Secretariat Economists
Economists INK
FALL 2021
A BRIEF ANALYSIS OF POLICY AND LITIGATION

FTC Obtains Preliminary Injunction in New Jersey Hospital Merger

Allison I. Holt

Director Allison Holt has consulted on numerous hospital mergers, in addition to mergers in other industries and other antitrust matters.

A United States District Judge for the District of New Jersey recently granted the Federal Trade Commission ("FTC") a preliminary injunction in the planned merger of Hackensack Meridian Health, Inc. ("HMH") and Englewood Healthcare Foundation ("Englewood"). The parties are appealing this District Court decision. The FTC alleged the proposed merger would allow the merged entity to control nearly half of inpatient hospital services in the relevant geographic market of Bergen County, New Jersey, resulting in a significant decrease in competition. HMH and Englewood responded that the merger would benefit consumers, and that the relevant geographic market is broader than Bergen County.

The FTC alleged that Englewood is the third largest provider of general acute care services and competes directly with HMH, the largest provider. The FTC further alleged that the merger of these two health systems would allow them to control three of the six general acute care hospitals in Bergen County. The remaining general acute care hospital competitors in Bergen County have considerably smaller market shares. The FTC argued that this loss of competition for inpatient services would result in both commercial insurers and fully-insured employers having fewer systems competing to be included in their networks. These payors would face increased reimbursement rates, and their enrollees would face increases in premiums, co-pays, and deductibles. In addition, the FTC alleged that the merger would lead to a decrease in non-price competition in such areas as quality and services offered.

HMH and Englewood responded by stating that the merger would generate significant pro-competitive effects, including increased access to additional services, quality improvements, and pricing efficiencies to the benefit of the patients they serve. In addition, both HMH and Englewood denied that the geographic market is limited to Bergen County. They argued that it should encompass a broader area, possibly including other hospitals in Northern New Jersey and New York that provide general acute care inpatient services. HMH further argued that there would be no loss in non-price factors, evidenced by the fact that they are currently involved in a large modernization project at one of the relevant hospitals.

Unlike last year's ruling in the FTC's challenge of Thomas Jefferson University's merger with Albert Einstein Healthcare Network, the District Judge appears to have accepted the FTC's arguments on relevant geographic market and likely competitive harm to payors and consumers. These decisions highlight the continued importance of market-specific facts in merger analyses.

Also In This Issue

FERC Reconsiders Transmission Planning and Cost Allocation

John Morris discusses the Federal Energy Regulatory Commission's ("FERC") recently issued Advance Notice of Proposed Rulemaking ("ANOPR") on transmission planning and cost allocation. FERC's ANOPR seeks comments on a wide range of complex issues, and Dr. Morris indicates that this ANOPR is well-timed given the likely changes in the transmission fleet, with wind and solar energy replacing coal-fired generation, and the current litigation on transmission cost allocation. A review of the current litigation involving PJM Interconnection L.L.C. ("PJM") on transmission cost allocation, including complaints at FERC, highlights the complexity of the issues. For example, FERC is reviewing complaints concerning two assumptions in the PJM's Flow-Based Method. Dr. Morris notes that comments on these issues may result in better methodologies for determining which transmission users should pay for system upgrades and how much they should pay.

Market Definition in the Epic-Apple Decision

Stephanie Mirrow discusses market definition in the recent ruling in Epic Games, Inc. ("Epic") versus Apple, Inc. ("Apple"). The Court considered evidence concerning switching costs and alleged lock-in. In particular, the Court analyzed whether consumers switching decisions are motivated by product loyalty and satisfaction or by switching costs. Apple presented consumer surveys that indicated the lack of switching is due to consumer satisfaction. The Court also considered evidence on substitution. Epic conducted a survey to address whether iPhone and iPad users would change their spending if iOS in-app purchases were slightly more expensive. However, Epic's survey considered past purchases and did not indicate that the price increase was intended to be in the future and permanent. The Court concluded Epic did not prove its alleged relevant markets.

FERC Reconsiders Transmission Planning and Cost Allocation

John R. Morris

The Federal Energy Regulatory Commission ("FERC") recently issued an Advance Notice of Proposed Rulemaking ("ANOPR") on transmission planning and cost allocation (FERC Docket No. RM21-17-000). FERC's ANOPR seeks comments on a wide range of complex issues, including whether utilities need to revise their planning processes to consider longer time frames, whether generation owners should fund transmission upgrades to make their generation fully deliverable to the transmission grid, and whether a portfolio of projects should be considered in the allocation process as opposed to individual projects. Comments on these issues may result in better methodologies for determining which transmission users should pay for system upgrades and how much they should pay.

This ANOPR is well-timed given the likely changes in the transmission fleet, with wind and solar energy replacing coal-fired generation, and the current litigation on transmission cost allocation. For example, fifteen FERC orders concerning the PJM Interconnection L.L.C. ("PJM") transmission cost allocation are on appeal to the federal courts. Additionally, FERC is processing two complaints concerning the PJM cost allocation methodology. A review of the current PJM litigation on transmission cost allocation highlights the complexity of the issues facing all FERC-jurisdictional service areas.

> "*The problem is properly identifying the benefits received by ratepayers...*"

Most transmission payments to PJM cover the cost of the individual utility transmission system in which the load (demand) is located. For example, load in Baltimore, Maryland pays for most of the transmission costs of the Baltimore Gas & Electric transmission system. However, new transmission facilities costs that are considered to produce regional benefits, such as upgrades to the high-voltage 500 kV transmission system, are allocated to all ratepayers in PJM. For example, fifty percent of the regional upgrade costs on high-voltage components (230 kV and above) are allocated based on shares of peak load. The remaining fifty percent of the upgrade costs are allocated by estimating the benefits of the upgrade using a methodology based on energy flows. This methodology is known as a Flow-Based Method, or alternatively as a Distribution Factor Method, or DFAX Method. Distribution factors measure the share of energy that flows through the transmission facilities going from generation sources to loads. For lower-voltage upgrades, costs of "regional" upgrades are allocated using only the Flow-Based Method. In contrast, when an upgrade is not considered regional, the costs are borne solely by the ratepayers of the utility implementing the upgrade.

Managing Director John Morris leads Secretariat Economists' energy practice. He advises clients on the effects of electric transmission cost allocation and pricing methodologies on transmission rates, wholesale market competition, and social welfare.

Several assumptions are necessary to implement a Flow-Based Method, and FERC is reviewing complaints concerning two assumptions in PJM's methodology. The first assumption under review is the distribution factor cut-off. The intuition behind the distribution-factor cut-off is that systems that are distant do not benefit from, and thus should not have to pay for, transmission upgrades far away. For example, transmission ratepayers in Chicago should not have to pay for transmission upgrades in New Jersey, and vice versa. Power flowing between any two points on a transmission system induces at least some power flows on every transmission line on the system. Without a cut-off, ratepayers in Chicago would pay a share of the costs for regional transmission upgrades in New Jersey. PJM currently sets its cut-off at one percent. This may seem low, because cut-offs of three percent or higher often are used for calculating transmission availability and for market power mitigation protocols. But setting the distribution cut-off too high, even at one percent, can result in the cost being allocated to a very small share of ratepayers—which means these ratepayers may pay very high rates for a project that has regional benefits. At present, there is no research-supported reason for the cut-off being set at any specific level, nor has research been presented on the net effects on sets of ratepayers from using different cut-off values. Hence, those viewing themselves as disadvantaged by the cut-off being set at one percent argue that the cut-off should be set at a lower level in order to allocate costs to a broader group of ratepayers.

The second assumption under review is called netting. To understand netting, consider the following example. Utility A has a north zone and a south zone, with energy generally flowing from north to south. Further suppose that Utility B has load embedded in the south zone. Finally, suppose that Utility A's load grows in the south, and to serve this growth Utility A needs a transmission upgrade. At the same time, Utility B's load in the south zone remains constant. With netting, the energy flows to serve Utility A's north load are netted against Utility A's south load. If Utility A's loads in

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Market Definition in the Epic-Apple Decision

Stephanie M. Mirrow

In her recent ruling in Epic Games, Inc. ("Epic") versus Apple, Inc. ("Apple"), Judge Gonzalez Rogers of the Northern District of California ("Court") disagreed with both parties' definition of the relevant market. The Court considered market specific facts, survey evidence, and evidence on consumer purchasing and switching patterns in concluding Epic did not prove its alleged relevant markets.

Epic alleged that Apple, through its control of the App Store, has monopoly power over the distribution of apps on iOS devices and over the payment processing for iOS apps. Apple argued that the relevant market is all digital video games.

The Court first noted that Epic's alleged "aftermarket" relevant markets depend on whether Apple's operating system should be viewed as a "foremarket." The Court recognized that Apple's operating system is not licensed or sold to anyone and that other features also are important considerations – including battery life, ease of use, durability, performance, and cameras. The Court found that Epic ignored these marketplace realities and that it is "illogical" to view Apple's operating system as a "foremarket."

In analyzing Epic's alleged "aftermarket" relevant markets, the Court considered Epic's evidence concerning switching costs, alleged lock-in, and substitution. Epic presented emails on the use of iTunes discounts to attract and maintain users and the benefits of Apple's text messaging service, iMessage, as evidence of "lock-in." However, the Court found that these emails "…suggest that Apple sought to compete by distinguishing their product," and that "[e]very business seeks to decrease switching away from its products." In this case, the Court found that the features that create lock-in also make Apple's products more attractive, and Epic did not provide sufficient evidence on whether consumers' switching decisions are motivated by product loyalty and satisfaction or by switching costs.

> *"…Epic did not provide sufficient evidence on whether consumers' switching decisions are motivated by product loyalty and satisfaction or by switching costs."*

In particular, the Court noted that plaintiff's expert did not conduct any original surveys, attempt to measure switching costs, analyze any literature on the magnitude of switching costs, consider additional evidence, or conduct any original analyses. The Court contrasted Epic's lack of data analysis with evidence presented by Apple concerning customer satisfaction. Apple presented consumer surveys that indicated the lack of switching is due to consumer satisfaction with iOS – including a Google survey showing that sixty-four percent of iOS users would not switch to Android because they "prefer iOS." The Court found this survey evidence significant, because it was created in the ordinary course of business and because Epic Games did not provide its own consumer surveys to show that users fail to switch even when they are dissatisfied with app price, quality, or availability.

Director Stephanie Mirrow has analyzed market definition in numerous antitrust matters, including monopolization cases.

The Court also considered evidence concerning substitution. Apple argued that all other game transaction platforms are substitute platforms for the App Store, including those accessed through all mobile, tablet, console, and PC devices. Epic argued, among other things, that economic and survey evidence show little substitution among game transaction platforms.

Epic's expert argued that the removal of Fortnite from the App Store provided a natural experiment from which to study user substitution in response to a change in quality – in this case, a decrease in quality for the App Store and iOS devices. Epic's expert evaluated iOS-only users and found they only shifted 16.7 percent of game play minutes to other platforms and 30.7 percent of spending to other platforms. Epic's expert concluded that this amount of switching was not sufficient for developers to abandon the iOS platform, because spending on other platforms would not make up for the loss in iOS spending. However, Epic's expert considered iOS-only users, yet evidence showed that between 32 percent and 52 percent of all Fortnite users multi-home. Moreover, Apple presented evidence that suggested users who access Fortnite on iOS spend the majority of their Fortnite time and spending on non-iOS platforms. Thus, the Court concluded that Epic's expert likely underestimated the substitution among different platforms.

Epic's experts also conducted a survey to address whether iPhone and iPad users would change their spending if iOS in-app purchases were slightly more expensive. Epic's experts' survey asked respondents to think about their in-app purchases from the App Store over the past thirty days and

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FERC Reconsiders

the north zone and south zone are roughly equal or if the north load is greater than the south load, then Utility A may not be allocated any of the costs associated with its transmission upgrade. Whereas, Utility B may be allocated one hundred percent of the costs, even though Utility B's load did not change and Utility B does not need the upgrade.

In this environment, FERC's ANOPR seeks comments on a wide range of issues. In Order No. 1000, FERC stated that the first principle for transmission pricing is that cost allocation be roughly commensurate with the benefits received by those who pay. The problem is properly identifying the benefits received by ratepayers, of which the PJM methodology is one of many possible solutions. Comments to FERC may help identify a methodology that yields better information on who benefits from changes to the transmission system, and thus may result in better methodologies for determining which transmission customers should pay, and how much they should pay, for system upgrades.

Market Definition in the Epic-Apple

imagine if their spending for these purchases was five percent higher. Based on this question, Epic's experts found that 81 percent of respondents indicated they would not have changed their purchases.

The Court found this survey to have several methodological flaws. Importantly, the Court found that the survey question did not appropriately convey that the five percent price increase was intended to be in the future and non-transient (permanent). Appropriate survey questions would address whether a hypothetical monopolist could impose a small but significant, non-transitory increase in price (or "SSNIP"), or would enough consumers switch to alternative product offerings. Instead, Epic's experts' survey was backward-looking and thus could not determine whether lack of alternatives, instead of customer satisfaction, was the reason for most respondents indicating they would not have changed their purchases.

In addition, the Court expressed concern over Epic's expert using these survey results in his SSNIP test, since the survey did not indicate that the price increase was intended to be permanent, and Epic's expert agreed that consumer responses to long-term price changes may be substantially different than responses to short-term price changes.

Finally, the Court noted that there is not an economic consensus on how to undertake the hypothetical monopolist test in two-sided platforms and how to appropriately implement a SSNIP test for such two-sided markets. For example, Epic's expert conducted his SSNIP test separately for the consumer-side and the developer-side. But this approach does not account for the responses of developers to changes in consumer behavior and vice versa.

The Court thus found that Epic's experts did not provide evidence and analyses sufficient and reliable to demonstrate the alleged high switching costs, lock-in, and a lack of substitution. The Court also rejected Apple's alleged relevant market. Instead, the Court used the market specific facts and evidence to define the relevant market as "digital mobile gaming transactions."

News and Notes

Keith Waehrer Presents on Digital Markets and the Sprint/T-Mobile Merger

Managing Director Keith Waehrer presented on a panel titled "Digital Markets: Big Data, Privacy Protection and AI" at the 2021 15th International Conference on Competition and Regulation organized by CRESSE. Dr. Waehrer discussed the FTC's litigation against Facebook and whether that litigation and DOJ's Google litigation are indicative of novel digital market specific theories or whether these fit in the traditional antitrust mold.

Dr. Waehrer also lead a seminar titled "Lessons from Sprint/T-Mobile Merger Investigations, Litigation, and Remedy" in the Mannheim Competition Policy Forum (MCPF) online series organized by Mannheim Centre for Competition and Innovation (MaCCI). Dr. Waehrer discussed several lessons from the investigations and litigation. Dr. Waehrer also discussed the remedy crafted by the Department of Justice – including whether the remedy is playing out as expected and whether the remedy makes sense from a broader economic welfare perspective.

Pablo Varas Joins Secretariat Economists and Publishes About Residential Broadband Markets

Pablo Varas has joined Secretariat Economists as an Associate Director. Dr. Varas has conducted economic analysis in the healthcare, electricity, retail, and oil industries. Dr. Varas recently published "Revising the Record: Six Stylized Economic Facts About Pre-Covid US Residential Broadband Markets" in the *Journal of Information Policy*. The paper uses publicly available data to study the evolution of the U.S. Broadband Industry pre-Covid. Dr. Varas and his coauthor find that service prices have not decreased much over time. Additionally, the authors find there has been very limited entry by new residential broadband service competitors, and this limited entry largely is due to technological innovations in wireless.

Jason Albert Publishes About Strategic Dynamics of Antibiotics Use

Associate Director Jason Albert published "Strategic Dynamics of Antibiotics Use and the Evolution of Antibiotic-resistant Infections" in the *International Journal of Industrial Organization*. In this article, Dr. Albert analyzes and models the effects of healthcare provider competition on antibiotic use and antibiotic-resistant infections. Dr. Albert finds a "Goldilocks" effect. In provider markets that are highly competitive, there is overuse of antibiotics and high levels of antibiotic resistance. Whereas, in markets with low levels of provider competition, there is underuse of antibiotics. Dr. Albert also analyzes the effects of policy proposals designed to mitigate the harms from antibiotic-resistance.

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