DEFINING GEOGRAPHIC MARKETS FOR HOSPITALS

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What is the controversy?

- Principles of Market Definition
- Tests (Facts & Data)
- Results

What is the controversy?

- Principles of market definition
  - Why not the Merger Guidelines?
  - Role of Critical Loss Analysis
  - What about Elzinga-Hogarty analysis?
    - Too static; plaintiff-oriented (small markets)
    - Too broad; silent majority problem

What is the controversy?

- Tests
  - What are the relevant tests?
    - Consumer choices
    - Competitive discipline and mechanisms
    - What drives hospital pricing and competition?
  - How are they being applied?
  - Payor testimony and payor facts
  - Role and usefulness of patient flow data

What is the controversy?

- Results
  - Have the Courts applied the correct principles and the correct tests and achieved sound results?
  - Claims of “overly” broad markets – inclusion of “too many” and “too distant” hospitals as competitors of merging hospitals

What are the common questions?

- What principles of market definition should apply to hospital mergers?
  - Should these be fundamentally different principles from those applied in other industries?
- What data and information are available to test market definitions?
- How well are the courts doing in applying the relevant principles to the facts?

What principles of market definition should apply?

- Use the Merger Guidelines
  - Hypothetical Monopolist Paradigm
- Before doing geographic market definition, examine:
  - What is the product?
  - What are the mechanisms?

Product Market

- Use the Merger Guidelines
  - Hypothetical Monopolist Paradigm
  - Product that is being purchased and consumed is inpatient service(s)
  - Understand how competitive pricing is determined
- Product market definition identified all possible suppliers of the relevant product(s) – geographic market determines which are relevant constraints

Merger Guidelines: Paradigm

- Absent price discrimination, the Agency will delineate the geographic market to be a region such that a hypothetical monopolist that was the only present or future producer of the relevant product at locations in that region would profitably impose at least a "small but significant and nontransitory" increase in price, holding constant the terms of sale for all products produced elsewhere. That is, assuming that buyers likely would respond to a price increase on products produced within the tentatively identified region only by shifting to products produced at locations of production outside the region, what would happen? If those locations of production outside the region were, in the aggregate, sufficiently attractive at their existing terms of sale, an attempt to raise price would result in a reduction in sales large enough that the price increase would not prove profitable, and the tentatively identified geographic area would prove to be too narrow. (Section 1.2)

Merger Guidelines: Principles

- In defining the geographic market or markets affected by a merger, the Agency will begin with the location of each merging firm (or each plant of a multiplant firm) and ask what would happen if a hypothetical monopolist of the relevant product at that point imposed at least a "small but significant and nontransitory" increase in price, but the terms of sale at all other locations remained constant. If, in response to the price increase, the reduction in sales of the product at that location would be large enough that a hypothetical monopolist producing or selling the relevant product at the merging firm's location would not find it profitable to impose such an increase in price, then the Agency will add the location from which production is the next-best substitute for production at the merging firm's location. (Section 1.2)

- Role of Critical Loss

Tests: What facts are relevant in the Guidelines?

- (1) evidence that buyers have shifted or have considered shifting purchases between different geographic locations in response to relative changes in price or other competitive variables;
- (2) evidence that sellers base business decisions on the prospect of buyer substitution between geographic locations in response to relative changes in price or other competitive variables;
- (3) the influence of downstream competition faced by buyers in their output markets; and
- (4) the timing and costs of switching suppliers. (Section 1.2)

How does this apply to hospitals? Data and Facts

- Where does the hospital obtain its patients?
  - Large proportion from close to other hospitals?
  - What data are they looking at? Why do hospitals look at patient origin data?
- How do hospitals compete for patients? What are the competitive variables?
  - Outreach clinics, physicians – attempts to attract more patients from more areas and from other hospitals
- Which other hospitals are used by similarly situated patients?
- Can hospitals price discriminate?
- Can and do payors direct patients to lower cost alternatives? (other lower cost in-network hospitals?)
- How much is enough?

Data and Factual Myths and Controversy

- Patient Origin Data – Is it usable for market definition? For competitive effects?
  - Are there fundamental differences between patient origin and managed care plan usage data?
- Inclusion or Exclusion from the Network
  - Necessary, but not sufficient to get patients.
  - Fundamental changes in consumer demand make this less relevant mechanism.
- What practically are payors accomplishing?
  - Have they succeeded in mechanisms
  - Key question: how do managed care plans manage costs?

Patient Origin Data Myths

- Small numbers, ER visits, and other idiosyncratic patterns
- Patient origin data focuses on the consumer, not the payor
- Patients are different from other consumers – one should focus on the customers with inelastic demands and strong preferences for the merging hospitals and ignore those who may be on the margin
- Patients using the merging hospitals are distinguishable in demand from most, if not all, of their neighbors.
  - The fact that others choose other hospitals in the network does not mean that the merging parties customers will do so
- Patients traveling long distances to come to the merging hospitals and passing other hospitals by, would rarely if ever "stay at home."

Patient Origin Data Myths

- There are not enough patients on the margin to protect those with less elastic demands for the merging hospitals – too few located as close to or closer to other hospitals.
- There are no prices in the data, hence, not usable
- Payors lack mechanisms to shift the marginal customer away from the merging hospitals.

Inclusion or Exclusion vs. Diversion (Payor Mechanisms)

- Fundamental principle of guidelines is assessment of diversion of sales
  - How is this accomplished in the current healthcare environment?
  - In pre-merger world, prices are influenced by the ability of plans to actually or potentially move at sufficient patients to other hospitals.
- Old world: Exclusion as primary tool
- New world: Consumers demand choice
  - Diversion is accomplished through mechanisms that divert marginal patients to lower cost alternatives
  - Hospitals are disciplined by threat of loss of sufficient revenues
  - What are the vulnerabilities of the merging hospitals to loss of patients? Why are they different from other firms in other industries?

Whither Elzinga Hogarty?

- Differences between E-H and the Merger Guidelines should be determinative of what to use.
- It's a way of organizing the data – but at best at starting point
- Problems in application that affect results
  - Sorting, weighting
  - Static
  - Differences between E-H and reality
  - Typically advanced by Plaintiffs
- Courts are treating E-H similarly in hospital cases to other cases

What’s the bottom line?

- Courts have been applying standard principles of Merger Guidelines to salient facts.
- Inclusion of hospitals in the relevant market has been based primarily on actual facts that sufficient numbers of marginal customers are conveniently situated to competing hospitals and payors have the mechanisms and tools to shift them in sufficient numbers to competing hospitals
- Ex-post – threat of diversion alone would be sufficient to discipline
- Lack of compelling coordinated effects stories.
- Each case will be fact specific.