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Cross-Market Implications In FTC's Anesthesia Complaint

By **Christopher Lau and Dina Older Aguilar** (November 20, 2023, 10:23 PM EST)

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Anti-competitive harm from cross-market hospital mergers has been a controversial topic in health care antitrust analysis.

Cross-market mergers are acquisitions involving hospital systems that are too far apart — geographically or in the product space — to serve as close substitutes for patient care. While there is some empirical evidence of price increases following these mergers, the mechanisms by which prices are affected remain unsettled.

The Federal Trade Commission has to date been unwilling to bring such a challenge, recently clearing two large cross-market hospital mergers: Spectrum Health's acquisition of Beaumont Health in 2021 and Advocate Aurora Health's acquisition of Atrium Health in 2022.[1]

On Sept. 21, however, the FTC **challenged** the conduct of U.S. Anesthesia Partners Inc., or USAP, and private equity group Welsh Carson Anderson & Stowe in a complaint that includes allegations that USAP's acquisitions in distinct relevant markets across Texas resulted in price increases at those practices.[2]

This is an allegation of cross-market harm. While antitrust practitioners are monitoring this case for guidance on how the FTC may scrutinize private equity firm strategies or serial acquisitions — the focus of Guideline 9 in the draft merger guidelines from the U.S. Department of Justice and the FTC — they should also keep an eye on how the court in this case, the U.S. District Court for the Southern District of Texas, views the allegations of cross-market harm.

Precedents from this case could potentially provide a framework under which the FTC will challenge mergers that they may have been unwilling to oppose in the past.

The FTC's complaint alleges that USAP engaged in a "multi-year anticompetitive scheme to consolidate anesthesia practices in Texas, drive up the price of anesthesia services provided to Texas patients, and increase their own profits." Specifically, the FTC has alleged that USAP acquired several anesthesiologist groups between 2012 and 2019, eliminated competitors, and used its increased negotiating leverage to raise prices.

According to the FTC's complaint, USAP initially entered the Houston market through the acquisition of Greater Houston Anesthesiology in 2012, followed by the acquisitions of North Houston Anesthesiology, MetroWest Anesthesia Care, and Guardian Anesthesia Services, ultimately gaining a 69.5% share by revenue of the alleged Houston market.

The FTC alleged that USAP next expanded to Dallas in 2014, which they define as a relevant antitrust market distinct from Houston, with the acquisition of Pinnacle Anesthesia Consultants, ultimately reaching a 68.3% share by revenue of the alleged Dallas market with the acquisitions of six more practices.

The FTC also claimed that USAP's alleged Texas "roll-up strategy" included acquisitions outside of

Houston and Dallas — East Texas Anesthesiology Associates in Tyler, Capitol Anesthesiology Association in Austin, Amarillo Anesthesia Consultants in Amarillo, and Star Anesthesia in San Antonio.[3] According to the FTC, USAP was able to raise prices at each acquired group, including those outside of Houston and Dallas.

The FTC's challenge of USAP alleges not only that USAP was able to raise prices through its incremental acquisition of providers within markets where USAP had an existing presence, but also that it was able to raise prices at physician groups when entering new markets.

These acquisitions did not lead to an increase in concentration or market power as traditionally defined. Nevertheless, the complaint alleges that USAP was able to extend prices through its contracts, which effected a "peanut butter spread" of its highest rates to new practices.[4]

And even when USAP was not able to obtain contractual price increases, the FTC claims it was still able to raise prices above what the acquiree had previously been charging. These price increases, in markets where USAP had no other presence, are claims of cross-market harm.

Increased Negotiating Leverage From Acquisitions Across Markets

In its complaint, the FTC has alleged that USAP was able to increase the prices of providers in new geographies, including those formally defined as separate relevant antitrust markets. The FTC includes evidence from USAP's entry into the alleged Dallas market but before its subsequent acquisition in the alleged market.

Prior to being acquired, Pinnacle comprised 26% of anesthesia providers and 40% of anesthesia services and had a strong presence in many large hospital systems.

The FTC's complaint alleges that "USAP immediately began attempting to apply its existing (higher) reimbursement rates from Houston to Pinnacle providers." The complaint further claims that while "insurers balked at the idea of Houston rates for Dallas anesthesia providers," USAP ultimately obtained a significant price increase from multiple insurers.

The FTC also claims that the Dallas acquisition increased USAP's leverage with Blue Cross Blue Shield of Texas in Houston:

> When USAP's predecessor Greater Houston Anesthesiology practiced only in Houston, Blue Cross could — and did — exclude Greater Houston Anesthesiology from its network in response to requested rate increases. Once USAP expanded to Dallas through the Pinnacle acquisition, however, Blue Cross concluded that it was too difficult to exclude USAP, even though the Pinnacle acquisition did not increase concentration in the Dallas market.

Additionally, the FTC alleges that the acquisition of Amarillo Anesthesia Consultants increased the practice's negotiating leverage with Blue Cross, even though the acquisition did not increase Amarillo market concentration:

> Before USAP acquired Amarillo Anesthesia — a group with as much as an 85% share of hospital-only services in that city — insurers successfully resisted Amarillo Anesthesia's demands to dramatically increase its reimbursement rates. But once USAP acquired Amarillo Anesthesia in 2018, USAP was able to [increase] its reimbursement rates from Blue Cross … even though the acquisition did not increase market concentration in Amarillo.

These allegations of cross-market effects go beyond USAP's entry into Dallas and Amarillo and are applied more generally to acquisitions across Texas.

For example, the complaint reports price increases from single, rather than serial, acquisitions in Tyler and San Antonio, as well as USAP's initial acquisition when entering Austin. The complaint generalizes these episodes, suggesting that "USAP's extensive — often exclusive — presence at key hospitals throughout Texas made taking USAP out-of-network too difficult," and that "USAP effectively exercised this leverage with each acquisition it made in Texas. Each time it acquired a group, even in places where it had no existing presence, USAP raised the target group's rates."

The FTC's complaint directly claims that acquisitions across separate relevant markets resulted in price increases through increased negotiating leverage for USAP and the acquired provider groups. It does not, however, specify the underlying economic theories and mechanism driving this change in leverage.

In general, the standard bargaining framework for analyzing health care provider mergers does not predict changes in leverage from acquisitions where there is little to no patient substitution. Below, we explore several theories that have been offered to explain cross-market merger effects and may be explored in this litigation.

The Economics of Cross-Market Mergers

Until recently, mergers between health care providers in two distant and distinct relevant markets were assumed to have no impact on bargaining leverage or hospital pricing. However, recent empirical studies have concluded that such mergers can increase prices.

While price increases following cross-market mergers have been observed in the data, the theoretical rationale and how these effects fit with the standard bargaining framework used to analyze health care provider mergers remain an area that requires further academic research. The lack of a theoretical explanation for this effect creates a challenge for predicting which cross-market mergers may lead to higher prices and which would not.

To date, the FTC has been willing to investigate, but unwilling to challenge, cross-market mergers. Most recently, the FTC allowed the Spectrum-Beaumont Health and Advocate-Atrium Health mergers, both of which involved several months of investigation.

There are at least three frequently cited conjectures for why the bargaining leverage of providers may increase after a merger of providers in different relevant markets; these may be expounded on in the USAP case.

1. Bargaining Sophistication

A merger between two providers in different relevant markets could result in a price increase if the acquirer is a better negotiator than the acquiree.[5] For example, the post-merger price for the acquiree may increase purely from the fact that it can use the acquirer, and their bargaining ability, to negotiate higher prices. However, price increases from improved bargaining ability are not a reflection of a loss of competition and do not reflect antitrust harm.[6]

The FTC discounted the bargaining sophistication theory in its complaint by explicitly claiming that the "price increase cannot be explained by USAP simply being a more skilled negotiator than Pinnacle, as Pinnacle's contract negotiations had been handled by EmCare, a subsidiary of a large, sophisticated corporation."[7]

2. Narrow Competition

It is also possible that two providers in different relevant markets do compete on a narrow subset of important services. For example, certain high acuity services may only be available at certain larger academic medical centers. If this is the case, a merger between two providers may limit competition for these services and increase bargaining leverage of the combined entity.

However, this has generally not been considered a novel theory of cross-market harm, but rather a reframing of horizontal unilateral effects in a narrow product market that includes services that are substitutable across a broad geographic market.[8] The fact that the FTC defined relevant markets as "commercially insured hospital-only anesthesia services" in distinct metro areas suggests that narrow competition is not an explanation they will offer for cross-market harm in this matter.

3. Common Customers

The bargaining framework used to evaluate provider mergers models the price setting negotiation between providers and insurers, but typically considers leverage in that negotiation as depending on whether patients view the merging provider groups as substitutes. However, this assumption is

typically based on a simplification of actual customer dynamics.

More generally, patients obtain insurance coverage through their employer or broader purchasing groups. If an insurer is able to use two providers as substitutes in constructing a network that is marketable to employers, even when the providers are not substitutes from the patient perspective, cross-market merger effects may be possible.[9]

For example, in the RAND Journal of Economics, Leemore Dafny, Kate Ho and Robin Lee in 2019 offered a hypothetical example of a firm with employees in two separate markets that is willing to offer its employees a plan so long as it has a covered hospital in at least one of two markets, but not if it does not include a covered hospital in either market.

This makes the hospitals substitutes for the insurer in marketing plans to that employer. If the hospitals merge and take away the insurer's ability to substitute between them, there will be a cross-market increase in negotiating leverage.[10] The authors also offer conditions under which cross-market effects would not be expected.

The above theories of cross-market harm, including the common customer theory, require a specific set of conditions to support cross-market effects. These may include the share of insurer business that comes from common customers, the extent of common customer's demand for plans with limited coverage in certain markets, and evidence that the merged entity does make access to some facilities contingent on other facilities being placed in-network.

The FTC may rely on (1) documented price changes following USAP acquisitions, and (2) USAP's alleged use of contracting clauses that specified price increases for new acquisitions. But their claims may be challenged without a theoretical foundation.

An understanding of the economic factors that would and would not have changed USAP's bargaining leverage as a result of the merger may be needed to exclude other explanations for these increases. This understanding may also provide insights into theories of harm the FTC may consider in future investigations of proposed cross-market acquisitions.

Conclusion

While the FTC has been unable or unwilling to challenge recent large cross-market hospital mergers like Spectrum-Beaumont and Advocate-Atrium, the challenge of USAP essentially includes a charge of cross-market harm. According to the complaint, USAP was able to increase its negotiating leverage from acquisitions across separately defined relevant antitrust markets.

The evidence that the FTC puts forward to support its cross-market allegations, the evidence and theory that USAP presents in response, and how the courts interpret that evidence, may suggest a pathway for further challenges or ways in which merging parties can defend themselves from similar claims.

The outcome would not only offer insights into anticipated increased enforcement of sequential acquisitions and of private equity firm activity, it may also have important implications for and insights into how the agencies may scrutinize cross-market mergers.

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[1] Spectrum/Beaumont announced its plans to merge in June 2021 and closed on Feb. 1, 2022, and Advocate/Atrium announced its plans to merger on May 11, 2022, and closed on Dec. 2, 2022.

[2] The complaint formally defines Houston, Dallas and Austin as relevant antitrust markets.

[3] The complaint does not formally define Tyler, Amarillo and San Antonio as relevant antitrust markets, but acknowledges that USAP did not have prior presence in these regions.

[4] The complaint describes USAP's application of its reimbursement rates to newly acquired providers as a "peanut butter spread."

[5] In bargaining theory, this is often considered equivalent to the merger influencing the "bargaining weight" or "split parameter" that determines the split of the joint surplus shared between providers and insurers.

[6] See Matthew Lewis and Kevin Pflum, "Diagnosing Hospital System Bargaining Power in Managed Care Networks," American Economic Journal: Economic Policy, 7(1), 2015, pp. 243–274 at p. 246.

[7] Pinnacle's use of a third-party negotiator could also signal its overall lack of bargaining power.

[8] See Keith J. Brand and Ted Rosenbaum, "A Review of the Economic Literature on Cross-Market Healthcare Mergers," Antitrust Law Journal, 82(2), 2019, pp. 533–549 at p. 544.

[9] See Leemore Dafny, Katherine Ho, and Robin S. Lee, "The Price Effects of Cross-Market Hospital Mergers: Theory and Evidence from the Hospital Industry," RAND Journal of Economics, 50(2), 2019, pp. 286–325 at pp. 294–295. See also Gregory S. Vistnes and Yianis Sarafidis, "Cross-Market Hospital Mergers: A Holistic Approach," Antitrust Law Journal, 79(1), 2013, pp. 253–293 at p. 275.

[10] While this is a stylized example for intuitive exposition, Dafny, Ho, and Lee (2019) show more generally that cross-market effects may be possible in scenarios where "the value of each hospital to the insurer is lower when the insurer's network is larger."
