UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Bureau of Competition
Bureau of Economics
Office of Policy Planning

April 1, 2003

The Honorable Richard P. Ieyoub
Attorney General
Department of Justice
State of Louisiana
Baton Rouge, LA 70825

Re: Acquisition of Slidell Memorial Hospital by Tenet Healthcare Corporation

Dear Attorney General Ieyoub:

The staff of the Bureau of Competition, the Bureau of Economics, and the Office of Policy Planning of the Federal Trade Commission ("Commission" or "FTC") welcome the opportunity to submit this letter in response to your request for our views regarding the potential effect of Tenet Healthcare Corporation's proposed purchase of Slidell Memorial Hospital.(1) We appreciate your invitation to present these views in connection with your review of the proposed acquisition pursuant to La. Rev. Stat. § 40:2115.11.(2)

The Commission staff has spent several months reviewing the potential impact of a sale of Slidell Memorial to Tenet Healthcare. As you are aware, Tenet is also the owner of NorthShore Regional Medical Center, which is located less than two miles from Slidell Memorial. Slidell Memorial and NorthShore Regional are the only two full-service acute care hospitals located in Slidell.(3)

As part of our review, we have talked with hospitals, employers, health insurance companies, and physicians and examined a significant amount of public and non-public information.(4) In addition, we have had the benefit of a growing body of empirical and economic evidence concerning the competitive effects of similar hospital mergers. While no two hospital mergers and no two communities are identical, analyzing prior mergers and their impact on competition is useful in gauging the accuracy of historical assumptions about how hospitals compete.

Tenet's proposed purchase of Slidell Memorial raises serious competitive concerns because it would combine the only two full-service hospitals in Slidell. As explained more fully herein, it appears unlikely that a significant number of employers and Slidell residents would be willing to select a health plan that does not include a Slidell hospital. Tenet's acquisition therefore may be expected to result in increased prices because health insurance companies could not use competition between Slidell Memorial and NorthShore Regional to keep prices down.

Our investigation of this transaction is on-going. Based on the substantial information we have reviewed so far and our historical knowledge of healthcare competition, we offer the following points, which we will discuss in greater detail following this summary:

- Many Slidell residents and their employers appear to require private health insurance plans that include either Slidell Memorial or NorthShore Regional in their provider networks. This may make it difficult for a health insurance company to successfully market its plan to those residents and employers if the plan does not include at least one of these hospitals.

- If health insurance plans need to include a Slidell hospital in their provider networks to be successful, it is unlikely that competition from hospitals outside Slidell could prevent Tenet from increasing prices after an acquisition.
- Specialty hospitals such as Louisiana Heart Hospital in Lacombe do not appear to be adequate substitutes for Slidell Memorial and NorthShore Regional because they are not full-service hospitals. Competition from these hospitals appears unlikely to prevent Tenet from increasing hospital prices if it owns both Slidell hospitals.
- Since the opening of NorthShore Regional, residents of Slidell and the surrounding area have benefitted from competition between that hospital and Slidell Memorial. The proposed sale will eliminate this competition.
- Slidell and surrounding east St. Tammany Parish are experiencing rapid growth and appear well-situated to support two competitive full-service hospitals. Reflecting the growing demand for hospital services in Slidell, a number of potential purchasers made proposals to acquire Slidell Memorial.

The Federal Trade Commission's Interest and Experience

The Commission is charged by statute with enforcing the laws that prohibit unfair methods of competition and unfair or deceptive acts or practices in or affecting commerce.(5) Pursuant to this statutory mandate, the Commission enforces the antitrust laws and encourages competition to the maximum extent compatible with other state and federal goals. Vigorous enforcement of antitrust laws ensures that American consumers benefit from a free and competitive marketplace. Competition promotes lower prices, higher quality, greater choice, and innovation. Because of its great importance to consumers, the Commission gives special attention to maintaining competition in the health care industry.

An important part of the Commission's role in protecting consumers is reviewing proposed mergers and acquisitions, including those involving hospitals. The Commission reviews these mergers and acquisitions to determine if they are likely to harm consumers. Mergers often benefit consumers by allowing companies to operate more efficiently and compete more effectively. Some mergers, however, particularly those between close competitors, can lessen competition and allow price increases or reductions in the quality or quantity of products or services offered. Preventing these types of mergers ensures that consumers receive lower prices and greater choices from continued competition.

The FTC staff has considerable experience reviewing hospital mergers. Changes in the healthcare industry have resulted in large numbers of hospital mergers, many of which the staff at the FTC has reviewed.(6) During the 1990s, the Commission challenged eighteen hospital mergers because of concerns that the mergers would harm competition.(7) Although the Commission's most recent court challenges have been unsuccessful,(8) new developments suggest that the Commission's concerns in these cases were well-founded. Over the past year, the Commission has received credible complaints from participants in the healthcare industry that several hospital mergers have led to abnormal price increases. In addition, empirical studies have looked at particular hospital mergers and found that those mergers have led to higher prices for hospital services.(9)

In response to these developments, the Commission's Merger Litigation Task Force is conducting a detailed review of several completed hospital mergers to determine whether any have led to anticompetitive price increases.(10) The Commission also recently conducted a two-day public workshop on competition law and policy in health care.(11) This letter draws on the collective work of the Commission's Bureau of Competition Healthcare Division and Task Force staffs and the Bureau of Economics staff, as well as the particular facts of the Tenet-Slidell Memorial transaction.

Competition Between Slidell Memorial and NorthShore Regional Benefits Consumers

Since NorthShore's opening in 1985, competition between NorthShore Regional and Slidell Memorial has benefitted consumers.

Before NorthShore opened, Slidell Memorial was the only full-service hospital located in Slidell. At the time, Slidell Memorial lacked advanced technical equipment, creating a dilemma for Slidell physicians and their patients. Slidell physicians could not easily provide care for patients admitted to better-equipped hospitals outside of Slidell and, thus, normally used the only hospital in town, despite its perceived shortcomings. NorthShore Regional's entry into Slidell provided an alternative, giving physicians and their patients a choice. This choice fostered competition between the Slidell hospitals for physician referrals and patient preference. The competition encouraged Slidell Memorial to improve its services.(12)

Competition between Slidell Memorial and NorthShore Regional also has helped keep competitive the prices charged by the hospitals to private health insurance plans. The price a health plan pays for hospital services is important to consumers. Higher prices often translate into higher premiums, co-pays, and deductibles. If prices increase enough, employers may be forced to cut back on their health insurance benefits for employees or even stop providing such benefits altogether.

Competition between the hospitals to be included in an insurance plan's network is important to maintain competitive prices and quality of services. Almost everyone who has private health insurance today is covered by a plan that requires patients to use physicians and hospitals in the plan's provider network to receive the maximum benefits of the plan.(13) A health plan's success in negotiating competitive rates with a particular hospital depends in large part on whether the plan can make a credible threat to exclude the hospital from its provider network.

NorthShore Regional and Slidell Memorial offer similar services and have many of the same physicians on their staffs. All things being equal, Slidell residents appear to prefer health plans that include both hospitals, maximizing patient choice. In response, most health plans in the region include both hospitals in their provider networks.(14) Nonetheless, health insurance companies report that if one Slidell hospital significantly raised its prices, the health insurance companies could exclude that hospital from their provider network as long as the other Slidell hospital was included. The fact that health insurance companies require only one Slidell hospital for their plan to be successful puts pressure on both Slidell Memorial and NorthShore Regional to negotiate competitive prices. Lower hospital prices generally translate into lower health insurance premiums.

Slidell is one of the fastest-growing communities in Louisiana. By all accounts, it appears that the community can support two general acute care hospitals and continue to benefit from competition between them. The number of bidders who sought to acquire Slidell Memorial attests to the fact that it can continue as a facility in competition with NorthShore Memorial.(15)

The Tenet / Slidell Memorial Transaction May Result in Increased Hospital Prices

If Tenet acquires Slidell Memorial, then competition between Slidell Memorial and NorthShore Regional will cease and Slidell will, in essence, revert to the one-hospital town it was prior to NorthShore's opening. From the evidence we have received to date, it does not appear likely that hospitals outside of Slidell can provide enough competition to prevent Tenet from increasing its prices to private health insurance plans after the acquisition.

If Tenet purchased Slidell Memorial, health insurance companies would have to agree to Tenet's pricing or drop both NorthShore Regional and Slidell Memorial from their provider networks and risk losing area customers that require a Slidell hospital. In addition, a health plan that did not include these hospitals could include only physicians willing and able to treat the plan's patients at hospitals outside of Slidell. Based on numerous interviews with employers, residents, and health insurance plans, it appears to us that significant numbers of Slidell employers and consumers would be unwilling to use a health insurance plan that did not include these hospitals and physicians. For this reason, health insurance companies will probably be unlikely to risk losing NorthShore Regional, Slidell Memorial, and the physician base of these hospitals and instead likely would agree to a price increase.

The experience of one health plan that did exclude both Slidell hospitals is illustrative. In July 2001, the State Office of Group Benefits for Louisiana, which provides health care plans for one of the largest employers in Slidell - the St. Tammany Parish School District - altered its EPO health plan and dropped the only Slidell hospital (Slidell Memorial) in that plan's provider network. Slidell residents employed by the School District expressed tremendous concern about the exclusion of Slidell hospitals from the EPO plan, and a number of employees switched to the state's PPO plan, even though that plan requires higher deductibles and co-payments.

Tenet and Slidell Memorial have stated that they believe the proposed merger does not violate the antitrust laws because the Slidell hospitals face competition from hospitals throughout New Orleans and the North Shore.(16) This contention appears to be based on the argument that any attempt by Tenet to increase prices after acquiring Slidell Memorial would fail because higher prices would cause patients, particularly those from outside of Slidell, to switch to other, lower-priced hospitals.(17) This would appear to be an unlikely scenario, however, if it is true that Slidell Memorial and NorthShore Regional cannot be excluded from a health plan that markets to employers with employees residing in Slidell. It is not uncommon for a hospital without local competition to be able to charge premium prices. Hammond appears to be an example of this phenomenon. Like Slidell, Hammond is somewhat geographically isolated, and the town has only one full-service hospital (North Oaks Medical Center). During our investigation, a number of sources have reported that North Oaks Medical Center charges private health insurance companies some of the highest rates in Louisiana.(18)

Patients rarely, if ever, choose among hospitals in their health plan's network based on which hospital has the lowest prices. In fact, because the health plan pays for most hospital costs if a hospital is in its network, patients have little reason to find out how much any particular hospital charges for its services. Rather, patients generally go to the in-network hospital they prefer where their physician has privileges or, in cases of serious diseases or injuries requiring specialized medical treatments, to the hospital with the necessary specialty care. Once a hospital is in a health plan's network, the prices it charges the health plan have very little impact on patient choice.(19) Consequently, the realities of how patients select their hospitals do not support Tenet's and Slidell Memorial's contention that increasing the prices charged to health insurance plans would cause patients to select lower-priced in-network hospitals.

Of course, what will actually determine Tenet's ability to increase prices is not the opinion of the FTC staff or the statements of Tenet Healthcare Corporation. The most important factor in determining whether Tenet could increase hospital prices is the response by employers and by Slidell residents to an attempted price increase. Only a sufficiently large percentage of employers and of Slidell residents willing to accept health insurance plans that do not include Slidell Memorial or NorthShore Regional will thwart an attempt by Tenet to increase its prices to private insurers (and the resulting effect on insurance premiums). Based on evidence received so far, it does not appear that this is a likely scenario.

Specialty Hospitals Are Not Substitutes for a Full-Service Acute Care Hospital

As residents of Slidell are aware, the Louisiana Heart Hospital recently opened in nearby Lacombe. If successful, this hospital will expand the treatment options of area residents for cardiac care. To be competitive, the Heart Hospital presumably will negotiate with health plans to be included in provider networks and will almost certainly compete with Slidell Memorial and NorthShore Regional for cardiac patients. Nevertheless, Louisiana Heart Hospital is a single specialty hospital that cannot offer the breadth of services available at Slidell Memorial and NorthShore Regional. Health plans will not be able to use competition between the Heart Hospital and the Slidell hospitals to obtain competitive prices if Slidell employers and residents will opt only for a health plan that includes a Slidell hospital in its network.

As with the Louisiana Heart Hospital, a small surgical hospital - such as the one Dynaq International plans to open in Slidell - would lack the range of services offered by Slidell Memorial and NorthShore Regional. Although a small specialty hospital would no doubt compete with these hospitals, it could not replace the full line of hospital services that Slidell Memorial and NorthShore Regional offer. As a result, health plans that excluded both Slidell Memorial and NorthShore Regional would still require patients to travel to Covington, Mandeville, or New Orleans for many hospital services (for instance, labor and delivery and oncology).

Conclusion

Competition between Slidell Memorial Hospital and NorthShore Regional Medical Center has benefitted consumers. It has ensured more competitive prices for hospital services. It has spurred both hospitals to provide quality services to attract physician referrals and patient admissions. Whether consumers continue to receive the benefits of a competitive health care market if Slidell Memorial and NorthShore Regional are both owned by Tenet, however, largely depends on how consumers and employers respond to prospects for hospital price increases. Unless a sufficient number of employers and consumers are willing to use health plans that exclude Slidell Memorial and NorthShore Regional, it is likely that Tenet will be able to increase prices successfully, leading to higher insurance premiums, deductibles, and co-pays for Slidell consumers. Our assessment suggests that price increases (rather than a "critical loss" of patients) may result from the combination of NorthShore and Slidell Memorial.

The sale of Slidell Memorial to another viable purchaser would preserve, and perhaps enhance, competition and its benefits for consumers. Therefore, we ask you to carefully weigh the likely impact of this transaction on competition in deciding whether it is in the public interest.

Thank you for the opportunity to present our views. We hope that they will be helpful as you evaluate the potential impact of Tenet's acquisition of Slidell Memorial.

Sincerely,

Joseph J. Simons, Director
Bureau of Competition

Michael Knight, Assistant Director
Bureau of Competition

David T. Scheffman, Director
Bureau of Economics

Michael Vita, Assistant Director
Bureau of Economics

Jerry Ellig, Acting Director
Office of Policy Planning

Maureen K. Ohlhausen, Attorney
Office of Policy Planning

1. This letter represents the views of the staff of the FTC's Bureau of Competition, Bureau of Economics, and Office of Policy Planning. It does not necessarily represent the views of the Commission or of any individual Commissioner. The Commission has, however, voted to authorize the staff to provide these comments.

2. Pursuant to a discussion with Roy Mongrue, Jr., Director of the Civil Division, Louisiana Department of Justice, on April 1, 2003, Eric Edmondson of the Commission staff confirmed that the request for the FTC staff's views on the

transaction was not limited to providing live testimony at the hearing but also was intended to solicit the FTC staff's views in any form, including a written comment submitted prior to the scheduled referendum vote.

3. The next closest general acute care hospitals are Crosby Memorial Hospital, Picayune, Mississippi (20 miles); Lakeland Medical Center, New Orleans (22.5 miles); and St. Tammany Parish Hospital, Covington/Mandeville (27 miles).

4. The Commission is prohibited from disclosing specific confidential information it receives during an investigation, absent the consent of the submitter.

5. 15 U.S.C. § 45.

6. In 1992, the Commission estimated that 50 to 100 hospital mergers and similar transactions occur annually. "Antitrust Enforcement Helps Control Health Care Costs, FTC Tell Congressional Committee," Press Release (June 24, 1992), *available at* <http://www.ftc.gov/opa/predawn/F93/hospitali5.htm>.

7. During the 1990s, the Commission issued 11 consent orders resolving the Commission's competitive concerns over hospital mergers. Of the seven cases involving hospital mergers that the Commission sought to stop, two mergers were enjoined, four were allowed to proceed, and one was abandoned by the parties.

8. *See, e.g., FTC v. Tenet Health Care Corp.*, 186 F.3d 1045 (8th Cir. 1999); *FTC v. Butterworth Health Corp.*, 946 F. Supp. 1285, 1291 (W.D. Mich. 1996), *aff'd*, 121 F.3d 708 (6th Cir. 1997) (unpublished opinion).

9. *See, e.g.*, Vita & Sacher, *The Competitive Effects of Not-for-Profit Hospital Mergers: A Case Study*, 49(1) J. Ind. Econ. 63 (Mar. 2001) (after the merger of two neighboring hospitals, prices increased $700 to $1,000 per admission at the combined facility and half that amount at the remaining competitive hospital in town); Cory Capps, David Dranove and Mark Satterthwaite, *Competition and Market Power in Option Demand Markets, Economic Analysis Group Discussion Paper* (Oct. 18, 2001).

10. Among other tasks, the Task Force is responsible for reviewing, and potentially challenging, completed hospital mergers that may have resulted in anticompetitive price increases. See Federal Trade Commission Announces Formation of Merger Litigation Task Force, Press Release (Aug. 28, 2002), *available at* <http://www.ftc.gov/opa/2002/08/mergerlitigation.htm>.

11. Public Workshop, Health Care and Competition Law and Policy, Federal Trade Commission, Sept. 9-10, 2002, transcripts and comments *available at* <http://www.ftc.gov/ogc/healthcare/index.htm>.

12. Hospitals often compete for patients by enticing physicians to join their staffs so that they can obtain referrals from those physicians. To compete for physician support, hospitals obtain technologically advanced equipment, sponsor physician training programs, and hire experienced staff. *See, e.g.*, 2002 10-K, Tenet Healthcare Corporation at 11, *available at* <http://www.etenet.com/Documents/1/tenet_10K.pdf>.

13. Managed care plans include Health Maintenance Organizations ("HMOs") and Preferred Provider Organizations ("PPOs"), and variations on these types of plans, *e.g.*, Point of Service ("POS") plans. Individuals insured through traditional HMO plans typically receive insurance benefits only if they obtain non-emergency healthcare services from physicians, hospitals, and other providers in the HMO's provider network and obtain a referral from their primary care physician. PPO plans typically provide some benefits to an insured who receives covered treatment from a provider not included in the plan's network, but these benefits are usually much lower than those provided to an insured who is treated by an in-network provider.

14. On the other hand, some health insurance plans, particularly HMOs, sometimes contract with only one hospital in a particular area to obtain lower rates in exchange for allowing the hospital to be the exclusive provider in the area. At least one HMO plan includes only one Slidell hospital in its provider network.

15. Ten bids were received - two for management contracts and eight to purchase or lease Slidell Memorial. The bids to purchase or lease the hospital ranged from $39 million to $130 million. "The latest on the sale or lease of our hospital," Transition Update Newsletter (Oct. 15, 2002), *available at* <http://www.smhplus.org/NewsReleases/SMHNEWS.pdf>.

16. *See* Paul Bartels, *A Hospital Monopoly? No Way, Lawyers Say SMH Board Wrestled With Issue, OK'd Tenet*, The Times-Picayune, Nov. 2, 2002. To determine the geographic area within which merging hospitals compete and constrain each other's prices (*i.e.*, the "relevant geographic market"), some courts analyzing prior hospital mergers have relied upon the "Elzinga-Hogarty test" (or some version thereof), which uses historical patient-flow data as a means of predicting future patient movements. *See, e.g., Butterworth Health Corp.*, 946 F. Supp. at 1291. The use of the Elzinga-Hogarty test for defining geographic markets for hospital mergers has been widely and correctly criticized. (*See, e.g.*, Daniel Kessler and Mark McClellan, "Designing Hospital Antitrust Policy to Promote Social Welfare," in Garber, Alan M., ed., 2 *Frontiers in Health Policy Research* 53, 55 (Cambridge and London: MIT Press for the National Bureau of Economic Research, 1999). *See also* G. Werden, *The Limited Relevance of Patient Migration Data in Market Delineation*, 8 J. Health Econ. 363 (1989); C. Capps, D. Dranove, S. Greenstein, and M. Satterthwaite, "The Silent Majority Fallacy of the Elzinga-Hogarty Criteria: A Critique and New Approach to Analyzing Hospital Mergers," NBER Working Paper No. 8216 (Apr. 2001).) The basic problem with the Elzinga-Hogarty test is that it does not provide evidence directly relevant to the central issue, *i.e.*, to what extent employers and consumers require access to a local hospital in their health care plans. Consumers covered by health insurance do not directly pay hospital costs, and a number of factors influence the hospital to which a particular patient is admitted. For a Slidell resident who previously traveled to Tulane University Hospital for a complicated medical procedure may still place great value on having a Slidell hospital in his or her health plan. If many employers require one hospital in Slidell in their health care plans in order to meet the requirements of their employees, the fact that historical patient-flow data indicate that patients in the Slidell area also utilize hospitals outside Slidell does not undermine the ability of a combined NorthShore Regional/Slidell Memorial to raise prices to health plans.

17. Of course, a hospital's price increase could be profitable even if the hospital lost some portion of its patients. The percentage of patients that a hospital could lose, and still profit from a price increase, is often identified as the "critical loss" a hospital would need to experience to make a price increase unprofitable. *See, e.g., Butterworth Health Corp.*, 946 F. Supp. at 1050. In determining whether a merged hospital would suffer a "critical loss" of patients if it increased prices, courts have sometimes relied on the assumption that if a significant portion of patients in a particular zip code or other area currently go to hospitals other than the merging hospitals, then that zip code or area is "contestable," and a price increase can be expected to drive away significant numbers of patients in that area who are privately insured. Id. at 1050-51. As discussed below, however, patients with private health insurance plans do not generally select among in-network hospitals based on price. Thus, the merged hospital is likely to lose patients only if the price increase causes the hospital to be excluded from health plans. Health plans may be reluctant, however, to exclude particular hospitals from their networks in response to price increases if employers and their employees require those hospitals as an option in their health plans.

18. Another point worth noting is that hospitals can charge different prices to different health plans. For example, to keep from losing Mississippi patients insured by a plan that markets primarily to Mississippi residents and employers, Slidell Memorial and NorthShore Regional could maintain lower prices for that plan while increasing prices to plans that market primarily to Louisiana residents and employers.

19. *See, e.g.*, R. Town and G. Vistnes, *Hospital Competition in HMO Networks*, 20 J. Health Econ. 733 (2001); G. Werden, *The Limited Relevance of Patient Migration Data in Market Delineation, supra* n.16.