Hospital Merger Enforcement at the FTC

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The views expressed are those of the author and do not necessarily reflect those of the Federal Trade Commission

Background

- In the 1980s and 1990s the government (FTC and DOJ) lost a bunch of hospital merger cases
  - Geographic market issues
  - Not-for-profit issues
- Long lull in enforcement, huge wave of mergers
- Evidence that many caused prices to increase
  - Vita & Sacher (2001)
  - Vogt & Town (2006)

Background

- In the early 2000s, then FTC Chairman Tim Muris decided to reinvigorate the hospital merger enforcement mission
- Decided to start with retrospectives
  - Easier to show effects than in prospective cases
  - Several studies
    - Tenn (2008)
    - Haas-Wilson & Garmon (2009)
    - Thompson (2009)
  - One litigated case (Evanston)

Evanston Case

- FTC retrospectively challenged the acquisition by Evanston Hospital of Highland Park Hospital (in Evanston Illinois)
- Full trial before the FTC Administrative Law Judge
- ALJ accepted FTC’s primary claims:
  - The merger caused a substantial price increase
  - No increase in clinical quality at Highland Park
- ALJ ordered that Highland Park be divested
- Commission upheld the ALJ’s findings but did not uphold the order requiring divestiture

Evanston Case

- Empirical analysis was straightforward difference-in-differences
  - For both price and clinical quality
- This produced *direct* evidence of a price increase
  - More clear-cut than in prospective cases
  - Advanced the broader hospital merger agenda by showing that anti-competitive hospital mergers are at least *possible*
    - Contrary to what one might infer from the string of losses

Evanston Case

- Still needed a theory to win the case though
  - Could be other (benign) explanations for the price increase
  - The merging parties offered such an alternative explanation
    - See Balan & Garmon (2008)
  - All else equal, the better the FTC's theory, the more likely its explanation for the price increase is the right one
- Surely need a theory for prospective cases
  - There won't be the same kind of direct evidence
- So a big part of the Evanston case was to develop a better theory than what we had before

Theory

- Here is a framework for thinking about the issue
  - Not necessarily what we did do or will do in any non-public case
- Prices are set via bargaining between hospitals and insurers
- Patients don't face prices when choosing hospitals
- A simple Nash Bargaining framework works nicely
  - Hospitals get higher prices when patients like them better
  - Hospitals get higher prices when they face less competition
  - "All or nothing" bargaining is *not* the source of harm
    - Conventional merger effect intuition applies
    - Separate bargaining will not solve the problem even in principle
      - Unclear whether it helps at all, might even hurt
    - Took a surprisingly long time to realize this
  - We lay out a framework like this in Balan & Brand (2009)

Prospective Merger Simulations

- New methods to predict hospital merger effects
  - Town & Vistnes (2001)
  - Capps, Dranove, & Satterthwaite (2003)
  - Gaynor & Vogt (2003)
  - Capps & Dranove (2004)
  - Melnick & Keeler (2007)
- Most are variations on the theme of a price-concentration study
- But there have been substantial improvements since the bad old days
  - The RHS "concentration" variables used in these newer papers are not based on a market definition exercise
    - The *data* determine which hospitals and zip codes are included in the analysis
  - Rather, the concentration measures are cleverly constructed so that:
    - The unit of analysis is a hospital rather than a "market"
    - The measures capture the substitution patterns between hospitals
- There is a need to see how well these methods perform

Balan & Brand (2009)

- Generate data on hospitals and consumers
- Employ a simple model of bargaining between hospitals and a monopoly Managed Care Organization (MCO)
  - We will soon add in MCO competition
- Solve for equilibrium prices and consumer choices
  - Consumer choices
    - Buy insurance?
    - Hospital choice?
- Merge two hospitals together and re-solve the model
  - The "true" merger effect is the difference between the post-merger prices and the pre-merger prices generated by the model

Balan & Brand (2009)

- Apply the hospital merger simulation methods referred to above to the pre-merger “data”
- Calculate the predicted merger effects
- Compare predicted merger effects to “true” effects
  - What is the difference between the predicted percent change in price and the “true” percent change in price?
- The smaller the difference, the better the simulation methods can be said to perform
- Results still very preliminary
- Suggest that these methods do a decent job
  - May have some tendency to under-predict effects

Clinical Quality

- Parties always claim that their merger will improve clinical quality
- It's sometimes even true
- It would be difficult to bring/win a case in which there was a demonstrated likelihood of a significant improvement in clinical quality
  - Though a slight quality improvement might be overbalanced by the health harm caused by a price increase
    - People lose their insurance and have worse health outcomes

Clinical Quality

- Broadly speaking, there are two kinds of claims about clinical quality:
- Hospital A will make costly investments at Hospital B
  - These investments wouldn't be made without the merger
  - These investments will improve clinical quality
- Hospital A's awesomeness will rub off on Hospital B
  - High fixed cost investments by A that B will benefit from
  - A will simply show B how to be better
- These each require their own analysis

Prospective Enforcement Actions

- The main goal of the retrospectives and of the retooling of the economic analysis of hospital mergers was to get the FTC back in the *prospective* hospital merger enforcement business
- Two cases where the FTC publicly took action
  - Inova acquisition of Prince William Hospital
    - Parties gave up after the FTC filed a complaint
  - Carilion acquisition of two free-standing centers
    - First case that didn't involve only inpatient hospitals
    - Parties gave up after the FTC filed a complaint
- (Disclaimer: what the FTC would have argued in these cases may or may not have been what has been described in this talk)

Conclusions

- The FTC is back in the hospital merger business
- The Evanston case was the first step
- We’ve now moved on to prospective cases
- There have been significant innovations in both the basic theory and in the methodology for simulating hospital mergers
- The FTC has also learned a lot about how to think about the effect of mergers on clinical quality
- This remains an active and exciting field, both in terms of enforcement and in terms of research