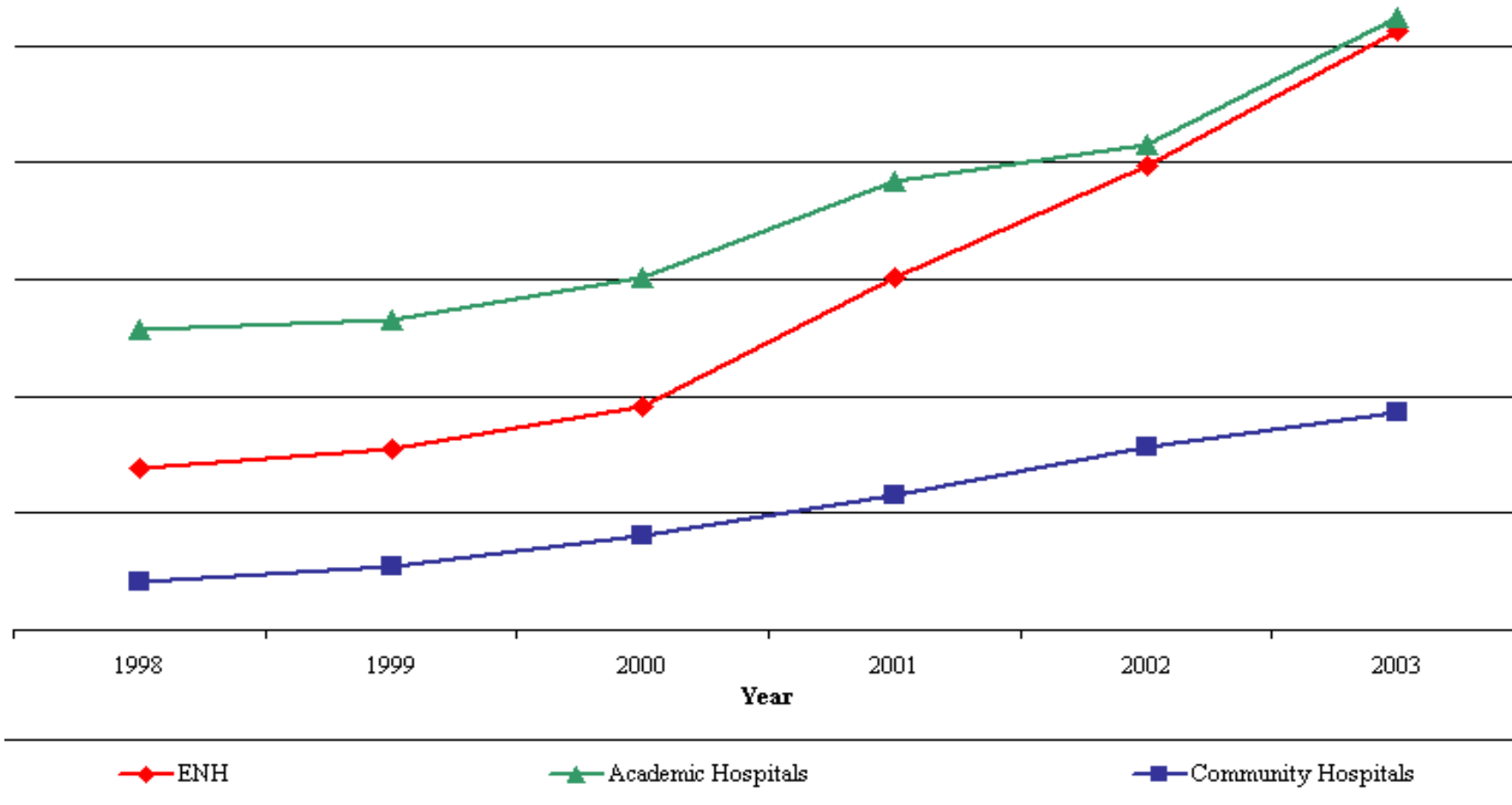


“Learning about Demand” Explanation of Price Increase

- **Given information on differences between Evanston and Highland Park, combined with price level patterns, need to think carefully about likely cause**
- **Analysis of trends in price levels demonstrated that ENH prices did not rise above those of comparable teaching hospitals**
 - FTC disputed that these hospitals were comparable
- **Documents revealed that ENH management had been mis-informed about market demand conditions prior to the merger**
 - Due diligence by Bain and Company suggested Evanston’s rates were low
 - Comparisons of Evanston and Highland Park pre-merger prices by ENH staff revealed that Highland Park community hospital rates exceeded those at Evanston, a teaching and tertiary facility
- **Evanston contracting head testified that his goal had been to include Evanston in as many MCO networks as possible**
- **This evidence suggests that ENH management gained information about market conditions in the context of the merger and the price increases resulted from this better information**



Learning About Demand



Geographic Market Analysis

- **FTC took position that patient discharge data that provide information used to measure patient travel patterns are useless in assessing a hospital's geographic market, arguing that**
 - Relevant competition is for MCO contracts and relies on MCOs' ability to construct alternative networks
 - Discharge data may not reflect preferences of underlying population
- **But -- hospitals (and MCOs) use these data regularly to assess competition and determine which hospitals are "must haves"**
- **Dismissal of patient flow data confuses basic analysis of the market place with more specific "Elzinga-Hogarty analysis," which focuses on inflow and outflow from a putative market**
 - EH analysis not used by respondents
 - Did analyze patient travel patterns to evaluate which hospitals patients in a particular geographic area view as substitutes



Quality Increases

- **Battle was primarily between clinical rather than economic experts**
- **Measurability issue**
 - FTC focused on outcome measures which they indicated were not compelling
 - Respondents argued that more easily observed structure and process measures are relevant indicators of quality
- **But-for issue**
 - Would Highland Park have implemented quality enhancements in absence of merger
 - Availability of necessary clinical expertise
 - Financial resources

ENH Remedy

- **FTC Remedy**
 - Reversed ALJ decision to order divestiture
 - Ordered separate managed care negotiations
- **If assume that a merger has caused anticompetitive harm, first best remedy restores the market to pre-merger competitive conditions**
- **But, in case of already consummated merger this may not be possible**
 - Market conditions have changed in intervening time
 - May be costly and time-consuming to undo the changes in the merged facilities
- **Second best solution recognizes substantial costs of divestiture**
 - Alternative requirement of separate negotiating teams balances perceived need to restore competition with costs of divestiture





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mnoether@crai.com
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