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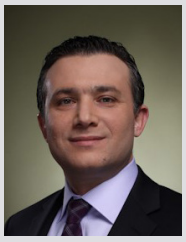
A BRIEF ANALYSIS OF POLICY AND LITIGATION

Cross-Market Hospital Transactions: A Need for Better Screens

Lona Fowdur and Cagatay Koc

Principal Lona Fowdur has provided economic testimony in antitrust cases involving hospitals, physician groups, insurers, PBMs, and pharmaceutical companies.



Senior Vice President Cagatay Koc has analyzed hospital, physician, and pharmaceutical mergers and has addressed allegations of monopolization and exclusionary conduct in the healthcare industry.

The Huntington Hospital ("Huntington") and Cedars-Sinai Health System ("Cedars-Sinai") transaction provides an interesting case-study of the current state of antitrust enforcement against cross-market hospital mergers. While the federal regulators did not issue a second request in this matter, the California Attorney General's Office ("AG") imposed several conditions including price caps, separate negotiation teams, and mandatory arbitration when negotiations with payors fail. Huntington and Cedars-Sinai filed a lawsuit challenging these conditions.

The AG imposed the conditions based on a cross-market analysis which found that the parties are not head-to-head competitors in the same geographic market, but that they have market power in their respective markets. The AG's economic analysis also relied on certain "plus-factors" to determine that cross-market competitive harm was likely, including payor concerns, the presence of large-employer customers whose members desire the inclusion of both parties in their provider networks, and high prices of one party relative to the other. In the AG's view, the absence of a price increase subsequent to a previous cross-market transaction by Cedars-Sinai did not illuminate likely effects in the present case.

The AG's reliance on "plus-factors" alone lacks economic rigor. The nascent economic literature on cross-market mergers recognizes that for competitively harmful cross-market effects to arise, at a minimum the parties need to be in separate markets, possess market power, and satisfy the "concavity" condition. The "concavity" condition requires the negotiating health plan to suffer a larger decline in the quality of its network when both parties are left out of the network simultaneously than the sum of the quality reductions with each hospital excluded individually.

The establishment of careful screens, consistent with the economic literature, would provide a more rigorous framework for analyzing cross-market mergers. These screens could rule out cross-market pricing concerns when (1) a properly conducted SSNIP test establishes that the hospitals are in the same geographic market, i.e., any harm could only arise in the context of a traditional horizontal transaction; (2) neither of the merging parties possesses market power, for example, because both can easily be replaced in health-plan networks; (3) the parties provide largely non-overlapping products (hospital services) and are complementary to one another in payors' networks, and (4) common customers can readily protect themselves against cross-market price increases by purchasing separate single-market provider networks, for example, by slicing their accounts across multiple insurers with distinct networks in each geographic market.

Secretariat Acquires Economists Incorporated

Secretariat, a leading global independent expert services and litigation consulting firm, has acquired Economists Incorporated. EI will operate as Secretariat Economists LLC, a wholly owned Secretariat subsidiary. Going forward, EI will continue to serve its clients as it always has, and it will have a deeper bench of experts and a wider global footprint. The entire team at EI is excited to join Secretariat and anticipates that the union of the two firms will allow the new entity to serve its existing clients better while offering new clients an attractive new choice among service providers.

Also In This Issue

"Killer Acquisitions" in the Pharmaceutical Industry

Jason Albert discusses a recent article by Colleen Cunningham, Florian Ederer, and Song Ma in the *Journal of Political Economy* on "killer acquisitions." Dr. Albert discusses the authors' findings, as well as some limitations in their analysis, including limitations in the authors' definitions of overlap drugs and development activity. Dr. Albert concludes that "killer acquisitions" are likely to be an area of continued focus for antitrust enforcers. However, more research is needed on both the extent and economic significance of "killer acquisitions" in the pharmaceutical industry as well as other innovative sectors.

Will the Southeast Have a New Competitive Energy Market?

Jeffrey Opgrand and Natalie Shen discuss the proposal by several entities in the Southeast to create a bilateral, 15-minute market for energy transactions dubbed the Southeastern Energy Exchange Market, or SEEM. The stated purpose of SEEM is to facilitate bilateral energy sales between members to decrease consumer costs. However, FERC issued a deficiency letter requesting additional information primarily related to market power mitigation and price transparency. The SEEM parties have responded to the deficiencies identified in their initial filing, and FERC will have to decide whether to encourage this modest step toward integration.

"Killer Acquisitions" in the Pharmaceutical Industry

Jason L. Albert

Senior Economist Jason L. Albert has worked on numerous healthcare related antitrust matters, including pharmaceutical pay-for-delay cases. This article is based on a paper presented at the American Health Lawyers Association's Virtual Healthcare Antitrust Conference.

A recent article by Colleen Cunningham, Florian Ederer, and Song Ma in the *Journal of Political Economy* coined the term "killer acquisitions." This term describes an incumbent's acquisition of an innovative target whose innovation the incumbent subsequently terminates. The incumbent's incentive is to protect its market from potential competition. Antitrust regulators have increased their scrutiny of transactions in both the pharmaceutical industry and other industries such as technology in which "killer acquisitions" are at issue. This article evaluates Cunningham, Ederer, and Ma's methodology and findings, and the implications for antitrust enforcers.

Cunningham, Ederer, and Ma study the pharmaceutical industry to test whether an incumbent can have a financial incentive to acquire an innovative target and then terminate further development of its innovation. The authors focus on acquisitions involving target drugs in early development that overlap with an existing drug in the acquirer's portfolio.

Cunningham, Ederer, and Ma make several important assumptions in their analysis of "killer acquisitions." Cunningham, Ederer, and Ma define overlapping drugs as those that are in the same therapeutic class with the same mechanism of action. Therapeutic class refers to the type of illness or disease that the drug is intended to treat (e.g., antidepressants are a therapeutic class), while the mechanism of action refers to the biological mechanism through which the drug treats the illness (e.g., select serotonin reuptake inhibitors ("SSRI") and serotonin and norepinephrine reuptake inhibitors ("SNRI") are two different mechanisms of action through which antidepressants work). The authors find that drug projects acquired by incumbents with an overlapping drug are 23.4 percent less likely to have continued development activity compared to drugs acquired by incumbents without an overlapping drug. The authors estimate that "killer acquisitions" occurred in five to seven percent of all pharmaceutical acquisitions and affected four percent of all drug projects. Notably, the "killer acquisitions" tended to occur in environments in which the acquirer has market power and in transactions that are valued below the Hart-Scott-Rodino ("HSR") reporting threshold.

> *"Identifying a pharmaceutical 'killer acquisition' that is an antitrust violation poses a significant challenge for antitrust enforcers."*

However, their definition of overlap drugs does not conform to how antitrust practitioners typically define a product market and may not capture relevant economic substitution patterns. For example, a consumer of antidepressants may find SSRIs and SNRIs to be economic substitutes even though they have a different mechanism of action. Additionally, among drugs in the same therapeutic class with the same mechanism of action, there are plausible reasons a consumer may not find two drugs to be economic substitutes, e.g., if one drug was administered orally as a pill and the other was administered via injection.

Another limitation concerns the authors' definition of development activity. Cunningham, Ederer, and Ma focus on development milestones such as a new patent application to indicate continued development; the lack of such development milestones indicates a "killed acquisition." The metrics used in the paper, while informative, do not capture the most relevant development milestone, which is a drug reaching the market. It may be the case that incumbents with overlap drugs are more likely to end early-stage development of an acquired drug sooner than non-overlapping incumbents because they more quickly realize the drug is unlikely to be successful. Incumbents who acquire overlap drugs may be just as likely or more likely to bring an acquired drug to the market. If this were the case, then the observed patterns in the data could be explained by an optimal project selection motive rather than a "killer acquisitions" motive.

Still, Cunningham, Ederer, and Ma's article offers strong suggestive, but not definitive, evidence that "killer acquisitions" are occurring in the pharmaceutical industry. However, there is an open question about the economic significance of this effect. The authors find that only about twenty percent of acquired drug projects have any continued development activity regardless of incumbent overlaps; generally, the literature finds that only a fraction of these ultimately will reach the market. It is unclear how many "killed acquisitions" would otherwise have made it to the market and had a competitive impact.

Identifying a pharmaceutical "killer acquisition" that is an antitrust violation poses a significant challenge for antitrust enforcers. There are legitimate reasons aside from the "killer acquisition" motive for ending product development

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Will the Southeast Have a New Competitive Energy Market?

Jeffrey J. Opgrand and Natalie Shen

In February 2021, several entities in the Southeast sought authority from the Federal Energy Regulatory Commission ("FERC") to create a bilateral, 15-minute market for energy transactions dubbed the Southeastern Energy Exchange Market, or SEEM (see FERC Docket No. ER21-1111). The parties proposing SEEM include investor-owned utilities such as subsidiaries of Southern Company, Dominion, and Duke Energy, as well as non-IOU entities such as PowerSouth Energy Cooperative and Tennessee Valley Authority – collectively, SEEM parties. The stated purpose of SEEM is to facilitate bilateral energy sales between members to decrease consumer costs. The SEEM proposal has not received full support, even though the SEEM parties estimate consumers will save approximately 40 million dollars per year.

The SEEM parties propose a market design that will use available transmission capacity between balancing areas to match pairs of buyers and sellers, with the transaction price consummating at the midpoint of the matched bid and offer prices. A matching algorithm will pair buyers and sellers to maximize total savings in each fifteen-minute interval. Additionally, the proposed market design indicates there will be no transmission cost (besides transmission line losses) associated with a transaction. However, the non-firm transmission service used by SEEM will have the lowest curtailment priority of all transmission types. The transactions will include energy only and no other products such as capacity or ancillary services.

> *"The SEEM parties propose a market design that will use available transmission capacity between balancing areas to match pairs of buyers and sellers, ..."*

A SEEM party can reduce costs by backing down a high-cost resource after pairing with a lower cost resource. A SEEM party also can lower consumer costs by selling excess power and revenue crediting consumers. Despite these mechanisms for reducing costs, the SEEM proposal has not received full support outside its own membership. The Georgia Association of Manufacturers is seeking FERC's assurance that if the benefits of SEEM outweigh the costs, the benefits are passed through to retail customers of electricity. Entergy protested the filing and is requesting that FERC require an amendment to the SEEM Agreement that ensures transactions occurring in SEEM will not exceed the physical capability of the most limiting transmission interface on the contract path between transacting members. Such a requirement would limit SEEM's ability to rely on third-party transmission systems, such as those under the purview of the Midcontinent Independent System Operator (MISO).

The SEEM proposal also received comments from a variety of environmental organizations, including the Environmental Defense Fund (EDF) and the Clean Energy Coalition (comprised of Advanced Energy Economy, Advanced Energy Buyers Group, Renewable Energy Buyers Alliance, and Solar Energy Industries Association). These environmental agencies called for increased transparency regarding transaction data, expanded governance roles, and enhanced market monitoring. EDF is seeking more information about how demand response and distributed energy resources could participate in the market. The Clean Energy Coalition argues that the SEEM proposal constitutes a loose power pool and requests that SEEM have an Open Access Transmission Tariff on file with FERC. Ultimately, several intervenors requested that FERC convene a technical conference to more broadly discuss the expansion of market opportunities in the Southeast. R Street, the Clean Energy Coalition, state Senator Tom Davis of South Carolina, and the Southern Renewable Energy Association all support such a technical conference.

In early May, FERC issued a deficiency letter to the filing entities, requesting additional information primarily related to market power mitigation and price transparency. FERC raised twelve questions in its deficiency letter, including a directive to explain how SEEM will interact with MISO and other neighboring regional transmission organizations ("RTOs") at the seams. Other questions include how the SEEM match price would be adjusted to the mitigated price cap set forth in the Southern Companies' market-based rate (MBR) Tariff, how market power would be mitigated under the SEEM mechanisms, how information would be made available to the Commission or reported by the SEEM

Senior Economist Jeffrey Opgrand has worked on cases related to competition in the energy industry and has researched Financial Transmission Rights. He has a paper forthcoming in The Energy Journal.

Senior Energy Economist Natalie Shen works on rate cases in the energy industry. She was formerly a member of FERC Trial Staff and an advisor to a FERC Commissioner.

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"Killer Acquisitions"

of an acquired drug. Distinguishing between drug projects that have been or are likely to be terminated for "killer acquisition" motives and drug projects that are terminated for other reasons is a non-trivial task. Antitrust practitioners should consider both documentary evidence and economic evidence to identify a "killer acquisition." For example, documents from the incumbent firm may indicate whether the acquirer views the target's drug project as a threat to their market. Economic evidence on market shares and customer substitution patterns can indicate whether the incumbent has market power. Additionally, an evaluation of whether the target has any unique characteristics, entry costs, and whether there are similar drugs in development by other firms can indicate whether the target is competitively significant and its acquisition would result in a lessening of competition.

The Federal Trade Commission evaluated such evidence in its 2019 review of Bristol-Myers Squibb Company's ("BMS") acquisition of Celgene Corporation ("Celgene"). The FTC focused on a potential overlap in oral treatments for moderate-to-severe psoriasis, a chronic skin disease. The FTC investigation revealed that Celgene's product Otezla was the dominant product on the market. The FTC also found that BMS' drug in development was likely the next entrant into the market, and therefore the most competitively significant potential entrant. Finally, the FTC found that no other potential entrant was comparable to BMS. The FTC thus determined that a divestiture of Otezla was necessary to maintain competition in the market for oral treatments of moderate-to-severe psoriasis.

"Killer acquisitions" are likely to be an area of continued focus for antitrust enforcers. However, more research is needed on both the extent and economic significance of "killer acquisitions" in the pharmaceutical industry as well as other innovative sectors.

New Competitive Energy Market?

Administrator to avoid potential market manipulation, and how the zero-charge transmission service (termed the Non-Firm Energy Exchange Transmission Service, or NFEETS) will impact rates for network service transmission customers in a manner consistent with the cost-causation principle. Furthermore, the Commission requests the SEEM parties to demonstrate that regulatory approval of the filing would be in the public interest consistent with the standard of review set forth in the *Mobile-Sierra* doctrine.

The SEEM parties responded to the deficiency letter in early June. To broadly address concerns related to market power, manipulation, and transparency, the SEEM parties propose to submit data to FERC on a weekly basis (which is comparable to RTO data submissions under Order No. 760). To mitigate concerns related to the uncompensated use of neighboring transmission facilities, the SEEM parties clarify that the available transmission capacity for each leg of a contract path for a matched transaction will be modeled to ensure there are no overloads. Finally, the SEEM parties revised the agreement such that issues and changes related to the market rules will be reviewed under the just and reasonable standard, whereas other issues that pertain to the rights and obligations of SEEM parties will be reviewed under the public interest standard in accordance with the *Mobile-Sierra* doctrine.

Few would argue that increased voluntary coordination among utilities in the Southeast is a step in the wrong direction. But, for some, the question remains as to whether SEEM goes far enough in the right direction. For example, in a letter dated June 2, 2021, nine former FERC Commissioners note the "growing interest in the Southeast for more ambitious market reform" and "urge the Commission to use the broad authorities and tools available under the Federal Power Act to move toward well-structured organized power markets in all regions of the country." The SEEM proposal makes clear that it is not proposing to establish a mandatory regional market. Now that the SEEM parties have responded to the deficiencies identified in their initial filing, FERC will have to decide whether to encourage this modest step toward integration.

News and Notes

Testimony Contributes to the Resolution of Breach of Contract Dispute

Principal Stuart D. Gurrea offered expert testimony assessing plaintiff's damages claims in a breach of contract mortgage dispute on behalf of defendant financial institution. Dr. Gurrea's testimony identified the flaws in plaintiff's damages claims under a recission theory of damages and an expectancy theory of damages. The parties settled the case after Dr. Gurrea's testimony.

Energy Law Journal Publishes Article by Secretariat Economists

Principal John R. Morris, Senior Economist Jéssica Dutra, and Economist Tristan Snow Cobb published "Alternative Measures of 'Representative Market Prices' for FERC Delivered Price Tests" in the May 2021 issue of *Energy Law Journal*. This article evaluates four practices for calculating representative market prices for the Federal Energy Regulatory Commission's merger screening methodology. The paper concludes that the typical practice of using average historical market prices as the basis for estimating potential future prices is the least likely to accurately assess market power. Alternatives such as using historical median price levels, prices that accurately match generation levels, and prices consistent with simple dispatch model simulations more accurately assess market power.

Economists Included in Global Competition Review's The International Who's Who of Competition Lawyers and Economists 2021

Corporate Vice President and Principal David A. Argue, Senior Vice President Paul E. Godek, Principal Philip B. Nelson, Principal Keith Waehrer, Special Consultant and Director William C. Myslinski, and Special Consultant and Director Bruce M. Owen are included in the latest edition of *The International Who's Who of Competition Lawyers and Economists 2021*. Principal Lona Fowdur has been named as a Future Leader.

Economists Appointed as ABA Young Economist Representatives

Senior Economists Jason Albert, Robert A. Arons, and Jéssica Dutra have been appointed to serve as Young Economist Representatives to the Mergers and Acquisitions Committee, Media and Technology Committee, and Economics Committee, respectively, during the 2021-2022 American Bar Association year.

The University of Toronto Appoints Laura Malowane Adjunct Lecturer in Economic Analysis of Law

Vice President Laura A. Malowane has been appointed adjunct lecturer in *Economic Analysis of Law* at The University of Toronto, Department of Economics. This course is taught to graduate students in the University's combined JD/MA (Economics) program.

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