

# Can PHOs Accomplish Anticompetitive Vertical Restraints?

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# Hospital-Physician Complementarity

- HOSPITALS AND PHYSICIANS ARE USUALLY COMPLEMENTS
- MOST ANTITRUST PRACTITIONERS WOULD CONCLUDE THAT FORMATION OF A PHO IS PROCOMPETITIVE
- THE JOINT PRICING OF TWO COMPLEMENTS, EACH WITH MARKET POWER, IMPROVES CONSUMER WELFARE

# Presumption of Competitiveness

- THE PACKAGE PRICE FOR HOSPITAL-PHYSICIAN SERVICES WILL OFTEN BE LOWER AFTER FORMATION OF A PHO
- PROBABLY THIS SHOULD BE THE PRESUMPTIVE RULE TO EVALUATE PHOs
- THERE ARE EXCEPTIONS

# Taxonomy of Anticompetitive Vertical Restraints

1. FACILITATING HORIZONTAL COLLUSION
2. ERECTING ENTRY BARRIERS (RAISING RIVALS' COSTS)
3. PRICE DISCRIMINATION
4. EVADING REGULATION
5. REDUCING SUBSTITUTION AWAY FROM A (QUASI-) MONOPOLIZED INPUT

# FACILITATING HORIZONTAL COLLUSION

- A HOSPITAL MIGHT WANT TO FOSTER PRICE FIXING OR COLLUSION AMONG ITS DOCTORS IN RETURN FOR RENT “SPLITTING”
- RENT SPLITTING COULD TAKE SEVERAL FORMS INCLUDING PHYSICIAN PAYMENTS AT ABOVE MARKET RATES FOR HOSPITAL SPACE OR SERVICES

# ERECTING ENTRY BARRIERS (RAISING RIVALS' COSTS)

- A HOSPITAL COULD USE A PHO TO COMPETITIVELY DISADVANTAGE OTHER HOSPITALS
- IF THE PHYSICIAN MEMBERS OF THE PHO MUST CONTRACT EXCLUSIVELY THROUGH THE PHO, COMPETITOR HOSPITALS WHO DEPEND ON ADMISSIONS FROM PHO PHYSICIANS MAY BE DISADVANTAGED

# PRICE DISCRIMINATION THROUGH EXCLUSION

- THE “BEST” HOSPITAL COULD FORM A PHO WITH THE “BEST” PHYSICIANS, “BUNDLE” TO EXTRACT CONSUMER SURPLUS
- WE DISCUSSED THE WELFARE IMPLICATIONS OF THIS POSSIBILITY IN AN EARLIER SESSION

# EVADING REGULATION

A HOSPITAL SUBJECT TO EXPLICIT  
OR IMPLICIT PRICE CONTROLS  
COULD “EMPLOY” PHYSICIANS, AND  
MARKUP THEIR SERVICES TO  
EFFECTIVELY EVADE REGULATION



# REDUCING SUBSTITUTION AWAY FROM A (QUASI-) MONOPOLIZED INPUT

ASSUME:

- THE HOSPITAL HAS MARKET POWER BUT IS NOT A “PURE MONOPOLIST”
- PAYERS BELIEVE THEY MUST CONTRACT WITH THE HOSPITAL TO HAVE A SALABLE PRODUCT
- BUYERS WOULD LIKE TO SUBSTITUTE AWAY FROM THE HOSPITAL

# REDUCING SUBSTITUTION (cont.)

- TO MINIMIZE SUBSTITUTION POSSIBILITIES, THE HOSPITAL FORMS A PHO AND CONTRACTS (SEMI-) EXCLUSIVELY WITH MEMBER PHYSICIANS
- THE HOSPITAL OFFERS PAYERS (HOSPITAL) CONTRACTS CONDITIONAL ON THOSE PAYERS CONTRACTING THROUGH THE PHO

# REDUCING SUBSTITUTION (cont.)

- THIS TYPE OF TYING CAN LIMIT PHYSICIAN USE OF LESS EXPENSIVE HOSPITALS
- IN ANTITRUST ECONOMICS, THIS TYPE OF BEHAVIOR IS KNOWN AS *TYING TO REDUCE SUBSTITUTION AWAY FROM THE MONOPOLIZED INPUT*
- COMPETITOR HOSPITALS MAY ALSO COMPLAIN THAT THIS TYPE OF TYING IS EXCLUSIONARY

# How Is Market Power Created Through This Type of Tying?

- REDUCING SUBSTITUTION AWAY FROM THE HOSPITAL REDUCES THE ELASTICITY OF DERIVED PAYER DEMAND FOR THE HOSPITAL
- FORMULA:  $e = a E + (1 - a)s$

WHERE

$e$  = ELASTICITY OF DERIVED DEMAND FOR THE HOSPITAL

$a$  = THE HOSPITAL'S SHARE IN PAYER'S COST

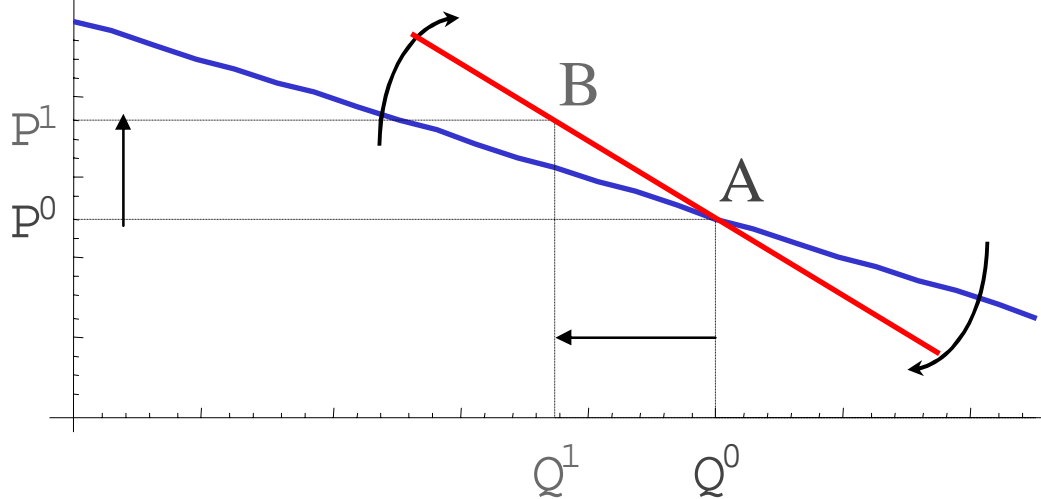
$E$  = ELASTICITY OF DEMAND FOR ALL HOSPITALS

$s$  = ELASTICITY OF SUBSTITUTION BETWEEN THE HOSPITAL AND OTHER HOSPITALS

# Hospital Market Power Created Through Tying to Reduce Substitution

When  $s$  is reduced,  $e$  is also reduced (demand for the hospital becomes less elastic), and the hospital can profitably raise price.

Price of  
Hospital  
Services



Quantity of  
Hospital  
Services

# Screening PHOs

PHOs ARE MORE LIKELY THAN NOT TO BE PRO-COMPETITIVE WHEN:

- A “PURE MONOPOLY” HOSPITAL COMBINES WITH A SINGLE PHYSICIAN GROUP WHICH ALSO FACES LITTLE OR NO COMPETITION
- A HOSPITAL WITH LITTLE MARKET POWER COMBINES ON A NON-EXCLUSIVE BASIS WITH A PHYSICIAN GROUP

# Screening Markers for Intermediate Market Structures

- (1) IS THE HOSPITAL-PHYSICIAN RELATIONSHIP EXCLUSIVE?
- (2) DO OTHER HOSPITALS COMPLAIN ABOUT PHO'S FORMATION? WHY?
- (3) HAVE PAYERS COMPLAINED ABOUT THE HOSPITAL'S RATES AND SOUGHT TO SUBSTITUTE OTHER HOSPITALS? E.G., HAVE THE PAYERS ENCOURAGED THE DOCTORS TO OBTAIN PRICING FROM OR SHIFT ADMISSIONS TO COMPETING HOSPITALS?

## Screening Markers (cont.)

- (4) DOES THE HOSPITAL ENGAGE IN OTHER ACTIVITIES WHICH REVEAL CONCERN ABOUT SUBSTITUTION AWAY FROM IT?
- (5) HAVE THE DOCTORS THREATENED TO “COMPETE” AGAINST THE HOSPITAL?