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A BRIEF ANALYSIS OF POLICY AND LITIGATION

Market Definition Key To Decision Blocking H&R Block-TaxACT Merger

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The Antitrust Division recently blocked an acquisition involving two firms selling digital do-it-yourself (DDIY) tax preparation products. The firms were H&R Block (HRB) and 2SS, which sells under the brand name TaxACT.

The Court's key determination was to accept DOJ's proposed product market, DDIY tax preparation products. Defendants argued that the market should also include assisted tax preparation and "pen and paper" tax preparation (including use of free online IRS forms).

To support a DDIY market, DOJ elicited defendant testimony that DDIY did not have much impact on HRB's assisted business. DOJ's economic expert presented IRS data that show the portion of DDIY filers staying with their DDIY provider, switching to each other DDIY provider, and switching to a non-DDIY method. He concluded that switching in response to a price increase by a hypothetical DDIY monopolist would be insufficient to invalidate the market.

Defendants attacked this market definition on several grounds. They objected that switching in the IRS data is not necessarily due to price changes and that DOJ's analysis of IRS data would also validate other possible markets. Moreover, defendants introduced a conjoint analysis based on a discrete choice survey used by HRB in the normal course of business. Based on this analysis, the closest substitute for TaxACT was "pen and paper," which was excluded from the hypothetical market tested by DOJ's economist. The Court rejected the conjoint analysis because it yielded some anomalous results, it failed to specify a price for one option and its sample size was tiny compared with the IRS data. The Court also rejected HRB's email survey because its questions about switching were not focused on switching due to a price change, its response rate was low and it used closed-ended questions without offering a full set of alternative responses.

Within a DDIY market, the largest providers are Intuit (TurboTax), HRB and TaxACT, with 62, 16 and 13 percent of DDIY tax returns, respectively. The Court found that anticompetitive coordinated effects could be presumed in what would effectively be a duopoly post-merger. To rebut this presumption, defendants argued that small DDIY firms could rapidly expand to fill TaxACT's competitive role. The Court was not persuaded, noting the difficulty of establishing reputation among users. The Court also found that unilateral effects were likely. The Court based that conclusion on head-to-head competition between the merging products and on DOJ's merger simulation.

Also In This Issue

A Closer Look at Bundled Discounting and Predation in *United Regional*

David A. Argue and John M. Gale discuss the Department of Justice's recent case in which a hospital's alleged predatory bundled discounting prevented a smaller hospital from expanding. DOJ argued that prices were below cost based on a "discount attribution" approach used in private litigation. DOJ, however, misapplied that approach by attributing the entire discount to the customers that the smaller hospital currently competed for, rather than the customers that it could compete for if it expanded its services. Moreover, DOJ ignored recoupment, even though recoupment is central to any analysis of predatory pricing.

Antitrust Guidelines for Accountable Care Organizations

Allison M. Holt discusses Guidelines that the U.S. Antitrust Agencies recently issued for Accountable Care Organizations (ACOs) established under the Medicare Shared Savings Program. ACOs' purpose is to allow providers to better coordinate patients' health care. ACOs may extend to commercially insured patients. The Agencies have announced that they will judge an ACO under the rule of reason to determine if its procompetitive effects outweigh its anticompetitive effects. The Guidelines state that ACOs that fall within a safety zone based on their market share likely will not raise competitive concerns. Availability of the safety zone may depend on the use of non-exclusive agreements. The Guidelines also outline the evaluation criteria for ACOs outside the safety zone.

A Closer Look at Bundled Discounting and Predation in *United Regional*

David A. Argue and John M. Gale

In February 2011, the Department of Justice settled its case alleging that United Regional Health Care System had engaged in predatory bundled discounting with certain managed care plans that prevented the smaller Kell West Regional Hospital from becoming a full-service competitor. DOJ's analysis relies on a novel variant of the "discount attribution" approach used in two prior cases: *Ortho* and *PeaceHealth*. That variant, however, is incompatible with DOJ's own theory of competitive dynamics. Critically, DOJ also fails to present an analysis of the economic rationality of below-cost pricing.

DOJ alleges that United Regional's managed care contracts with non-Blue Cross plans harmed competition by excluding Kell West from the payors' networks in exchange for increased discounts on all services at United Regional. Had these insurance networks included Kell West, DOJ argues, Kell West's increased profits would have enabled it to expand into United Regional's "monopoly services." Kell West ostensibly would have added "additional intensive-care capabilities, cardiology services, and obstetrics services." Since DOJ does not allege that United Regional's scheme would have forced Kell West to close, its theory implies that United Regional must maintain this scheme into perpetuity to continue excluding Kell West from the "monopoly services."

To test its predatory pricing theory, DOJ applied a modified form of the *Ortho* and *PeaceHealth* "discount attribution" approach. In general, the discount attribution approach assigns the entire discount for the bundle of services to the sales of the competitive service alone. The modification used by DOJ involves dividing United Regional's patients under exclusive contracts into (1) those receiving services not available at Kell West, (2) those receiving services available at Kell West but who prefer United Regional ("preferred services patients") and (3) those receiving services available at Kell West who would switch to Kell West but for the exclusive contracts. The third group, termed "contestable" patients by DOJ, constitutes what DOJ believes are the competitive sales. DOJ estimates that only 10% of United Regional's non-Blue Cross commercially insured patients are contestable. After attributing the discount on the whole bundle of services entirely to the 10% of patients, DOJ concludes that United Regional's prices for the services supplied to the contestable patients are well below its costs, resulting

EI Principal David A. Argue has extensive experience analyzing competition in health care matters. He has previously written an article on bundled discounting in the PeaceHealth *matter. EI Vice President John M. Gale also has been involved in numerous health care matters. A more detailed version of this article will appear in the latest issue of* Antitrust Health Care Chronicle.

in competitively harmful predatory pricing.

To better understand the implications of DOJ's theory, consider a stylized example used in *Ortho* (and cited by the Ninth Circuit in *PeaceHealth*) of bundled discounting of shampoo and conditioner. A slight variation of that example features one firm that produces both shampoo and conditioner and a second firm attempting to enter the shampoo market. The incumbent monopolist offers the two-product bundle at a discount below the products' combined stand-alone prices. The discount attribution approach weighs the entire bundled discount against the stand-alone price of the shampoo, the product in which entry threatens. This attribution captures the intent to block competition in the shampoo market without affecting the monopoly conditioner market.

United Regional's alleged attempt to thwart Kell West's entry into the monopoly services market is analogous to the hair-products monopolist's preventing entry into the shampoo market, but there are some important differences. In the *Ortho* example, the discount affects competition in the market for the competitive product, leaving the monopoly product untouched. United Regional, however, has virtually no service line that is free from Kell West's threatened entry, under DOJ's assumptions. That difference is important because identifying the markets ultimately affected by the alleged anticompetitive conduct is the key to determining proper attribution. In the hair products example, the entire discount is attributed to shampoo because that is the market with the competitive impact. In *United Regional*, DOJ theorizes that the bundled discount prevents Kell West from entering the monopoly services markets and becom-

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Antitrust Guidelines for Accountable Care Organizations

Allison M. Holt

The Affordable Care Act of 2010 required the establishment of a Medicare Shared Savings Program by the Centers for Medicare and Medicaid Services (CMS). Under this program, Accountable Care Organizations (ACOs) could be established by primary care doctors, specialists, hospitals and other health care providers to jointly manage the health care of Medicare beneficiaries. ACOs' purpose is to allow providers to work together to better coordinate patients' health care, thus improving the quality of care, reducing duplication of services and reducing costs. Some health care providers seeking to establish ACOs for Medicare recipients were also expected to extend the expected cost savings to commercially insured patients. Because collaborations that involve an ACO under the Shared Savings Program might result in market power that would raise prices and reduce the quality of care, the U.S. Department of Justice and the Federal Trade Commission (the Agencies) issued antitrust guidelines on October 20, 2011, for these collaborations.

Unlike other pricing agreements among competitors, which are per se illegal, an ACO will be judged under the rule of reason to determine if its procompetitive effects outweigh its anticompetitive effects. These effects will be evaluated using data on cost and quality gathered by CMS, to determine if, in fact, these collaborations are decreasing costs to consumers and increasing quality of care. To qualify for treatment under the rule of reason, an ACO must use the same leadership, and clinical and administrative processes to serve their commercial patients as it uses to serve the Medicaid beneficiaries and it must meet all of the criteria set forth by CMS. If those criteria are met, then the Guidelines set forth by the Agencies will be used to determine if the ACO complies with the antitrust laws.

Those Guidelines state that ACOs that fall within a defined safety zone are unlikely to raise competitive concerns. This safety zone regulation indicates the importance that market share plays in the Agencies' determination of market power and highlights that market share will be the first screening device in reviewing an ACO. For an independent ACO to fall within the safety zone, participants in the ACO providing a common service must have a combined market share of 30 percent or less in each primary service area (PSA) where they overlap. This market share analysis needs to be done separately for inpatient services, outpatient services, and each physician specialty. These services or specialties are evaluated separately based on their own PSAs.

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Availability of the safety zone may depend on the use of non-exclusive agreements. Hospitals must have non-exclusive agreements with ACOs to fall within the safety zone—meaning that the hospitals are free to contract with private payers separately from their agreement with the ACO. A physician or physicians' group must have non-exclusive agreements to qualify for the "rural exception." The exception allows for one physician or physicians' group in each specialty located in a small or isolated rural area to be in the safety zone even if the physician or group is above the 30 percent PSA market share cut off. Finally, if one of the ACO participants already has a share greater than 50 percent in its PSA, then to fall into the safety zone it too must have a non-exclusive agreement with the ACO.

The Agencies' Guidelines also outline the evaluation criteria for ACOs outside the defined safety zones and circumstances under which such ACOs might raise competitive concerns. First and foremost, all ACOs, both inside and outside the safety zone should avoid sharing of information that would lead to collusion in competing sales of services outside the ACO.

For ACOs that are not within the safety zone, the Agencies provide a list of activities that might raise competitive concerns. First, any type of anti-steering provision that discourages private payers from directing participants to providers outside the ACO would be questionable. Second, the Agencies advise against tying sales of services within the ACO to the provision of services to providers outside the ACO. This type of exclusive contracting can harm both competing physicians and hospitals and the competing health plans buying the services. Third, exclusive contracting with providers that prevents them from contracting with private insurers outside the ACO should be avoided. The Agencies have consistently investigated firms with high market shares that engage in exclusive dealing. Finally, ACOs must allow

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Bundled Discounting

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ing a full-service hospital, thus preventing it from attracting monopoly services patients. Presumably, not being full-service also prevents Kell West from attracting the preferred services patients. The effect of the alleged anticompetitive conduct thus is not restricted to the contestable 10% of patients. They are simply the mechanism to harm competition by preventing Kell West's expansion. The bundled discount affects United Regional's competition for all patients, and it should be attributed to all of them. As DOJ's Competitive Impact Statement states, "the entire discount should be attributed…to the patients that United Regional would actually be at risk of losing," and it risks losing all patients to an expanded Kell West.

Moreover, DOJ ignored the question of recouping forgone profits. Recoupment is a central feature of any analysis of predatory pricing because no economically rational firm will price below cost with no prospect of recovering forgone profits. A straightforward way to consider recoupment is to assess United Regional's pricing options. One option would be to avoid the restrictive contracts altogether. In this no-exclusives, no-discounts scenario, United Regional would price its monopoly services at the monopoly level until Kell West expanded into a full-service hospital, and then it would lower those prices to competitive levels. Alternatively, United Regional might enter into exclusive contracts in which health plans forgo a broad hospital network in exchange for greater discounts. In doing so, it may construct discounts to the health plans that are sufficient to compensate the plans for accepting a narrow hospital network, but nevertheless result in prices above cost. Finally, United Regional might offer health plans a discount that results in its price being below cost, as DOJ alleges. That is the only scenario in which United Regional would be engaged in the alleged predatory strategy. Insofar as DOJ alleges that United Regional's strategy actually involved pricing below cost to keep Kell West out of the market for monopoly services, it must also explain why it is economically rational for United Regional to engage in an apparent money-losing strategy. DOJ does not explain how the below-cost pricing losses are to be recovered by United Regional or how the pricing strategy may otherwise be profit-maximizing.

Perhaps DOJ ignored recoupment because it made the same mistake as the Ninth Circuit, which stated in *PeaceHealth* that a seller of bundled products need not meet the recoupment standard as long as it makes positive profits on bundled sales. In fact, any pricing below a single-period profit maximizing price involves forgone profits that must be recovered. Alternatively, DOJ may have avoided discussing recoupment because it recognized that by necessity, United Regional never can both meet the below-cost requirement of predatory pricing and still recover the forgone profits attributable to this alleged predation strategy.

Thus DOJ's analysis of United Regional's alleged predatory pricing is deficient in two key respects. DOJ's logic of attributing the full bundled discount to the "contestable" patients is faulty. Moreover, DOJ's inexplicable silence on recoupment leaves a critical gap that cannot be ignored.

Antitrust Guidelines

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health plans to provide information about costs and quality to their enrollees to enable them to make decisions about which providers to choose. ACOs with high market share should not restrict the ability of patients to obtain information about potential providers.

For ACOs seeking additional guidance, the Agencies have provided for a voluntary review process, where a newly-formed ACO can request an expedited 90-day review. This review will be a very fact-intensive process. Materials reviewed will include share calculations, business plans and other documents, lists of the common services that the ACO participants provide, a list of the five largest commercial payors that might potentially contract with the ACO and a list of competing ACOs. An ACO is also free to provide information to the Agencies explaining why it will not have market power in the relevant markets as well as any procompetitive arguments for its formation. After reviewing all the information it receives, the Agencies will advise whether the ACO likely raises competitive concerns, potentially raises competitive concerns, or does not raise competitive concerns.

EI News and Notes

ABS Arbitration with Republic

Republic Engineered Products Inc. (Republic) sought damages from Acciaierie Bertioli Safau SPA (ABS) for breach of contract. EI Principal Joseph W. McAnneny submitted reports to the arbitration panel disputing the amount of the claim. The panel adopted Dr. McAnneny's key arguments and reduced Republic's damages award close to the amount that he had proposed. Dr. McAnneny's team included EI Vice President Henry B. McFarland and EI Senior Vice President Kent W Mikkelsen. EI worked with Reed Smith LLP, the law firm representing ABS.

Regal Beloit Corporation Acquires AO Smith's Electric Motor Business

EI Principals Philip B. Nelson and William P. Hall assisted Regal Beloit Corporation in obtaining approval of its purchase of the electric motor business of AO Smith. Regal Beloit and the business acquired from AO Smith both manufactured a variety of electric motors. Following an investigation by the Department of Justice, Regal Beloit agreed to sell certain assets to address the Department's competitive concerns. EI worked closely with Howard Fogt and Alan Rutenberg of Foley & Lardner LLP, who represented Regal Beloit.

Armstrong v. DIRECTV Arbitration Award Upheld by FCC

The Federal Communications Commission (FCC) recently upheld an arbitrator's decision that the final offer submitted by Armstrong most closely approximated the fair market value of certain programming carriage rights. EI Principal Stephen E. Siwek submitted a report and testified at a hearing on behalf of Armstrong. He provided a historical benchmark analysis to support Armstrong's claim that the rates in its final offer most closely approximated the fair market value of those rights. He also testified concerning the definition of fair market value and the factors affecting Armstrong's revenue. Armstrong was represented by Proskauer Rose LLP.

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