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HOSPITAL MERGERS: ONE MARKET OR MANY?

As a result of changes in the ways in which health care services are provided, many hospitals face difficult financial futures and have entered into merger agreements in an attempt to obtain much needed costs savings. However, a significant problem in gaining approval for hospital mergers is the variety of services and geographic areas relevant to market definition.

Both the Justice Department and the FTC have filed cases based on a "general acute care hospital" market using definitions premised on a cluster of services providing complete treatment. While such a product market definition can sometimes provide a convenient approximation, it can also lead to incorrect conclusions. A proper application of the Guidelines analysis must consider each of the services provided by the merging hospitals. Patients are generally not able to substitute among the various procedures and services. Consequently, at least on the demand side, each service offered by the merging hospitals likely constitutes a separate product market. If a particular service is also supplied by non-hospital providers, as is often the case, then these alternative providers must be included in that market. A failure to include non-hospital providers can severely distort the analysis.

Despite the absence of demand-side substitution, a general acute care hospital market might be appropriate if a hospital could quickly change the mix of services it provides. Closer examination reveals, however, that even extensive supply-side substitution capabilities usually will not produce a general acute care hospital market. The existence of that market would imply that a group of general acute care hospitals would find it profitable to raise price or lower quality for the cluster of services. Yet, since many of the services in the cluster compete with non-hospital facilities, the group of hospitals would find it more profitable to restrict price increases to those services for which close substitutes do not exist. The ability to price in this manner implies that those services without close substitutes constitute separate relevant markets.

Product market analyses often show that there are different product markets for each hospital service. Even for those product markets consisting only of general acute care hospitals, the competitive review should not be based on simple calculations of market share. Geographic market delineation is often the most critical element of the agencies' review of a hospital merger. As with any merger, the appropriate geographic markets for analyzing a hospital merger depend on the specific product markets that have been identified. Consequently, a hospital offering a range of services may compete in several different geographic markets. The existence of numerous product markets, each with its own geographic market, produces conceptual difficulties for measuring and interpreting market share. These difficulties do not vanish, even for local hospital services that only general acute care hospitals provide. For example, unless supply-side substitution is likely, tertiary services that compete in regional or national markets should not be included in a calculation of market share for local hospital services.

A general acute care product market may be appropriate, however, if transaction costs or other considerations cause hospital services to be sold collectively. One such possibility involves competition for serving managed care plans, such as HMO's, PPO's, some government plans (e.g., MediCal), and employers that contract directly with hospitals. Managed care plans usually need to contract with hospitals

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that collectively provide all needed services and cover the geographic region in which the plan obtains its members. While neither agency has filed a case based on a "managed care hospital market," they typically consider the effect of the merger on both narrow, individual services provisional markets and broad, managed care provisional markets.

Barry C. Harris, Senior Vice President, has testified in a number of antitrust proceedings involving health care. During the past year, his analysis assisted in gaining FTC approval of hospital mergers in St. Augustine, Florida and San Francisco. A more detailed treatment of this subject appears in International Merger Law, *February 1992.*

COATED GROUNDWOOD PAPER ANTIDUMPING INVESTIGATION

No Injury to U.S. Producers Found by International Trade Commission

Following a final hearing, the International Trade Commission (ITC) announced in December its unanimous determination that the domestic coated groundwood paper industry had not been materially injured (*Coated Groundwood Paper from Belgium, Finland, France, Germany, and The United Kingdom*). Furthermore, the ITC found that even if the domestic industry had been materially injured, the European manufacturers of coated groundwood paper had neither caused nor threatened to cause material injury. While the vote following the preliminary hearing in January 1991 was 3-1 in support of the petitioners, the majority of the commissioners delayed consideration of key issues and evidence until the final hearing.

The key to the respondents' victory in this case was a demonstration that there were no significant changes in the quantity, market share, or prices of imports from Europe between 1988 and mid-1991, the period of investigation. From this it would follow that whatever difficulties the domestic coated groundwood paper industry faced, they were not caused by the European suppliers. This type of incremental analysis formed the core of the argument throughout the case. In addition to exploring the causal relationship between European imports and domestic prices, the analysis focused on other causal factors such as declining demand and imports from non-subject countries, primarily Canada.

Significantly, increases in imports from Europe were associated with increases in domestic prices but increases in imports from Canada appeared to have had a depressing effect on domestic prices. Explaining the reasons for these divergent results was critical to the presentation of the respondents' case. U.S.

Pitfalls for Voluntary Respondents at Department of Commerce

The recently completed antidumping duty investigation of coated groundwood paper illustrates two new perils facing voluntary respondents at the Department of Commerce. First, the case confirms the fear of any voluntary respondent that through the administrative caprice of the Department, it is possible for a voluntary respondent to receive a prohibitively high margin of dumping. Second, the coated groundwood paper case provides a precedent for the Department denying a voluntary respondent the right to opt for the "all others" rate by withdrawing its response from the administrative record.

In making its final determination in the coated groundwood paper case, the Department did not adjust the "U.S. price" for the amount of value added tax imposed in the third country that was used as the basis for "Foreign Market Value" (FMV) for the voluntary respondent. This was done even though such an adjustment was made for all the respondents selected by the Department, each of whom had sufficient home market sales to serve as the basis for FMV. Moreover, in denying this adjustment the Department reversed the position it had taken in its preliminary determination. Neither petitioner nor respondent had raised the issue during the hearing process. Thus, both parties were denied the opportunity to comment on this significant change in margin calculation methodology. In its notice of final determination the Department made only brief and indirect reference to this decision in response to another issue. The Department cited neither precedent nor authority for its decision, which was contrary to the Department's own precedent in numerous other cases.

The Department's denial of this adjustment raised

No Injury... purchasers of coated groundwood paper (printers and magazine publishers) bought paper from Europe to ensure supply when faced with periodic shortages from U.S. manufacturers. In addition, U.S. manufacturers could not always meet the exacting quality requirements of their U.S. customers, who then turned to European producers. This enabled the European firms to charge a premium for much of the paper they sold in the U.S. As the ITC investigation determined, European manufacturers were overselling, not underselling, U.S. manufacturers. Canadian manufacturers, on the other hand, were generally found to be underselling U.S. manufacturers.

The U.S. producers may have been more alarmed about the possibility of increased imports due to the relatively low capacity utilization of European producers than about the prevailing level of imports. In a declining market, the European producers would arguably have incentives to improve their capacity utilization at the expense of U.S. producers. But the ITC found no threat of material injury for many of the same reasons that they found no material injury during the period of investigation. Incremental analysis showed that there was no causal nexus between the quantity, share, or prices of European imports and the declining performance of the U.S. industry even though European capacity utilization had steadily declined during the period of investigation. Therefore, there was not a sufficient basis to determine that European imports presented a threat of material injury.

John H. Preston, an expert in the paper industry, and a team of EI economists developed the economic analysis and much of the evidence used in the preliminary hearing.

Pitfalls... the dumping margin for the respondent significantly by sharply reducing the denominator used in calculating the dumping margin. The Department rejected the respondent's request to withdraw its voluntary response after the issuance of the final determination, maintaining that the investigation had been completed. The respondent argued that because the Department had preliminarily determined that the respondent was sufficiently related to another respondent to warrant the issuance of a single margin for both companies, the respondent had not been at liberty to withdraw its voluntary response earlier. Only when the Department reversed that preliminary finding, as it did in the final determination, could the voluntary respondent withdraw its response. However, the Department replied that these facts were not relevant and the matter was closed.

Traditionally, the Department has been loath to accept voluntary responses because of the additional burden they create. Until the coated groundwood paper case, the Department had consistently rejected voluntary responses, making it virtually impossible for companies that were not dumping the subject goods, but were not selected as respondents, to win exclusion from a dumping order. The case offers an example of how the Department's departure from that practice, ironically, can actually work to the detriment of the voluntary respondent.

Jess M. Bratton, III, a former Senior International Trade Analyst with the Department of Commerce and an expert in import relief proceedings, directed EI litigation support for three Finnish respondents.

NEW REGULATORY ALTERNATIVE FOR PROTECTED WETLANDS

Changes in environmental statutes and regulations have made it increasingly difficult to develop wetlands. However, some recent legislation and policy pronouncements offer a potentially useful alternative to developers of both private and public projects seeking to use protected wetlands. This alternative, wetland mitigation banking, allows for the creation of new wetlands or enhancement of degraded wetlands in exchange for the ability to develop other areas. Like similar schemes established for air and water pollution, trading in wetland credits currently is allowed in many states and will be increasingly important to developers who wish to utilize environmentally sensitive areas. Key elements of the programs need to be resolved, however, if trading in wetlands credits is to achieve its potential.

Wetland mitigation banks are created by agreements that detail responsibilities of the bank operator and affected state and federal agencies and indicate how credits will be calculated. Existing banks are

SELECTED EI CASES IN 1991

***Exxon Valdez* Oil Spill:** Wilmer, Cutler & Pickering, counsel to the Trans-Alaska Pipeline Liability Fund, retained EI President Bruce M. Owen to measure what seafood prices in Alaska would have been had the *Exxon Valdez* oil spill not occurred. These prices, as measured by EI, are being used as part of the settlement of claims.

Machine Tools Merger: EI assisted Foley & Lardner and Jones, Day, Reavis & Pogue in obtaining DOJ approval for the merger of machine tool manufacturers Giddings & Lewis and Cross & Trecker. EI economists Barry C. Harris and Philip B. Nelson led EI's effort in analyzing the viability of specific brands and the ability of other manufacturers to supply systems of machine tools.

Ansell Incorporated v. Schmid Laboratories, Inc. and Allercare/NSL, Inc.: EI economist David D. Smith, working with Pepper, Hamilton & Scheetz attorneys, testified on product and geographic market definition in this merger trial involving latex condoms. The court accepted the EI analysis, but ruled in favor of the defendants after deciding that the plaintiff did not have standing to sue.

Hazardous Waste Cleanup: In conjunction with Holme, Roberts & Owen, EI economist Joseph W. McAnneny successfully argued that Southern Pacific Transportation Company was being forced to purchase from a government-licensed monopolist in an EPA-mandated hazardous waste site cleanup. EPA rescinded its order that Southern Pacific clean up the site using a technology that DOE had licensed exclusively to one company.

POM Inc. v. Duncan Industries: EI economist Bruce R. Snapp persuaded the jury in this monopolization trial that although the defendant had a large share of the parking meter market, it had not engaged in the predatory practices alleged by the plaintiff. This matter was litigated by Jones, Day, Reavis & Pogue; Robinson, Staley & Marshall; and Curtis, Mallet-Prevost, Colt & Mosle.

operated by states for use by their highway departments, by port authorities, and by private organizations. Typically, units of credit are either acres or some measure of wildlife habitat. In the case of banks operated by private organizations and port authorities, outsiders may purchase credits to mitigate wetland losses at prices established by the bank.

The appeal of wetland banking to developers is clear. Making wetland credits available up-front enables developers to gauge more accurately the ultimate cost and feasibility of proposed projects as well as reduce permitting time. Wetland banks usually encompass large areas because per-acre costs are lower, due to economies of scale, and planning and long-term management are easier. Thus, wetland banking yields environmental benefits as well, because preserving or enhancing large contiguous areas increases the chances of providing valuable habitat.

Recently, President Bush called for the creation of federal wetland mitigation banking to augment some 30 wetland mitigation banks currently operating in the states. The President's proposal would create a federal interagency committee to detail the system under which mitigation credits would be created and sold. The Surface Transportation Act of 1991 enables state departments of transportation to create wetland mitigation banks for use by state highway departments. In addition, many of the Clean Water Act reauthorization bills before Congress would authorize wetland mitigation banking as part of the federal wetland regulatory apparatus.

To gain wider acceptance, wetland banking faces many of the same hurdles as other systems for trading environmental credits (such as Clean Air Act banking and offset trading, acid rain trading, and water effluent trading). Credits must be quantifiable, enforceable, and tradeable. However, quantifying credits in acres or units of habitat does not capture the economic value of the wetland. Consequently, the ratio of wetlands in the bank that must be exchanged for wetlands to be developed is often arbitrary and economically meaningless. Instead, the exchange ratio should be based on economic valuation of all of the important wetland functions: flood control, water quality improvements, and recreation, in addition to wildlife habitat.

Robert C. Anderson, special consultant to Economists Incorporated, recently prepared a review entitled Economic Valuation of Wetlands *for the American Petroleum Institute.*