

## Antitrust Alert

### DOJ Settlement with Texas Hospital Prohibits Anticompetitive Contracts with Health Insurers

March 30, 2011

On February 25, 2011, in a small but significant case out of Texas, *United States v. United Regional Health Care System*,<sup>1</sup> the Department of Justice (DOJ) brought its first action in over 10 years against a monopolist engaging in anticompetitive conduct. DOJ's complaint, filed along with a proposed consent judgment, offers important insight into DOJ's present intentions regarding Sherman Act Section 2 enforcement, generally, as well as issues related to competition in the health care sector, including—

1. *United Regional* is DOJ's first Section 2 case since Assistant Attorney General for the Antitrust Division Christine Varney publicly withdrew the Section 2 enforcement policy of the previous administration in May 2009.<sup>2</sup> The complaint breaks new ground in the standard it applies to determining whether "discounting" in connection with exclusive dealing is predatory. In *United Regional*, the department finds a violation by focusing on the level of discount offered by the hospital provider in exchange for exclusive contracts with health insurers. DOJ alleges a violation by attributing the entire discount received by a health insurer to the "contestable volume" of patients, i.e., the volume of patients the hospital would lose in the absence of an exclusive contract. This standard is derived from the standard articulated by the 9th Circuit in *Cascade Health Solutions v. PeaceHealth*<sup>3</sup>, but in a much different context. In *PeaceHealth*, the court attributed the discount to the volume of the entirety of one of the services at issue—a readily ascertainable number—and developed what it believed was a standard that provided "clear guidance for sellers that engage in bundled discounting practices."<sup>4</sup> The rationale for this rule was that a seller "can ascertain its own prices and costs of production and calculate whether its discounting practices run afoul of the rule."<sup>5</sup> After *United Regional*, however, determining the "contestable volume" of customers within an entire product or service line may prove a daunting exercise for firms seeking guidance in assessing their antitrust exposure.
2. The complaint is aggressive regarding anticompetitive foreclosure: 8 percent of market admissions is alleged to constitute substantial foreclosure. The two largest customers in the market, the Blue Cross Blue Plan and the government payers, did not have exclusive contracts and, thus, were not foreclosed. Even excluding government payers, the foreclosure rate was still a relatively low 35 to 40 percent of revenue.
3. The *United Regional* complaint also signals a potential change in DOJ's view of health care markets. In past matters, DOJ has counted payments from government programs, such as Medicare and Medicaid, as significant sources of revenue in examining the competitive options available to health care providers. While the issue arises

<sup>1</sup> No. 7:11-cv-00030-O (N.D. Tex., Feb. 25, 2011).

<sup>2</sup> Christine A. Varney, Remarks as Prepared for the Center for American Progress, *Vigorous Antitrust Enforcement in This Challenging Era* (May 11, 2009), available at <http://www.justice.gov/atr/public/speeches/245711.htm>.

<sup>3</sup> 515 F.3d 883 (9th Cir. 2008).

<sup>4</sup> *Id.* at 907.

<sup>5</sup> *Id.*



here in a different context, DOJ gave little or no weight to the government payers as sources of revenue, focusing, instead, on the foreclosure rate of 35 to 40 percent of the revenue from commercial payers.

Below we discuss these points in further detail.

## DOJ's Allegations

DOJ's complaint<sup>6</sup> alleges that United Regional Health Care System possessed monopoly power in the sale of both inpatient hospital services and outpatient surgical services to commercial health insurers within the Wichita Falls Metropolitan Statistical Area (MSA). In support of its monopoly claims, DOJ pointed to United Regional's 90 percent share of inpatient hospital services and 65 percent share of outpatient surgical services sold to commercial health insurers in the Wichita Falls MSA. The complaint asserts that United Regional—considered a “must have” hospital by commercial health insurers because of its size and essential services offering—charged supracompetitive prices for its services since 1997 when it was formed.

United Regional allegedly maintained its monopoly power through exclusionary contracts with health insurers. All of the major commercial health insurers but Blue Cross Blue Shield of Texas had contracts with United Regional carrying a 13 to 27 percent pricing penalty (i.e., a reduction in discount) should the insurer contract with certain competing providers. By 2010, United Regional had entered into exclusive contracts with eight commercial health insurers, and payments to United Regional under these contracts accounted for 35 to 40 percent of payments received from commercial health insurers.

The absence of pricing penalties in United Regional's contract with Blue Cross Blue Shield of Texas meant competitors were not precluded from contracting with the largest commercial health insurer—with approximately a 55 to 65 percent share of the commercially insured lives—in the Wichita Falls MSA. United Regional's competitors were also able to contract with government payers Medicare and Medicaid. Therefore, even with United Regional's anticompetitive contracts in place, United Regional's competitors still had access to 55 to 65 percent of the commercially insured lives in the Wichita Falls MSA, as well as to Medicare and Medicaid beneficiaries.

## Foreclosure Analysis and Methodology

The exclusive contracts allegedly foreclosed United Regional's competitors from securing contracts with commercial health insurers. Health care providers consider commercial health insurers important to a provider's profitability. These contracts are significant in that 35 to 40 percent of the payments that United Regional received from commercial health insurers under the exclusionary contracts accounted for only about 8 percent of its total patient volume. By effectively preventing commercial health insurers in the area from contracting with United Regional's competitors, United Regional effectively slowed or blocked expansion by its competitors into additional services, which DOJ claimed would likely have resulted in more competition and lower health care costs. The department also alleged these contracts dissuaded new providers from entering the market because they could not obtain contracts with many of the commercial health insurers in the Wichita Falls area. Lastly, DOJ claimed that the contracts limited price competition for price-sensitive patients and reduced overall quality of care and service competition that would otherwise have existed between United Regional and its competitors.

DOJ's Competitive Impact Statement<sup>7</sup> expands its analysis of the anticompetitive effects of the exclusionary contracts. Although the contracts technically offered commercial health insurers a choice between an exclusive and nonexclusive arrangement, United Regional's nonexclusive rates were not a commercially feasible alternative for insurers. No

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<sup>6</sup> Complaint, *United States v. United Regional Health Care System*, No. 7:11-cv-00030-O (N.D. Tex., Feb. 25, 2011), available at <http://www.justice.gov/atr/cases/f267600/267651.pdf>.

<sup>7</sup> Competitive Impact Statement, *United States v. United Regional Health Care System*, No. 7:11-cv-00030-O (N.D. Tex., Feb. 25, 2011), available at <http://www.justice.gov/atr/cases/f267600/267653.pdf>.

insurer had opted for the less-discounted nonexclusive rate option in over 12 years. Thus, DOJ asserted, foreclosure was achieved by United Regional's tying pricing discounts to exclusivity.

Discounting tied to exclusivity can be procompetitive—a point conceded by DOJ—where there is “competition on the merits” by rival suppliers, leading to the more efficient firms winning. Alternatively, if discounting leads to an equally efficient competitor being foreclosed from capturing additional customers, the discounts could be anticompetitive. DOJ distinguished between procompetitive and anticompetitive discounting with its “price-cost test.”

The price-cost test applied by DOJ is similar to the “discount-attribution test” adopted in *Cascade Health Solutions v. PeaceHealth*.<sup>8</sup> In *PeaceHealth*, the defendant competed for only a portion of the services it provided, but offered a discount that encompasses all of its services. Regarding bundled discounts, the *PeaceHealth* court held that the proper test requires “the full amount of the discounts given by the defendant on the bundle [to be] allocated to the competitive product or products.”<sup>9</sup> If the resulting prices are still above the defendant's incremental cost to provide those services, the discount would likely be procompetitive.<sup>10</sup>

In *PeaceHealth*, the court considered whether the hospital provider's prices, including the bundled discounts attributed to the entire volume of competitive products, were below the incremental cost for providing the competitive services. Where prices were below the incremental cost of providing the services, the prices would tend to exclude an equally efficient provider and demonstrate anticompetitive effects. In contrast, the *United Regional* complaint applies the discount offered by the provider only to the patients that United Regional would risk losing if an insurer chose a nonexclusivity option—the “contestable volume” of patients—instead of the total patient volume for which United Regional and other providers competed. Based on patient usage patterns from Blue Cross and Medicare, two major payers not subject to exclusivity, DOJ estimated that the likely contestable volume was 10 percent of the patient volume that United Regional received from payers with exclusionary contracts. The low contestable volume of patients comes from the limited portfolio of services offered by United Regional's competitors and the tendency of patients to choose United Regional even for services that competing providers offer.

Using its modified *PeaceHealth* test, DOJ alleged that discounts offered to insurers in exchange for exclusivity were below United Regional's incremental costs. In other words, United Regional's competitors would need to offer a price below United Regional's incremental costs for an insurer to profitably decline an offer of exclusivity. DOJ concluded that these discounts served no valid procompetitive business justification.

DOJ determined that the government payers, Medicare and Medicaid, would not be viable alternative payers for United Regional's competitors.<sup>11</sup> The Competitive Impact Statement explains that profits from government payers would be an inadequate substitute for profits lost from commercial insurers: “[c]ommercial health insurers pay hospitals and other health-care providers substantially more than the government plans: in the Wichita Falls MSA, all commercial health insurers pay United Regional at least double the Medicare payment rate, and all but one insurer (Blue Cross) pay United Regional more than triple the Medicare payment rate.” DOJ noted that revenue from exclusive contracts with commercial health insurers account for 30 to 35 percent of United Regional's profits, even though such contracts only account for approximately 8 percent of United Regional's patient volume. DOJ makes the somewhat-axiomatic point that “if the excluded insurers added Kell West and other health-care providers to their networks, these providers would earn substantially higher profits than they do now, increasing their ability to compete against United Regional.”

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<sup>8</sup> *Supra* note 3.

<sup>9</sup> *Id.* at 906.

<sup>10</sup> *Id.* at 909.

<sup>11</sup> DOJ also excluded these payers in defining the relevant market in which United Regional exercised monopoly power by focusing on whether United Regional as a seller of services faced significant competitive constraints in selling to managed care plans. Its competitive effects analysis of foreclosure, however, examined competition from a different perspective, namely: whether foreclosure of sales opportunities in that market would so weaken its rivals that they could not make the necessary investments to make their hospitals competitive alternatives in the monopolized market. In essence, if Medicare and Medicaid were viewed as robust payers for hospital services, foreclosure of United Regional's competitors from the commercial markets would not have impaired their investment or competitiveness.

## Proposed Terms of Settlement

DOJ's Proposed Final Judgment<sup>12</sup> prohibits United Regional in its contracting with commercial insurers for seven years from: (1) conditioning prices or discounts it offers on an insurer's refraining from contracting with other hospital-services providers; (2) prohibiting insurers from contracting with other hospital-services providers; (3) retaliating against insurers that contract with rival hospital-services providers; (4) conditioning volume discounts—meaning a price, discount or rebate—on an insurer meeting or exceeding a threshold volume of purchases from United Regional.

## Implications of United Regional

*United Regional* demonstrates that Assistant Attorney General Varney intends to make good on her promise that “[v]igorous antitrust enforcement action under Section 2 of the Sherman Act” would be part of DOJ's agenda.<sup>13</sup> Furthermore, DOJ's aggressive position on what constitutes competitive foreclosure could signal a possible trend for future enforcement, where even a low foreclosure rate, here less than 10 percent, may adequately demonstrate the competitive effects required for a viable Section 2 case.

The *United Regional* decision may present some difficulties for market-leading firms attempting to comply with the standard it applies. Firms that want to offer discounts in connection with exclusive dealing are now presented with the challenging task of determining the “contestable customers.” Perhaps that determination was reasonably, readily doable in the unique circumstances of hospital competition in Wichita Falls, Texas. But in many markets, that kind of determination may prove impracticable. Moreover, firms must also apparently know something about which customers are profitable for their rivals. In excluding Medicare and Medicaid patients from the competitive analysis, DOJ looked to whether these payers were profitable for the defendant's competitors. Having such insight may prove a daunting task for other market-leading firms.

Another notable aspect of DOJ's exclusion of Medicare and Medicaid from its competitive effects analyses is the tension created with other DOJ public announcements about the role of these payers. In past matters, DOJ has cited Medicare and Medicaid as significant sources of revenue to providers as part of its competitive analysis.<sup>14</sup> In this area, the *United Regional* case demonstrates that DOJ's positions in the health care arena continue to evolve.

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<sup>12</sup> Proposed Final Judgment, *United States v. United Regional Health Care System*, No. 7:11-cv-00030-O (N.D. Tex., Feb. 25, 2011), available at <http://www.justice.gov/atr/cases/f267600/267655.pdf>.

<sup>13</sup> Varney, *supra* note 2.

<sup>14</sup> See Background to Closing of Investigation of UnitedHealth Group's Acquisition of Oxford Health Plans (July 20, 2004), available at [http://www.justice.gov/atr/public/press\\_releases/2004/204676.pdf](http://www.justice.gov/atr/public/press_releases/2004/204676.pdf).