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ECONOMIC CONSULTING

Mergers of Healthcare Providers – Market Definition, Competitive Effects, and Efficiencies

Payer testimony in provider mergers

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Overview

- Recent mergers: two FTC appellate wins and one legislative preemption
  - Hershey/Pinnacle (FTC win)
  - Advocate/North Shore (FTC win, trial pending)
  - Cabell/St. Mary's (FTC loss via preemption/state action)
- Common issues
  - Geographic market definition
  - Hypothetical monopolist test
  - Efficiencies
  - **Payer testimony**
- ***What inferences can we draw from Payer support?***

Common to the recent mergers: support from major payers

- Formal price commitments in two of three recent merger cases
  - **Hershey/Pinnacle**: 10-year contract with Capital Blue Cross and 5-year with Highmark preserving rates
    - District court loss; Appellate win
  - **Cabell/St. Mary's**: Letter of agreement (LOA) with Highmark; Assurance of Voluntary Compliance (AVC) with the state
    - FTC withdrew challenge for State Action / COPA reasons
  - **Advocate/NorthShore**: Support from United, Aetna, and Cigna – but not BCBSIL
    - District court loss; Appellate win; Trial pending
    - No commitment evident in rulings

Merger Guidelines on customer support (§2.2.2)

- “The **conclusions of well-informed and sophisticated customers** on the likely impact of the merger itself can also help the Agencies investigate competitive effects…”
- “Agencies are mindful that **customers may oppose, or favor, a merger for reasons unrelated to the antitrust issues** raised by that merger.”
- “When direct customers of the merging firms compete against one another in a downstream market, their **interests may not be aligned with the interests of final consumers**, especially if the direct customers expect to pass on any anticompetitive price increase.”
- “A **customer that is protected from adverse competitive effects . . . may even welcome an anticompetitive merger** that provides that customer with a competitive advantage over its downstream rivals.”

Commitments and payer testimony: **Hershey/Pinnacle**

- District court
  - "The Court finds it **extremely compelling that the Hospitals have already taken steps to ensure that post-merger rates do not increase with CBC and Highmark**, central Pennsylvania's two largest payors, representing 75-80% of the Hospitals' commercial patients."
  - "The result of these agreements is that the Hospitals cannot walk away from these payors and that rates <u>cannot increase</u> for at least 5 years. The Court simply cannot be blind to this reality when considering the import of the hypothetical monopolist test advanced by the *Merger Guidelines.*"
- Pricing agreements do not inform the *hypothetical* monopolist test
  - **Third Circuit**: "And regardless of whether the private agreements were the sole basis for, or only a part of, the District Court's decision, we conclude that they are not at all relevant to the economic analysis [of relevant geographic market]."

Payer testimony and provider commitments: **Cabell/St. Mary's**

- West Virginia Health Care Authority (WVHCA) decision
  - "…in the circumstances present here, such **competition is not necessary to provide consumer protection**. In this case, there are three separate instrumentalities in place to ensure that consumers will not be harmed by the transaction. The first such instrumentality is the AVC entered into between the two hospitals and the Attorney General."
    - AVC = Assurance of Voluntary Compliance [COPA]
  - "The second important instrumentality which provides protection to consumers is the **LOA entered into between CHH and Highmark** in November of 2014."
  - "Given the combined effect of the AVC, the Highmark Blue Cross LOA and the recently enacted legislation, the **combination of CHH and SMMC simply cannot have an adverse impact**…"

Commitments and payer testimony: **Advocate/NorthShore**

- Defendants' Findings of Fact
  - "United supports the merger and believes it will lead to a decrease in the "total cost of care" for its members, while improving the quality of that care…"
  - "Aetna similarly believes the merger could lead to better coordination of care, 'clinical efficiencies,' and 'lower total medical costs,' all of which would benefit Aetna members."
  - "Cigna, per its President of the Midwest Region, Michael Phillips, informed Advocate that…you [Advocate and NorthShore] have our [Cigna's] support and would be happy to share our [Cigna's] position with the FTC or other entities as appropriate."

Economics of payer support

- Payers are well-informed but support is not dispositive
  - May rationally support if the merger will lessen competition
  - May rationally support if the merger is procompetitive

- Expressing support can be a *dominant strategy* for a payer facing an anticompetitive merger
  - If a payer supports and the merger does not close, no harm is done
  - If a payer supports and the merger does close, the payer is better off if it receives some concession than no concession, *even if it prefers the merger not close*

- Generally, the requisite concession will be *insufficient* to fully compensate the payer for the harm from the merger
- Payers' pursuit of their individual strategic interests can make them all worse off, and consumers worse off

Logic

- **Extreme 1**. *A payer's support/opposition does not affect the probability of the merger closing*.
  - Payer compares (1) the value of the acquisition closing and having expressed support with (2) the value of the acquisition closing and having opposed
  - Not the merger closing vs. not closing -- that is not affected by support in this scenario
  - In this case, a negligible concession will induce support

- **Extreme 2**. *A payer's support/opposition is dispositive*.
  - Provider must make that Payer at least as well off with the merger as it would be without

- **Intermediate / standard case**. *A payer's support increases the probability the merger will occur but is not dispositive*.
  - Provider must offer a concession sufficient to make the payer's *expected benefit of supporting* > *expected benefit of opposing*
  - In general, the requisite concession is less than the harm to the payer from the merger
    - See appendix slides
  - Consider: 4 payers, and support from any 2 of them would allow the merger to close

Implications

- Payers' strategic considerations can cause them to express support even if a merger is anticompetitive
  - But, payers would also have an incentive to support a procompetitive merger
- FTC/Courts credit adverse payer testimony but discount supportive testimony?
  - Fair? Logical?
- Strategic incentive for payers to oppose a procompetitive merger?
  - An opportunity to get concessions?
  - If merged system is more likely to enter insurance business or bear risk in ways that might disintermediate insurers?
  - If pro-competitive benefits are spread over a larger group but price increase is concentrated on the payer?
- **Bottom line**: Yes/no tallies unlikely to be reliable relative to more detailed analyses
  - Payer's internal documents and assessments
  - Scrutiny of bases for expressions of support/opposition
  - Trust, but verify

Appendix

Analyzing payer incentives: a simple model

- P_{su} : probability that the merger occurs with the payer support
- P_{op} : probability that the merger occurs with the payer opposition ($P_{su} \geq P_{op}$)
- Π_m : profit earned by the payer after merger, when there is no price agreement with the provider
- Π_0 : profit earned by the payer before merger occurs or if the merger does not occur at all
- C : profit required by payer (including provider commitment) in order for it to support the merger
- If the merger is anticompetitive: $\Pi_0 > \Pi_m$
- The payer supports the merger if payoff from supporting is greater than the payoff from opposing. Thus,

$$P_{su} \times C + (1 - P_{su}) \times \Pi_0 \geq P_{op} \times \Pi_m + (1 - P_{op}) \times \Pi_0$$

- We can solve for the smallest payoff, C^*

Analyzing payer incentives: discussion

$$C^* = \Pi_0 + P_{op}/P_{su}\,(\Pi_m - \Pi_0)$$

- **Extreme 1**: *A payer's support/opposition <u>does not affect</u> the probability of the merger closing*
  - $P_{op} = P_{su}$ and $C^* = \Pi_m$
  - The provider will offer negligible or no concession because support has no value
- **Extreme 2**: *A payer's support/opposition is dispositive*
  - $P_{op} = 0$ and $C^* = \Pi_0$
  - To earn payer support provider will have to guarantee the pre-merger profit
- **Intermediate / standard case**: *A payer's support increases the probability the merger will occur but is not dispositive*
  - $0 < P_{op}, P_{su} < 1$
  - $\Pi_m < \Pi_0 \rightarrow C^* < \Pi_0$
  - For a range of probabilities and possible harm, $\Pi_m < C^* < \Pi_0$. It is rational for the payer to accept a price commitment in exchange for supporting the merger.