

Klick
Antitrust
Final Exam
Summer 2017

You have 24 hours to complete the exam, but the latest the exam can be returned is 5:00 pm on June 17. You may use your casebook, notes, and commercial outlines in the completion of this exam, but you may not confer with anyone else about it during the exam period (i.e. June 16 at 9:00 am through 5:00 pm on June 17). Each question (1 and 2) is equally weighted subject to your choice in question 3. Good luck.

1. Nowheresville, NY is served by three major full service hospitals, all of which are operated as non-profits, and an independent for-profit outpatient diagnostic imaging center. Assume that in the relevant healthcare market, margins on imaging procedures are quite high. This is contrasted with the margins on many other hospital services where limited Medicare reimbursement rates and pressure from insurance companies keep prices (and therefore margins) low. Given this reality, it is generally believed that imaging revenues cover much of the overhead for other hospital services. Because the independent imaging center does not face these other overhead costs, prices at the imaging center are generally lower than the prices charged by the hospitals for identical services, though the prices are still high enough to generate a healthy profit. Although the hospitals retain much of the imaging business, despite higher prices, because of the semi-emergency nature of much of the imaging that is done as well as the one stop shopping convenience for individuals who are already at the hospital complexes for their doctor appointments, lab work, etc., the imaging center dominates the non-emergency elective imaging line of business.

New York State has a certificate of need (CON) law which requires state approval for any entity to provide imaging services within the state. The law requires that a determination be made by local health boards that the underlying medical needs of the community justify the additional supply of imaging services. Because the three Nowheresville hospitals and the imaging center pre-dated the passage of the CON law, their services were exempted from regulatory approval; however, this exemption is not transferable if the entity happened to be sold. Any new entity in Nowheresville that wished to provide diagnostic imaging services would need to petition the Nowheresville health board which is made up of doctors from Nowheresville. A determination would be made by this board regarding whether existing imaging providers were insufficient to meet the demand for imaging in Nowheresville.

At the annual "Nowheresville Health Check-Up" meeting in which doctors and administrators of the town's three hospitals meet to discuss current public health issues, a top administrator of one of the hospitals lamented that it has gotten very difficult to maintain financial health since her hospital could no longer rely on imaging services to finance the background operations and overhead of the hospital because many patients choose to have their imaging done at the imaging center, and insurer pressures make it difficult to make up any short falls through higher prices for hospital and physician services. Administrators from the other hospitals nodded in agreement, and one spoke up saying, "It's time we push those good for nothing profiteers out of our community." Although nothing else was publicly stated, administrators and doctors from all three hospitals interact frequently, and this challenge remained a talking point for some time.

Three months after the “Nowheresville Health Check-Up” meeting, one of the hospitals tripled its investment in diagnostic equipment such that it could offer what was basically on-demand service (i.e., no difficulty in getting an appointment for imaging services); one of the hospitals enacted what amounted to a 50% reduction in what it charged for imaging procedures; and the last hospital sent out a memo to its physician staff indicating that the staff should recommend the hospital’s facilities to their patients when writing any imaging orders (providing tips such as saying “time is of the essence and the hospital’s facilities are right in the building” and “I can vouch for the hospital’s services but I’ve heard bad things about other providers” etc).

Does the description above generate any concerns under antitrust law? Write a memo outlining these concerns, as well as any defenses/mitigating factors any potential defendant could raise. Also, if more information is necessary to evaluate the concerns, indicate what information would be needed and why.

There are horizontal (i.e., Sherman Act Section 1) and unilateral (i.e., Sherman Act Section 2) issues here. The former involves the coordinated acts among the hospitals and the latter involves the attempt to somehow foreclose the market for imaging services to competitors (the existing stand alone imaging firm and potential future entrants).

A number of people started with jurisdictional issues, believing that perhaps federal law wouldn’t apply given the local nature of health markets. This is an interesting theoretical discussion but likely wouldn’t arise in practice. There are a number of ways for the federal regulators to get involved here (for starters, the large role Medicare plays in paying for hospital and imaging services would be enough to get jurisdiction) and the fact that we studied a number of “local” hospital cases in class where federal law applied should have tipped you off that jurisdiction generally doesn’t cause problems here.

As for the collusion claim, we would need some evidence of an agreement and we would need to either argue that the agreed actions are covered by a per-se rule or that the actions are likely harmful to consumers. As for the agreement, it is clear there is no explicit agreement, but the public statements about needing to do something about the profiteer and acknowledgement by the other hospitals might suffice. However, the fact that all 3 hospitals did very different things (each of which, in addition to potentially hurting the stand alone provider, presumably increased competition among the purported colluders) undercuts the inference of the agreement. Adding to the plausibility of the inference is the relatively high market concentration, the presumptive homogeneity of imaging services, the frequent interactions among the purported colluders, and the limited scope for entry into the market. On balance, the fact that their actions were completely different and seemingly harmful to each other would likely make it very difficult to demonstrate that an agreement existed here.

As for the foreclosure claims, if there is no finding of collusion, none of the individual hospitals has much market power with respect to discretionary imaging services (i.e., the market where foreclosure is supposedly a concern) which is a pre-condition for most section 2 claims (as well as claims under other antitrust statutes). Further, expanding supply, lowering prices, and engaging in a form of advertising are all presumably good for consumers, so the underlying behavior is hard to attack except through something like a predatory pricing claim or an increased capacity claim (as in ALCOA).

For predatory pricing, one would need to demonstrate below cost pricing which would be hard to do given the fixed cost nature of imaging (once you have the machine, an additional image is very low cost) and the inquiry would only be sensible for the hospital that lowered its prices. Predatory pricing claims require a plausible story that it makes sense for the firm to engage in this strategy which requires a likelihood that competitors will be driven from the market and entry is not likely to stop the predator from recouping its losses during the predatory pricing period. Absent a collusion showing, one would have to face the Brooke Group problem where the predatory hospital bears the full cost of its reduced price for imaging but, if it gets the stand alone provider out of the market, it would share the benefits of reduced competition with the other two hospitals. That said, as compared to many predatory pricing cases, the certificate of need law does help to make the case that recoupment is possible since other entrants will be unlikely (since the hospitals themselves more or less control the regulatory body that decides CON issues).

As for the hospital that expanded imaging services, while one might try to make an ALCOA type argument, it is harder here since the implication in the question is that prior to the expansion, the hospital could not meet all of its demand (since it expanded imaging capacity such that people didn't need to wait, implying that previously people did have to wait). One would need to make an argument that on-demand service = excess capacity. This is different from ALCOA where there was evidence that the capacity was basically never used.

Some people tried to suggest that the third hospital engaged in tying, but there is no conditioned sale (to get hospital service A, you must also buy imaging service B), which makes any tying claim difficult. The third hospital's actions are more akin to advertising ("our imaging services are more convenient and better quality") which may be challenged on grounds it was misleading or something like that, but it is hard to challenge it on antitrust grounds.

Since all of the hospitals' actions are seemingly either neutral or pro-consumer, it will be an uphill battle to challenge them on Section 2 grounds. This is even more so the case if the Section 1 claims cannot be made (because of a lack of an agreement and because the actions are very disparate, even harmful to each other) so that market power is in real question. The main thing going for a plaintiff is the certificate of need law which does make competition in this market more fragile than usual (because entry is extremely limited).

2. Are price aggregators (e.g., kayak.com for flight tickets and other travel needs) that show the prices for multiple suppliers and/or retailers of a given good all in one place, good for competition/consumers or not or does it depend (and, if so, what does it depend on)? What evidence would be relevant in testing your position?

It depends (as always). Price aggregators presumably lower search costs for consumers which improves consumer welfare. Further, if consumers can easily compare prices from multiple suppliers on an apples to apples basis, presumably this will increase competition among the suppliers, leading to a reduction in price and an increase in output (which would increase consumer welfare).

Some people indicated that aggregators may induce suppliers to focus only on price, limiting competition on quality, amenities, etc., leading to an ambiguous effect on consumer welfare

or, perhaps, a distributional effect on consumer welfare (those placing relatively high value on quality, etc lose welfare while those placing relatively high value on price gain). Notably, many price aggregators do provide/aggregate metrics on quality as well (e.g., Expedia providing on-time ratings for flights or user reviews for hotels, etc) and virtually all provide at least product descriptions (this hotel has a pool; that hotel has air conditioning) which presumably do increase competition on non-price attributes as well, but a general re-weighting of competition toward price attributes is possible.

An antitrust concern could arise as aggregators also lower the cost to competitors of monitoring the pricing behavior of other competitors, which could facilitate collusion (which would lower consumer welfare). This concern would be greater with respect to more concentrated industries (say, airlines as opposed to hotels) and industries where the product is more homogenous. In addition to monitoring prices, the aggregator provides information regarding what is included in the price (meal/no meal on a flight; included internet access vs paid access, etc) which would also limit a supplier's ability to cheat on a collusive agreement by providing a higher quality product.

Some people also raised a concern that an aggregator with market power may be able to extract consumer surplus by charging consumers directly (by adding fees to the consumers who use the service) or indirectly by charging suppliers to be part of the service. It is difficult, however, to imagine how an aggregator can gain market power since any attempt to extract surplus presumably will be met with either 1) other aggregators entering the market (what barriers to entry are there?) or 2) consumers going back to simply comparison shopping with the suppliers themselves. For this concern to be plausible, one would need to come up with a barrier to entry story. Some people offered the possibility that the aggregator will develop a good reputation and that will serve as the barrier. This gets a little tricky, though, since presumably a good reputation can manifest as an improvement in consumer welfare as well (e.g., I am confident Expedia gives me the best price and so I face less risk than using some other aggregator => improved consumer welfare). Perhaps a reputation story can be told that clearly reduces consumer welfare through reduced entry (maybe relying on some behavioral story), but it's not obvious.

In terms of evidence, the most basic test would involve looking at output changes before and after an aggregator covers an industry. By examining output, instead of prices, one could take account of changes in quality (if the welfare effect of a lower price is more than offset by quality degradation, people will buy less) and it bypasses the challenge that the relevant cost for consumer welfare purposes is price (which is observable) + search costs (which are much harder to observe). Perhaps a difference-in-difference design could be used looking at when an existing aggregator adds an additional product line (if you think the existing product line is a good comparator for the newly added product line).

3. Choose one of the questions (1 or 2) to count double in the calculation of your final exam score, or choose to have each question count the same (i.e., multiply the score for each question by 1.5 in determining your final exam score). Make your choice clear; failure to do so will result in an automatic loss of 1/3 of the potential points available for the exam.