ORIGINAL

UNITED STATES OF AMERICA

BEFORE FEDERAL TRADE COMMISSION

COMMISSIONERS: Deborah Platt Majoras, Chairman
Pamela Jones Harbour
Jon Leibowitz
William E. Kovacic
J. Thomas Rosch

In the matter of

EVANSTON NORTHWESTERN HEALTHCARE CORPORATION | Docket No. 9315

BRIEF *AMICUS CURIAE* OF ECONOMICS PROFESSORS

David Dranove, Northwestern University
Leemore Dafny, Northwestern University
Roger Feldman, University of Minnesota
Martin Gaynor, Carnegie Mellon University
Vivian Ho, Rice University
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1. Interest of *Amici Curiae*

Amici are professors at major universities who have researched and written extensively on health economics and the economics of industrial organization.[1] This submission describes what we believe are consensus views on some economic questions that arise in connection with with the August 6, 2007 ruling by the Federal Trade Commission.

2. Background

The recent 5-0 ruling by the FTC Commissioners in the matter of Evanston Northwestern Healthcare Corporation (ENH) Docket 9315 compromises a 23 year long effort by FTC economists and lawyers to limit provider market power and raises major issues about the future of competition in healthcare.

The FTC has long sought to limit market power and promote competition in hospital markets. However, case after case failed in the past because in the view of the courts, FTC economists and lawyers were unable to satisfactorily demonstrate market power. In ENH, the FTC combined rigorous new analysis of market power with strong empirical evidence to overcome past objections. In a seeming landmark decision, an administrative court judge accepted the FTC's conclusion that concentration was excessive and ordered the hospitals to be split up.

3. The Commissioners' ruling

The Commissioners agreed with the judge's ruling that Evanston and Highland Park Hospitals had achieved excessive market power by forming ENH. But instead of affirming the judge's

[1] A biographic sketch of each signatory is included in the Appendix.

order to force ENH to split up, the Commissioners ruled that ENH could remain intact provided that the member hospitals set prices independently.

4. Why the Commissioners' ruling will reduce competition and harm consumers

In our view, the FTC Commissioners' decision effectively vitiates the judge's decision and substitutes a remedy which is likely to be ineffective in curbing anticompetitive behavior for two reasons:

A. Effective price competition is improbable. Given that both Evanston and Highland Park Hospitals report to the same ENH central office, there will be ample, hard to oversee opportunities for collusion. The FTC could try to institute explicit oversight of pricing (which is unlikely to be successful), but this amounts to substituting regulation for competition, which is outside the FTC's legislated authority. But even if Evanston and Highland Park Hospitals do not directly or indirectly communicate about pricing, as long as they act on behalf of the parent ENH, we can still expect serious problems. Here is why. Suppose that one ENH hospital holds out for a high price and is excluded from a managed care network, its patients will just end up at the other ENH hospital. This will encourage each to drive prices higher. In economics parlance, prices will become "strategic complements." Systematic research and employer surveys show that when hospital prices increase, health insurers pass the costs along to enrollees, premiums increase, and some individuals and employers are priced out of the insurance market altogether. When hospital prices increase, consumers and society overall shoulder the burden.

B. The commissioners' ruling is an invitation to collude on quality, about which the decision says nothing. Given the importance of quality for consumers of hospital services, the potential harm must not be overlooked. While quality competition may occur on general dimensions—e.g. efforts to cut prescribing errors for medications, the literature suggests that competition often centers on the availability of services. Under the banner of improving efficiency, what if Evanston and Highland Park decide to segment the market—say, let Evanston dominate in heart care and give cancer to Highland Park? This could easily create a "must have" situation for each hospital for some services, putting managed care plans in the situation of having to contract with both if they want to serve the North Shore market. The FTC could respond by trying to regulate strategic manipulation of service offerings. But this has the potential of making a bad situation worse.

5. Summary

If the United States is going to have a market-based healthcare system, it is critical to preserve competition in the marketplace. If the FTC takes its charge of protecting consumers and society in all markets, including heath care, seriously, then the Commissioners' ENH ruling is clearly a step in the wrong direction.

Dated: October 16, 2007

Respectfully submitted,

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Appendix

David Dranove is the Walter McNerney Distinguished Professor of Health Industry Management at Northwestern University's Kellogg Graduate School of Management, where he is also Professor of Management and Strategy and Director of the Center for Health Industry Market Economics. He has a Ph.D. in Economics from Stanford University. Professor Dranove's research focuses on problems in industrial organization and business strategy with an emphasis on the health care industry.

Leemore Dafny is Assistant Professor of Management and Strategy at Northwestern University's Kellogg Graduate School of Management. Her research focuses on competition in healthcare markets. She has a Ph.D. in economics from MIT.

Roger Feldman is the Blue Cross Professor of Health Insurance and Professor of Economics at the University of Minnesota. Dr. Feldman served on the Senior Staff of the President's Council of Economic Advisers during the Reagan Administration. He has advised Medicare on the design of a demonstration of competitive pricing for Medicare health plans and recently provided advice to the Assistant Secretary for Planning and Evaluation (HHS) on the potential of a national market for health savings accounts. He has been a consultant to the U.S. Department of Justice and several state regulatory agencies regarding health plan mergers and ownership changes.

Martin Gaynor is the E. J. Barone Professor of Economics and Health Policy at Carnegie Mellon University's Heinz School of Public Policy and Management. Professor Gaynor's research focuses on competition in health care markets and on the role of incentive structures within health care. He has served as a consultant to the Federal Trade Commission, U.S.

Department of Justice, and the California Department of Corporations on antitrust issues.He received his Ph.D. in economics from Northwestern University.

Vivian Ho holds the James A. Baker III Institute Chair in Health Economics at Rice University. She is also an Associate Professor of Economics at Rice and an Associate Professor at the Baylor College of Medicine. Ho has a PhD in Economics from Stanford University. Ho's research examines the effects of economic incentives and institutions on healthcare costs and outcomes, with a focus on the hospital sector.

Richard Lindrooth is an Associate Professor in Medical University of South Carolina's Department of Health Administration and Policy, where he is also Associate Director of the Center for Health Economic and Policy Studies. He has a Ph.D. in Economics from the University of Washington. Professor Lindrooth's research is focused on the economics of the health care industry with an emphasis on the delivery hospital services.

Mark Satterthwaite is the A .C. Buehler Professor in Hospital and Health Services Management at Northwestern University's Kellogg School of Management. In addition, he is Professor of Managerial Economics, Professor of Strategy, and Director of the General Motors Research Center for Strategy in Management. He received his Ph.D. from the University of Wisconsin and is a fellow of both the Econometric Society and the American Academy of Arts and Sciences. A central theme of his research, which has been in both microeconomic theory and health care economics, is how market participants' information affects the prices that are realized in the market.

William D. White is a Professor of Policy Analysis and Management and Director of the Sloan Program in Health Administration at Cornell University. He has a Ph.D. in Economics from Harvard University. Prior to coming to Cornell, he taught at the University of Illinois in Chicago and Yale University. Professor White's research focuses on the organization and operation of healthcare markets.

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